IMPACT OF FOREIGN DIRECT INVESTMENT ON CAPITAL MARKET CAPITALIZATION IN NIGERIA

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ABSTRACT

The study investigates the impact of foreign direct investment on capital market capitalization in Nigeria. It makes use of secondary data spanning through 34 years (1986-2020). The study employed ordinary least square (OLS), Johansen co-integration and Error correction model. The result of the study revealed that all variables except FDI maintain positive/direct relationship with the dependent variable (MC). The long run model revealed that only money supply (M2) was negatively related to market capitalization (MC) while the remaining variables (FDI, SPI and INF) maintained positive relationship with market capitalization (MC). From the short-run analysis, the R^2 revealed that the short-run model which envelopes (FDI, INF, SPI and M2) account for 97% of the changes that occur in market capitalization (MC), while the remaining 3% is accounted for by other unexplained variables outside the research model. Meanwhile, the R^2 of the over-parameterized ECM model is 0.963946≈0.96. This implies that in the long run, about 96% of the slight difference of MC explained by all the exogenous variables together with the lagged variables. Based on the findings, the study showed that there are short-run and long-run relationships between the dependent and the independent variables. Therefore, the study recommended that since foreign direct investment is a significant determinant, efforts should be made by government and monetary authority to encourage foreign direct investment into Nigeria.

Keywords: Money Supply (M_2), Inflation (INF), Share Price Index (SPI)

1.0 Introduction

Nigeria‘s over-dependence on oil as the only source of revenue, in addition to her persistent negative trade balance which is due to the import dependent nature of her economy has contributed significantly to the volatile nature of the economy (Saksouk & Pires, 2007). The Nigeria economy benefited immensely from the oil boom in the early 70‘s in terms of cash inflow to the economy, but this seems not enough contribution to improve investment and infrastructural development that will support the growth and development of the Nigeria economy. Therefore, the mono-product nature of the Nigeria economy, the low per capita income level, trade imbalances, continuous fiscal deficits, low productivity, unemployment situation and the attendant low savings level, demands that substantial level of foreign investment, either in the form of foreign direct investment or foreign portfolio investment is needed to grow the economy and create employment (Idenyi, Ifeyinwa, Obinna & Promise, 2016).

Kolapo and Adaramola (2012) pointed out element of control and define it as an investment in a foreign country where the investing party that is, corporations, firms, and so on retain control over the investment. According to International Monetary Fund (IMF, 1977), foreign direct investment is defined as investment that is made to acquire a lasting business in an enterprise‘s operation on economy other than that of the investor, the investor‘s purpose being to have an effective voice in the management of the enterprises.

The importance of foreign investment either by private, public or portfolio agencies in promoting growth and development of market capitalization in a country cannot be overemphasized. That is why countries all over the World see FDI as a catalyst to growth and development. Foreign investment is expected to complement domestic investment in order to ensure development and improve the worth of stock market (Adaramola & Obisesan, 2015).

Stock market is an aspect of financial market that deals with the mobilization and channeling of long term funds for investment purposes bringing together economic units requiring funds and economic units that are willing to part with funds for a longer period of time.

It is a framework of institutions that arrange for long term financial instruments which includes shares, debentures, stocks and mortgages (Adeusi, 2000). Some of the most important functions of stock market includes, the promotion of liquidity and safety of financial assets in order to bring about saving and investment, ensuring a more robust allocation of resources by equating the demand and supply of loanable funds, enabling the transfer of funds from one sector or country to another for economic or commercial growth and, enhancing successful implementation or monetary and indigenization policy (Adeusi, 2000).

There are array of factors that affect stock market performance, this includes; economic, political, international, and company-specific issues. When it comes to the overall index performance then, the domestic economy's National Income (NI), Gross National Product growth (GNP), Purchasing Power Parity (PPP), Monetary issues, Political Stability, International Relations, Balance-of-Payment situation, etc. comes into consideration.

One of the aims of establishing capital market is to serve as a facility for investment in government and firms‘ financial securities such as options, futures, and other derivatives traded for improved specialization that supports growth and to act as the space where those who have a demand are matched with the supply (Saksouk & Pires, 2007). Donwa and Odia (2009) remarked that investment expands productive capacity, which is also a major explanation of the contributory factor to long run growth in the economy. Some studies such as Adaramola and Obisesan, (2014), and Sulaiman and Mohammed, (2015) have shown a significant and positive relationship between FDI and stock market development.

