

## THE NIGERIAN STOCK EXCHANGE: A BANE FOR SUSTAINABLE ECONOMIC DEVELOPMENT

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### ABSTRACT

**T**he focus of this paper is to evaluate the impact of Nigerian stock exchange as a tool for sustainable economic development. This paper outlines the functions of the Nigerian Stock Exchange, reviews its contributions to economic development process and draws some useful lessons. These lessons include the need to strengthen private enterprise sector through structural reforms, infrastructural development, the importance of strong government commitment and the need for a professional and highly development securities industry.

**Keywords:** Foreign Investment, NSE, Institutional Investors, Economic Development, SAP

## 1. INTRODUCTION

In any model of economic development, capital occupies a position of crucial and strategic importance. Economic development of any sort will not be possible unless there is adequate degree of capital formation in the country. However, a very important trait of underdeveloped economy is deficiency of capital, which is due to small saving by communities.

Underdeveloped economics hardly saved 5% of the national income, whereas they should save and invest at least 12% in order to secure a reasonable level of development (Dewett, 2002).

The keys to accelerated economic development are much higher investments and domestic savings, combined with efficient financial system necessary to maintain macroeconomic stability significantly improve productivity. The slow growing economies like Nigeria need to raise their savings and investment rates from the current low level to at least 20-25% percent levels already achieved or exceeded by India, Kenya and Zimbabwe. Currently, Nigeria has between 12-16 percent of Gross Domestic Product, below what is needed for sustainable long-term growth (World Bank, 1996).

It is recognized that to maintain this level of economic activities in Nigeria, we need to expand the financial system that will create facilities needed for short and long-term investments.

An efficient and vibrant financial system contributes more to economic development. It mobilizes savings and allocates them to investments by private entrepreneurs. And it ensures that dynamic parts of the economy are well funded.

In the Schumpeterian spirit, all services performed by financial intermediaries – savings, mobilization, project evaluation, risk management, monitoring managers, utilization of credit facilities and facilitating transactions – are catalysts for technological innovation and economic development. The pace at which this is achieved depends much on the health of the financial system.

The Nigerian stock exchange is a key determinant of the Nigerian financial system. The Nigerian stock exchange provides the essential facilities for companies and government to raise money for business expansion and development projects through investors who own shares in companies for the ultimate economic benefits of all members of the society.

The main thrust of this paper is to evaluate the impact of Nigerian stock exchange as a tool for sustainable economic development. To achieve this objective, the remainder of the paper is divided into five sections. The next section examines the conceptual issues associated with the Nigerian financial system off which the Nigerian stock exchange is an integral part. Section III highlights the functions and markets of Nigerian stock exchange, while section IV examines the effects of Nigerian stock exchange in the economic development process. Section V considers problems affecting orderly development of Nigerian stock exchange. Section VI concludes and provides policy recommendation.

## 2.1 CONCEPTUAL ISSUES

### **The Nigerian Financial System**

Okoro-Okoro (1994) has described the Nigerian financial system as consisting of financial intermediaries, financial markets, financial institutions, rules, conventions and norms that facilitate and regulate the flow of funds through the macro economy”.

Schumpeter (1934) asked a question “do we need the financial system in the elaborate manner we have”? Both affirmative and negative respondents to the question, have however, agreed on a few basic issues, one is that if you operate a capitalist economic system, the answer is that you need the financial system because the decision to save and invest is left at the discretion of the individual and so, there is need to have financial intermediaries. However, if you operate a socialist communist economic system, you do need the financial system because the decision to save and invest is left at the discretion of the individual and so, there is need to have financial intermediaries. However, if you operate a socialist communist economic system, you do not need the financial system because the decisions to save and invest lie with the government. In Nigeria because of our choice of the capitalist path of development a safe, sound and efficiently functioning financial system is in sine qua non of economic development (Shola 1999).

Okigbo (1981) defined the financial system as the family of rules and regulations, the congeries of financial arrangements, institutions, agents and the mechanism whereby they relate to each other within the financial sector with the rest of the world. Here, the financial sector is as the grouping of all financial agents whose transactions determine quantitatively the flows in the economy. The financial system mainly deals on financial intermediaries. Intermediaries consists of the financial institutions purchasing the securities of the borrowers and issuing claims on themselves for the portfolio of the lenders thus converting securities to other types of financial assets.

It is important to note that in Nigeria, the federal government through statutory regulatory agencies: central bank of Nigeria, the Nigerian deposit insurance corporation and Securities and Exchange Commission as well as defacto regulatory ones such as, the national board for community banks and the Nigerian stock exchange manages the financial system in the country. The Nigerian financial system is made up of two main financial markets; the money market and the capital market.