The debate on how important the FDI is still ongoing in the finance literatures because, many research works on the same topic, most especially those that were conducted in Nigeria, have failed to make use of data during the resent dispensation where a number of investors had reportedly left the country due to so many reasons, among and prominent is the issue of insecurity. Therefore, the results concerning foreign direct investment and stock market capitalization are mixed, which prompt this present study to shift its centers of attention towards the impact of Foreign Direct Investment variables on Nigerian capital market development using a unique set of macroeconomic variables, Viz: market capitalization (MC), foreign direct investment (FDI), share price Index (SPI), The study investigated the relationship that occurs between foreign direct investment and stock market capitalization, and analyzed the impact of share price index on stock market capitalization.

2.0 **Literature Review**

Capital market is viewed as a market for long-term financing, especially, long-term investment. The main dealers in this market are development banks, building societies,

insurance companies, merchant bank, investment, savings bank and the stock exchange. The main instruments used in the market are stocks and shares, company bonds and government bonds, industrialization and economic development which led to the increase in the demand for shares hence, the development of capital market to meet the demand of the market (Papaioannou & Duke, 1993). These markets are the products, not only those that are being demanded domestically, but also of international investors. Indirectly, capital inflow towards the new markets, capital markets are not only embryonic in development and same in characteristics, but some operate under the changes of economic and political instability. The early markets, which were dominated by low liquidity, high volatility and reduced efficiency have become highly attractive in the market due to increase in the types and volume of securities they offer, more stable government mandated macroeconomic policies and decreased regulation that allows easy access of investment information (Papaioannou & Duke, 1993).

2.1.1 **Role of Capital Market**

The capital has demonstrated its ability to make financial resources available through equity and debt, thereby contribution to all economic sectors. Alike and Anao (1986) limited that, the capital market which is required to operate the huge industrial and commercial corporation can be raised in such competitive terms (cost, condition, length of negotiation). Okereke (1959) described capital market as a major for long term commitment on the part of the lenders and long term needs on part of the borrowers. The borrowing side of the market is represented by the industry, commerce and government through their increasing sums of capital to meet public needs. The supply side as represented by individual and institutional investment.

Peter (1985) saw capital market as a framework of institutions that arrange for long-term financial assets such as shares, debentures, stock and mortgages. Kamioukor (1985) defined capital market as a network of specialized financial institutions unique and ways to bring together the issuers of capital and the suppliers of capital.

2.2 Empirical Review

Idenyi, Ifeyinwa, Obinn and Promise (2016) examined the impact of foreign direct investment on stock market growth in Nigeria from 1984 to 2015. The study employs co integration, vector error correction model and pair wise granger causality econometric process in the estimation of the variables specified in the regression model. The findings from the VECM indicated that FDI and EXPT has negative relationship with stock market growth both in the long and short run while IMP and GCF was found to have a positive relationship with stock market growth both in the short and long run periods. The result of the pair wise granger causality indicated no causality between FDI and stock market growth. A unidirectional causality however was found running from MCAP to GCF, IMP to MCAP and FDI to GCF. The study recommends among others that government should as a matter of urgency and national interest ensure that foreign investors sourcing for investment funds in Nigeria are encouraged to go through the Nigeria stock market in raising their funds.

Isaac, Sylvanus and Santeli (2016) examined the impact of foreign direct investment on economic growth in Nigeria. Data were collected from secondary source spanning through a period of 13 years. That is from 2002 to 2014. The (OLS) was adopted and, the findings revealed that foreign direct investment has significant relationship with economic growth in

Nigeria. Other result revealed that FDI contributes to GDP, reduces interest rate and improve employment rate in Nigeria. The study meanwhile recommended that the government should allow the FDI inflows into the country since its statistically contributes to the growth of the economy through improvement in GDP and creation of employment opportunity.

Abel and Nikki (2011) investigated the impact of financial development, macroeconomic and institutional factors on the flow of foreign direct investments to the Sub-Saharan African region. Panel data from 1995 to 2008 were drawn from 30 Sub-Saharan African countries. The study revealed that financial development, the countries' market size, and corruption among others adversely affect FDI in the region. That means, the absence of infrastructure, trade openness and financial development discourage foreign direct investment in the region.

Nsofor (2016) examined the impact of investment on stock market development in Nigeria from 2001-2010. Investment was proxy by gross fixed capital formation and stock market development proxy by market capitalization. The study made use of secondary data gotten from the CBN statistical bulleting and the data were analysed using Ordinary least square regression (OLS) technique. The study revealed positive and significant effect on stock market development within the period covered. The study recommends that government should therefore formulate some interesting policies that will attract more investment inflow into the stock market.

Okafor, Ezeaku and Eje (2015) examined effect of foreign investment inflows on economic growth in Nigeria. The study divided foreign investment into foreign direct investment and portfolio investment in other to realize the stated objectives of the study using data spanning through 1987 to 2012, and employed OLS and granger causality econometric procedures to analyze the data. The results indicate that FDI and FPI have significant positive impact on economic growth in Nigeria. The study recommended that government should pursue policies that will encourage foreign investors to bring their investment into the country.

Okwuchukwu (2015) examined the impact of exchange rate volatility, stock market performance and foreign direct investment in Nigeria. Ordinary least square technique was used to analyze the data sourced. The result indicated a significant negative effect on FDI inflow to Nigeria. This means that the FDI inflow into the country is so minimal. It was concluded that a stable and well developed capital market will attract FDI to Nigeria.

Uwazie, Igwemme and Nnabu (2015), examined the causal relationship between foreign direct investment and economic growth in Nigeria from 1970 to 2013. The author sees the motivation to carry out the study due to the inability of several empirical studies to reach a consensus on the subject matter. The study made use of vector error correction model method of causality analyses to estimate the variables specified in the model. The result of the analyses indicate an equilibrium long run relationship between FDI and economic growth, while the causality test carried out indicates that both FDI and economic growth correlate significantly in the short and long run periods in Nigeria. The researchers relying on the outcome of the result suggested the pursuance of aggressive policy reforms to boost investor's confidence and promote qualitative human capital development to attract foreign capital inflow into the Nigeria economy.

Sulaiman and Mohammed (2014) reviewed stock market development, foreign direct investment and macroeconomic stability using evidence from Nigerian stock market. Johansen co-integration and the error correction mechanism (ECM) techniques were used to examine the FDI impact on the level of development of the Nigerian stock market from 1981

to 2010.The result showed that FDI has a positive but insignificant effect while the exchange rate has a significant and negative relationship with the stock market performance.

Odita and Oghoghomeh (2013) examined the resource mobilization for long term economic development, an insight into the role of the Nigerian capital market. The study modeled the effect and importance of the Nigerian capital market, as a veritable source of medium and long term development. The data collected were from the Central Bank of Nigeria statistical bulletin and the Security and Exchange Commission spanning through 2001 to 2010. The SPSS statistical tool was used to analyze the data. The economic development was proxied by gross domestic product (GDP), while the capital market variables considered included the annual market capitalization (AMC) and the total volume of transactions (TVT). Findings revealed that there was a positive relationship between the capital market activities and gross domestic product, although the relationship was not statistically significant. The study recommended that the more fundamental issue of building investor confidence must be addressed through transparency, fair trading transactions, political stability and social security; stringent requirements for entry into the market should be relaxed and adequate publicity should be given to the activity of the capital market.

In the word of Uwazie, Igwemme and Nnabu (2015), the study believed that consensus has not been reached by a number of empirical works on how important is the FDI to the economic and stock market development of Nigeria. Sulaiman and Mohammed, (2014), Odita and Oghoghonah, (2013) believed that foreign direct investment has a positive but insignificant effect on the development of Nigeria stock market. Their recommendations centered on positive government policies, giant infrastructural drive by the government, political stability, adequate security, among others that can attract foreign investors.

It is on this backdrop that the study looked into impact of foreign direct investment on capital market capitalization in Nigeria as a result of the recent improvement in the infrastructure drive of the government, favourable government policies such as banning of importation and the efforts of the Nigeria government in improving the level of insecurity to improve the influx of foreign investors which has been a difficult issue in the past.