### **Money Market**

The money market is the market for short fund or short term credits where the securities traded here are money instruments which include; treasury bills, treasury certificates, promissory notes, commercial papers, etc.

### **The Capital Market**

The capital market is the market for long term financial claims and obligations (Nwankwo, 1988). Here the financial securities traded have long and medium term maturities ranging from 3 years and above. Therefore, this means that the capital market is the market for mobilization and utilization of long term funds for economic development.

Anyanwu (1993) states that “Capital market is a mechanism whereby economic units desirous to invest their funds interact directly with financial intermediaries and those who wish to procure funds for their business. These securities which may take the form of equities or bonds are raised and procured in an organized market called the Nigerian stock exchange”.

## **Nigerian Stock Exchange**

The Nigerian stock exchange which is the main thrust of this paper is the key participant in the capital market. Stock exchange is a market place where those who wish to buy or sell shares, stocks, government bonds, debentures and other approved securities can do so though only through members of the stock exchange (Anyanwu, 19993). Thus, it is a market where large and small investors alike buy and sell through stock brokers. In this sense, the stock exchange provides the essential facilities for companies and government to raise money for business expansion and development projects through investors who own shares in companies for ultimate economic benefits of all members of the society.

### **The Origin of Nigerian Stock Exchange**

Before independence, the Nigerian government at various levels recognized the need for a stock exchange. According to Afolabi (1991), the need for establishment of a stock exchange in Nigeria arose partly from the deteriorating government earnings coupled with the mourning recurrent expenditure which left gap for capital budgeting, in such instance, budget deficit was inevitable if capital investments were to be intensified. Also the development plans of that time expected a sizeable proportion of planned investments to be financed through borrowing. Thus, in 1958 a commission headed by R. E. Barbark was set up by the government of Nigeria to advice on ways and means of fostering a share's market in Nigeria (Okoro-Okoro, 1994). Following the recommendations of the Barbark commission, the Lagos stock exchange was registered and presented with the certificate of registration of business name on 1<sup>st</sup> march 1959 while on 5<sup>th</sup> September 1960 it became incorporated and thus began operations on the 5<sup>th</sup> June, 1961 (Nwankwo, 1988).

Again, following the recommendation for Dr. Pius Okigbo's led financial review committee of 1975/76, the then Lagos stock exchange was changed into the Nigerian stock exchange on the 2<sup>nd</sup> December, 1977 by the federal government. From the date of transformation of the Lagos stock exchange, more branches were opened in Kaduna, Kano, Port Harcourt, Onitsha, Yola and Abuja with its headquarters in Lagos.

It is important to note that the activities of Nigerian stock exchange are regulated by the Securities and Exchange Commission (SEC) which was set up by decree No. 71 of 1979.

### **Functions of the Nigerian Stock Exchange**

The Nigerian stock exchange was set up to perform a number of functions. Again, these functions have been identified and stated by Anyanwu (1993) as follows:

- (a) To promote appropriate machinery top facilitate further offerings of stock and shares to the general public,
- (b) To promote increasing participation by the public in the private sector of the economy,
- (c) To encourage the investments of savings as soon as it is clear that the stocks and shares are readily available,
- (d) To provide a central meeting place for members to buy and sell existing stocks and shares and for granting quotations to new ones,
- (e) To provide the machinery for mobilizing private and public savings and making these available for productive investments through stocks and shares,
- (f) Provide opportunities for raising new capital
- (g) To facilitate dealings in government activities and hence enhance foreign investment in Nigerian manufacturing since government goes into joint venture with foreign investors
- (h) To reduce the risk of liquidity by facilitating the purchase and sale of securities
- (i) To protect the public from shady deals and practices in quoted securities so as to ensure fair trading through its rules, regulations and operational codes
- (j) To provide opportunities for continued operation and attraction of foreign capital for the nation's developments.

## **Markets of the Nigerian Stock Exchange**

Principally, there are two markets that are found in the stock exchange namely; the primary market and the secondary market.

- (i) Primary market: This is the new issue market as it is concerned with issue and sale of new securities. In this market government and corporations (quoted companies) can issue new securities to raise money for growth, expansion or modernization.
- (ii) The secondary market: This is a market where already existing securities are exchanged. It is the mechanism for providing liquidity to investors in the stock exchange through the operations of brokers.

In Nigeria, as in some other countries, the stock exchange is classified into; first-tier securities market in which securities of big quoted public limited liability companies are traded.