3.0 Methodology

To capture the impact of foreign direct investment on capital market performance, this study employed an empirical model based on the modification of Sulaiman & Mohammed (2013). The Model for this study is given as:

MC = f (FDI, SPI, M2, INF, μ)……..…… (3.1)
Which it's written in econometric form as:

$MC = b_0 + b_1FDI + b_2SPI + b_3M2 + b_4INF + \mu$ ..... (3.2)

Where:

MC = Market Capitalization, representing the dependent variable;
FDI = Foreign Direct Investment,
SPI = Share Price Index,
M2 = Broad Money Supply
INF = Inflation Rate
μ =White Noise
f = Functional Notation b_0
= Constant Parameter

b_0, b_1, b_2, b_3, b_4,; are regression coefficients or parameters;
From equation 3.2, the research model can further be stated in time series form as:
$(MC)_t = b_0 + b_1(FDI)_t + b_2(SPI)_t + b_3(M2)_t + +$
$b_4(INF)_t$ μ……(3.3)
Where:-
t = Time Lag

In testing for the existence of long run equilibrium relationship, the error correction model (ECM) i.e. equation can be conducted by placing some restrictions on estimated long run coefficient of variables.

4.0 Interpretation of Results and Findings

Table 1: Result of ADF Unit Root Test at level

Variables	ADF Statistics Value	Mackinnon Critical Value @ 5%	H_0	H_1	Remarks
MC	0.444363	-2.957110	Accept	Reject	Non- Stationary
FDI	-2.791410	-2.957110	Accept	Reject	Non- Stationary
SPI	-1.595709	-2.957110	Reject	Accept	Non- Stationary
M2	1.106019	-2.967767	Accept	Reject	Non- Stationary
INF	-2.710740	-2.957110	Reject	Accept	Non- Stationary

Source: E-View version 20

The table above shows that all the variables are non-stationary before their differencing because all variables shows a value less than 5% Mackinnon critical value (at absolute value). In order to ensure data stationarity of data for all the variables that were found to be non-stationary at level, we proceed to test for stationarity at first difference.

Table: 2 Result of ADF Unit Root Test at First Difference

Variables	ADF Statistics Value	Mackinnon Critical Value @ 5%	H_0	H_1	Remarks
MC	-5.734695	-2.960411	Reject	Accept	Stationary
FDI	-6.564665	-2.963972	Reject	Accept	Stationary
SPI	-5.716237	-2.963972	Reject	Accept	Stationary
M2	-3.632193	-2.963972	Reject	Accept	Stationary
INF	-4.920936	-2.971853	Reject	Accept	Stationary

***Source*: -** *E-view version 20*

It could be revealed that all the variables (MC, FDI, SPI, M2 and INF) were obtained as stationary at first difference. This is because their respective ADF test statistics value is greater than Mackinnon critical value at 5% and at absolute term.

Summary of Ordinary Least Square (OLS) Result

Dependent Variable: - MC

Independent Variables	Regression Coefficients	T- Statistics	Probability Value
FDI	-3.11005	-0.295285	0.7700
SPI	0.152628	6.879364	0.0000
M2	0.721668	17.13325	0.0000
INF	11.89961	0.878227	0.3873
C	-1276.657	-2.407085	0.0229

R^2 = 0.974613 **Adjusted R^2** = 0.970987 **F-Stat** = 268.7358 **DW-Stat**= 1.138341 ***Sources:*** **-** OLS result computed

From the table above, it can be affirmed that the research model for short-run dynamic relationship between market capitalization and four other explanatory variables respectively can be expressed mathematically below as:

$$\mathbf{MC} = -3.11005_{FDI} + 0.152628_{SPI} + 0.721668_{M2} + 11.89961_{INF} - 1276.657 + \mu$$

Evidence from the results of the Ordinary Least Square (OLS) as depicted above revealed that the constant parameter is inversely related to market capitalization (MC). The Constant parameter (B_0) has a negative coefficient of -1276.657. This implies that when all the explanatory variables are fixed at zero level i.e. they are held constant in the short-run, it will decrease the level of the explained variable (MC) by 1276.657 units.

The coefficient of Money Supply (M2) is 0.721668. This implies that the value of the coefficient of M2 shows that in the short run, a positive relationship exists between MC and M2. A unit increase in M2 i.e. volume of money supply in circulation will lead to increase in MC by 0.721668 units.

Similarly, the coefficient of Inflation Rate (INF) also appeared positive. This indicates a direct relationship occurred between INF and MC in the short run. The short run equilibrium relationship exists between MC and INF. The relationship shows that a unit increase in INF will cause MC to rise by 11.89961 units.

The coefficient of share price index (SPI) showed a positive figure of 0.152628, this implies that the variable exhibits a direct relationship with the dependent variable (MC). It therefore typifies that a unit increase in the prices of SPI will result into 0.152628 units increase in the value of the market capitalization in the Nigeria capital market. This dynamic relationship exists between SPI and MC.

Conversely, the coefficient of foreign direct investment was obtained as -3.11005. This implies that in the short run, FDI is inversely related to the dependent variable (MC). This relationship portends that as FDI increases by a unit, MC will also decrease in the same proportion, therefore reducing the value of MC by 3.11005 units.

Meanwhile, the coefficient of multiple determination denoted as R^2 with a value of 0.974613 which implies a 97% explanation of the behaviour of the market capitalization in the Nigeria stock exchange by the totality of the explanatory variables (FDI, SPI,M2 and INF) on the

short-run while the remaining 3% is being explained by the stochastic / random variable in the research model. After series of adjustment, the adjusted R^2 revealed a value of 0.970987, shows that 97.1% of the total variation of market capitalization behaviour can be explained by all the explanatory variables put together while the remaining 2.9% behaviour attributed to other unexplained variables outside the research model otherwise referred to as the error term/white noise.

Presentation of Johansen Co-Integration Result

Eigen Value	Trace Statistics	5% Critical Value	Probability Value	Hypothesised No of (CE_S)
0.857511	120.3454	69.81889	0.0000	None *
0.639193	59.94216	47.85613	0.0025	At most 1 *
0.417368	28.34037	29.79707	0.0729	At most 2
0.311327	11.59420	15.49471	0.1775	At most 3
0.001017	0.031529	3.841466	0.8590	At most 4

Source: -E-view 20

Evidence from the table above reveals that long-run relationship (co-integration) exist among market capitalization and it identified monetary fundamentals' determinants; foreign direct investment, share price index, inflation rate and money supply. This is reflected in the Trace Statistics (likelihood ratio) of the first two rows of the table that which shows a value greater than that of the 5% critical value in the table respectively.

The Long Run Model

From the Johansen co-integration result in the test conducted above for the existence of a long-run relationship, it could be inferred that there is the presence of long-run relationship among the dependent and the explanatory variables in the research model adopted for the study. This however prompted the need for the establishment of a co-integration model. The co-integrating equation in this study was chosen based on log likelihood ratio. This is derived from the Johansen co-integration result from which the equation with the lowest log-likelihood ratio was chosen when all equations obtained are positively signed. But the researcher chosed the equation with highest log likelihood ratio, if all equations obtained are negatively signed. Since all the co-integrating equations obtained in the result are negatively signed, the decision is that the equation with the highest log-likelihood ratio which also simultaneously appeared as though the first normalised equation with the corresponding value of -1404.122 is chosen. It is therefore presented below:

$$\underset{\textbf{(0.00011)}}{\textbf{MC} = 0.000120FDI} + \underset{\textbf{(0.03232)}}{0.180203SPI} - \underset{\textbf{(0.04386)}}{0.522244M2} + \underset{\textbf{(0.15409)}}{2.450226INF}$$

Note: The Standard Error Statistics are those stated in parenthesis.

From the long run equation above, the coefficient of FDI as a panorama variable is 0.000120 which implies a direct relationship exist between FDI and MC in the long run. A unit increase in FDI will cause an increase in MC by 0.000120 units. The coefficient of INF is 2.450226.

The coefficient is positively signed showing that in the long run, INF and MC are directly related and that a unit increase in the value of INF by a unit will increase the value of MC by 2.450226 units. The study also confirmed from the results of the long run model, that MC

will decrease in the long run by 0.522244 units if M_2 increases by a unit. Meanwhile, INF on its own has a coefficient of 2.450226. It can be deduced that in the long run, if INF should increase by a unit; it will cause MC to increase by 2.450226 units.