The second-tier securities market was established in 1985 to meet the need of small and medium scale companies and other privately owned companies wishing to go public but cannot meet listing requirement on the first-tier securities market.

## **2.2 NIGERIAN STOCKS EXCHANGE AS A TOOL FOR SUSTAINABLE ECONOMIC DEVELOPMENT**

In spite of its few branches and relatively recent origin, the Nigerian stock exchange has since its introduction continued to serve as a veritable tool for development of the Nigerian economy. In fact, it is safe to stress that Nigeria's present economic development is greatly facilitated by the establishment of the Nigerian stock exchange which plays its role as a surveyor of cheap and stable sources of long term funds for needed economic development. The effect of the Nigerian stock exchange as an economic development tool is therefore practical and appreciable and can be viewed from different standpoints:

- (1) Platform for Implementation of Economic Reforms: The Nigerians stock exchange has provided a platform for the implementation of the privatization programme which is intended to promote a market-based economy that will hasten growth and development of the economy. It should be recalled that at indigenization programme of 1972, government intervened to acquire and control on behalf of the citizens of the greater proportion of the capital assets of the country. However, government could not efficiently and effectively manage those productive assets or many reasons including the failure to put the right people in the right managerial positions. The consequences of this were many, the most devastating of which was the relegation of the hitherto to make rich Nigeria to a beggar, poor nation. Those consequences initiated the IMF inspired structural adjustment programme (SAP) in the middle of s1980s during Babangida military rule which brought privatization – divesture of government economic activities. Since the promulgation of the decree No. 25 of 1988 which put the privatization programme on course, the Nigerian stock exchange has been a platform necessitating the accomplishment of the objectives of privatization. Through the Nigerian stock exchange, those privatized companies have had their shares traded. The BCC Plc, one of the privatized companies is currently being resuscitated by its core investor Aliko Dangote and the question of how the company can raise capital required for financing its operations is a little matter to the Nigerian stock exchange.

- (2) Aid the mobilization of capital for economic expansion: The Nigerian stock exchange as an economic development tool over the years aided the mobilization of capital for economic expansion and production of goods and services meant for satisfaction of the general citizenry of the country. Through the Nigerian stock exchange, capital for financing the operations of every company been (and is still being) raised. In fact, there are very many investors in the Nigerian stock exchange today for investments in different securities of the companies.

Ndanusa (2004) positioned that “as at 2001, the stock exchange had about 3 million individual investors and hundreds of institutional investors (including foreign investors who own about 47% of the quoted companies”. The above facts confirm the Nigerian stock exchange role of attracting both the local and foreign investors for the purpose of mobilizing capital for economic expansion and production of goods and services.

- (3) Attract direct foreign investment: The Nigerian stock exchange has attracted foreign participation in investment in the country through its internationalization by the federal government. It should be recalled that following the regulation of the capital market in 1993, the federal government in 1955 internationalized the Nigerian stock exchange with abrogation of laws that constrained foreign participation. Consequent upon the abrogation of the exchange Act of 1962 and Nigerian enterprises promotion decree of 1989, foreign investors have been participating in the Nigerian capital market both as investors and operators. There are no limits any more to the percentage of foreign holding in any company registered in Nigeria. With this foreign participation, more capital flows for economic activities in the country.
- (4) Employment generation: The contribution of Nigerian stock exchange can also be noticed in the area of employment generation for Nigerians. Not only has the stock exchange promoted employment by encouraging expansion of businesses, it has also led to the direct employment of many people in the country through establishment of branch offices and subsidiaries in the major industrial cities of the country. The numbers of branches of the Nigerian stock exchange have increased from 1 in 1961 to 8 in 2002. Apart from generating employment opportunities through establishment of branch offices, the Nigerian stock exchange has created job openings through its stock broking firms which are staffed with many workers. It is obvious that those who have been employed with either Nigerian stock exchange its subsidiaries or the stock broking firms are earning income on which they are living.
- (5) Increased market capitalization: The growth in the number of securities listed on the Nigerian stock exchange since its introduction has left credence to the effect of Nigerian stock exchange as tool for increased market capitalization. Over a period of year of 41 years, (1961 – 2002)
- (6) Increased market capitalization: The growth in the number of securities listed on the Nigerian stock exchange since its introduction has lent credence to the effect of Nigerian stock exchange as tool for increased market capitalization. Over a period of 41 years, (1961-2000) there has been a modest growth in the number of securities listed on the exchange. It should be noted that the Nigerian stock exchange, which started operations in 1961 securities listed for trading. Interesting now has over 260 securities listed for trading as tat 2002 (Okereke, 2003). See table 1 below:

*Table 1: A statistical summary of stock market performance in 2002 (250 day year assumed)*

Activity	2002	2001	Increased	% change
Total volume of transactions	N6.66bn	N6.06bn	0.6bnh	+ 10.0
Average daily volume	N26.4m	N24.0m	N2.4m	+ 10.0
Total daily turnover	N239.2m	N230.4m	N8.8m	+3.8
New issued approved	N68.6m	N45.6m	N23.0m	+50.4
All shared index closing figure	12,137.72	10,963.11	1,174.61	10.71
No of listed companies	95	194	1	+0.5
No of listed securities	261	258	3	+1.2
Market capitalization	N763.9b	N662.28b	N101.3b	+15.28

Source: From end of year speech by the director-general Nigerian stock exchange (Okereke, 2003).

### 2.3 PROBLEMS AFFECTING NIGERIAN STOCK EXCHANGE

The effect of the Nigerian stock exchange as economic development tool could have been more tremendous if the exchange were not impeded by certain problems. These problems, according to Okaro (2002) are as follows:

- (a) Poor partnership spirit of Nigerians that has inhibited the development of public limited liability companies.
- (b) Persuasive poverty that has impacted adversely on the saving culture of Nigerians.
- (c) An underdeveloped savings/investment systems
- (d) Hostile and inconsistent macro-economic policy and regulatory environments and lack of transparency in economic management
- (e) Inadequate market infrastructural facilities
- (f) Low public awareness of the benefits of an investment in the stock market
- (g) High rate of withholding tax on dividends
- (h) Paucity of specialized financial market instrument
- (i) Buy and hold-tight attitudes of the average Nigerians
- (j) Absence of a fully, developed, efficiency resale market for corporate securities
- (k) Inadequate technological knowledge and dearth of trained manpower
- (l) Poor perception of the Nigerian stock market by off shore investors in terms of keeping to international financial reporting standards thus constraining foreign portfolio flow.
- (m) High transaction costs in the stock market
- (n) long time span between offering shares for public subscription and allotment of the shares
- (o) lack of transparency in corporate performance
- (p) insufficient investment advisers
- (q) absence of venture capitalist

### 3. CONCLUSION

Given the important role that well developed stock markets play in economic growth; Nigerians cannot afford to demotivate the development of its stock exchange. Legal regulatory, accounting, tax and supervisory systems influence stock market illiquidity. The efficiency of trading systems influences the ease and confidence with which investors can buy and sell their shares.

How fast the Nigerian stock exchange moves to assume its rightful position as a major provider of long term finance needed for Nigeria's rapid economic development will depend on how fast the major problems impeding its growth are solved.

### 4. RECOMMENDATIONS

The Nigerian stock exchange is relatively of recent origin. Since its introduction in 1961 the exchange has had positive effect on the economy of the country in very many ways. Nevertheless, these positive contributions of Nigerian stock exchange to economic development are adversely affected by numerous problems as highlighted above. In this respect, I therefore, make the following recommendations:

#### **Government measures:**

The federal government through her agencies such as national orientation agency (NOA), Nigerian investment promotion council (NIPC), central bank, etc. should carry out enlightenment campaigns and educate Nigerians on the need to imbibe the culture of savings and investment in securities and also avoid excessive consumption. A situation where one Nigerians owns five to ten cars without any investment should be discouraged. An NTA network programme titled "Capital Market Watch" (aired every Monday) has been recently introduced by management of Nigerian television authority. This is a positive move capable of changing attitudes of the Nigerian public in the understanding of operations of the stock market.

The federal government should also improve on the infrastructural facilities distribution in the country; this will further encourages the setting up of industries. More so, the stock brokers and potential investors would be able to access the needed information about the market via their personal computer systems from their homes. Changing the infrastructural landscape of Nigeria economy can enhance the prospects for many new economic activities. It will also reduce the operating costs of most enterprises and the cost of new projects which will no longer need to generate their electricity etc. thus, providing small and medium scale enterprise a real chance for survival and growth. This development will demand even greater innovations and efficiency of our stock market. As the pace of economic activities increases, so will the financing requirements and the need to enhance savings mobilization.

Federal government existing poverty reduction programmes need to be reappraised with a view of developing more focused strategies that will economically empower the citizens and hence stimulate their interest in investments. This respects the truth dictum that investment is equal to savings.

The federal government should consider abolishing withholding tax on dividends as well as providing some incentives to companies that are listed on the stock exchange. Although this may mean some loss of revenue to the government at the initial stage, the actual benefits to the company will be more than compensate for any previous losses.

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