Moreover, key explanatory variable provided opposite relationship with MC in the long run to what was obtained in the regression equation provided by the short run results.

Error Correction Model (ECM)

The error correction mechanism is the speed or degree of adjustment, that is, the rate at which the dependent variable adjust to changes that occur in the independent variables. In line with the result obtained in the unit root test, the error correction mechanism showed that the ECM is stationary at level, therefore, an over-parameterized error correction model is required in this analysis and was obtained by using the lag length to ensure that the dynamics of the model is not compromised and properly captured. The result of the over-parameterized error correction model (ECM1) is presented below

Result of the Over-Parameterized Model (ECM 1)

Dependent Variable = D (MC, 2)

Variable	Coefficients	Standard Error	T-Statistics	Probability Value
D(MC(-1),2)	-0.612533	0.141667	-4.323750	0.0003
D(FDI,2)	-0.000103	5.062305	-2.043324	0.0544
D(FDI(-1),2)	-0.000134	5.312405	-2.529217	0.0199
D(SPI,2)	0.186023	0.018894	9.845447	0.0000
D(SPI(-1),2)	0.174767	0.034997	4.993726	0.0001
D(M2,2)	-0.306492	0.389157	-0.787580	0.4402
D(M2(-1),2)	-0.093698	0.380155	-0.246473	0.8078
D(INF,2)	5.270377	6.780592	0.777274	0.4461
D(INF(-1),2)	-0.271494	6.141484	-0.044207	0.9652
ECM(-1)	-0.594542	0.147247	-4.037729	0.0006
R-squared =	0.963946		**Durbin-Watson Stat** =	1.607926

The summary of the over-parameterized ECM results reveals that the coefficient of the error correction term is significant with the negative sign i.e. the (–) sign justifies its significance. This means that it will be effective in the correction of any deviations from the long-run equilibrium. The coefficient of ECM is -0.594542, indicating that, the speed of adjustment to long run equilibrium is approximately 59% when any past deviation will be corrected in the present period.

However, in order to attain effectiveness of the research model there is a need to simplify the research model into a more interpretable and certainly more parsimonious model. The parsimonious model would be developed by estimating the equations of only those variables found to be significant in the over-parameterized model i.e. those that have the least probability value, with the lead and lagged value of the dependent variable being inclusive. The table below shows the result of the parsimonious model estimated.

Research Findings

In the study, not only that the analysis of the study in the short run revealed that all variables except FDI maintain positive/direct relationship with the dependent variable (MC) but also that all the explanatory variables except FDI conforms to the prior expectation of the study. The long run model, on the other hand revealed that only money supply (M2) was negatively signed with market capitalization (MC) while the remaining variables (FDI, SPI and INF) maintained a positive relationship with market capitalization (MC). Evidence from the long run model portends that all variables (FDI, INF, SPI and M2) conformed to the prior expectation of the study in the long run. That is, there is a positive relationship between the independent variables (FDI, SPI and INF) and the dependent variable (MC), except M_2 which returned a negative relationship.

5.0 Conclusion

The study revealed that on the long-run, foreign direct investment (FDI) has a positive and significant impact on market capitalization. Therefore, this study have been done in its best possible and objective manner to serve as good starting point for further research by both academicians and practitioners who may want to undertake same study for future development in the subject matter, through objective contribution of this nature.

The study hereby recommends that, since foreign direct investment has positive and significant relationship with market capitalization, efforts should be made by government and monetary authority to encourage foreign direct investment into Nigeria. It is also suggested that emphasis should also be laid on foreign direct investment as a way of stimulating long term growth in the developing nation like Nigeria. Government should create public awareness to encourage investors‘ cash inflow into the stock market investment. Also, policy makers in Nigeria should formulate some investor‘s friendly policies like making efforts in reducing inflation rate to single digit in order to facilitate Nigeria‘s market growth and development. It is also suggested that the infrastructures stride of the government should continue unabated to boost the investor‘s confidence in the country. It is believed that these measures, if given adequate attention, will attract more investors to stock market in Nigeria.

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