

**AN ANALYSIS OF THE ECONOMIC IMPACT OF STOCK MARKET ON  
NIGERIAN ECONOMY (1986-2010)**

**BY**

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**TITLE PAGE****AN ANALYSIS OF THE ECONOMIC IMPACT OF STOCK MARKET ON  
NIGERIAN ECONOMY (1986-2010)****BY****NWANGWU MAURICE .O.****REG. NO: EC/2009/735****A PROJECT WORK SUBMITTED IN PARTIAL FULFILLMENT OF  
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## APPROVAL PAGE

This research has been approved and supervised having justified the Condition for the award of bachelor degree of science (B.Sc) in economics at Caritas University, Amorji-nike, Enugu.

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God bless you all.

## **ABSTRACT**

*A major engine of economic growth and development of any nation is the stock market. It impacts positively on the economy by providing financial resources through its intermediation process for financing long term projects. These projects could be promoted by governments or private institutions. The analysis scope covered a period of twenty-five years spanning from 1986-2010. The econometric methodology adopted is the Ordinary Least square method (OLS). Using the independent variables of market capitalization, value of trade, inflation rate and exchange rate and the dependent variable of gross domestic product, this study analyzes the impact of the stock market on the Nigerian economy. In conclusion, the result shows that the stock market has a highly significant impact on the Nigerian economy. Hence, without an efficient stock market, the economy may be starved of the required long term funds for sustainable growth and development.*

## **DEDICATION**

I dedicate this work to God almighty, the author and the giver of life who sustained my life throughout my stay in Caritas University. And to my wonderful parents for their immeasurable support, love and the opportunity they accord me.

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### CHAPTER ONE

#### 1.0 INTRODUCTION

#### 1.1 BACKGROUND OF THE STUDY

The stock market is supposed to play an important role in the economy in the sense that it mobilizes domestic resources and channels them to productive investments. However, to perform this role it must have significant relationship with the economy.

The development of stock market in Nigeria, as in other developing countries has been induced by the government. Though prior to the establishment of stock market in Nigeria, there existed some less formal market arrangement for the operations of the stock market. It was not prominent until the visit of Mr. J.B. Lobynesion in 1959, on the invitation of the federal government, to advice on the role the central bank could play in the development of the local money and stock market. As a follow-up to this, the government commissioned and set up a Barback committee to study and make recommendations on the ways and means of establishing a stock market in Nigeria as a formal market. (Alile and Anao 1990)

Capital markets are key elements of a modern market-based economic system as they serve as the channel for flow of resources from the SAVERS of capital to the BORROWERS of capital. Efficient capital markets are hence essential for economic growth and prosperity. With growing globalization of economies, the international capital markets are also becoming increasingly integrated. While such integration is positive for global economic growth, the downside risk is the contagion effect of financial crisis especially if its origin lies in the bigger markets.

As for the effect of macroeconomic variables such as money supply and interest rate on stock prices, the efficient market hypothesis suggests that competition among the profit maximizing investor's impact of macroeconomics. Variables on stock market will ensure that all the relevant information currently known about changes in macroeconomics variables are fully reflected in current stock market, so that investors will not be able to earn abnormal profit through

prediction of the future stock markets investments. (Chong and Koh 2008).

Therefore, since investment advisors would not be able to help investors earn above average returns consistently except through access to employer insider information.

Stock market is a critical log in the wheel that smoothens the transfer of funds for economic growth. Broadly speaking, stock exchanges are expected to accelerate economic growth by increasing liquidity of financial assets, making global diversification easier for investors and promoting wiser investment decisions. In principle, a well functioning stock market may help the economic growth and development process in an economy through growth of savings, efficient allocation of investment resources and alluring of foreign portfolio investments. The stock market encourages savings by providing the household having investable funds, an additional financial instruments which meets their risk preferences and liquidity needs

better, it in fact provides individuals with relatively liquid means for risk sharing in investments projects.(Agrawalla 2006).

The stock markets capacity to contribute to the development of the economy has been largely impaired by various inadequacies. The market over the years have been characterized by-Lack of depth with few securities-poor liquidity, partly due to inefficiency-Poor infrastructural for secondary market operations-Basically, an equity market with largely dormant bond market-High transaction costs-Lack of sophisticated product investments and instruments. The market is mainly dominated by traditional instruments such as BONDS and EQUITIES with limited derivatives-Unfavorable tax regime-Unstable and largely in appropriatein macro-economic environment.

## **1.2 STATEMENT OF THE PROBLEM**

InNigeria, the capital markets have over the years been performing its traditional role. However, its efficiency and effectiveness in this regard

have been greatly limited by various factors notable among which are price level and the structure of the economy, which is dominated by oil production, yet, the oil producing companies are listed on the stock market, the lack of long term capital in the business, the business sector depends mainly on short-term financing such as overdrafts to finance even long term-capital. The economic reforms of the federal government particularly those that have taken place in the financial sector are therefore intended among other objectives to attain. The focus of this paper is to examine stock market and it's impact on the Nigerian economy.

As a result of the above, the market has therefore not been in the best position to contribute maximally to economic growth and the real sector. These inadequacies have made the reforms that have taken place over the years imperative. Recent reforms in stock market with the enactments of the Investments and Security Act (ISA) no 45 of 1999

which replaced the SEC degree of 1986. Other reforms that have been taken place in the stock market include:

- Review of minimum capital requirement for operators.
- Reduction of transaction costs.
- Introduction of code of corporate governance.
- Reactivation of the Bond market.
- Introduction of market makers.
- Introduction of self registration.
- Development of a commodity market.

Many emerging stock markets are being restricted by lot complaints which impede the realization of capital market serving as a catalyst for economic growth. Such problems include:

A. Unquoted companies: Many companies are not quoted because of perceived loss of control. They are afraid of sharing the ownership of

the company with others and because of this reason they prefer to restrict themselves to funds provided by family members and friends and are therefore unable to unanticipated challenges in a timely manner.

B.        Domination of public sector: The dominance of public sector like government s has greatly hindered the capital market growth as many them are yet to be privatized(especially the public utilities)that can deepen the market almost immediately.

C.        A lot of sharp practices exist in the flow of the exchange fostering improper disclosure of information, unfairpricing, insider dealings e.t.c

Currently, the performance of the Nigerian stock market during the last month rallied 118 points or 7.3%. from 2013, the Nigerian stock market average 1106 index points reaching an all time-high of 1718 index point in may 2013 and a record of 848 index points (NSE 30). This rise and fall of the Nigerian stock market index point has resulted

in the slow meltdown of the capital market. This meltdown of the capital market could result in unbalances on the economy.

According to the NSE report the process of this rise and fall began in January 2007 as the capital market nose-dived from all time high of ₦13.5 trillion to less than ₦4.6 trillion by the second week of January. The all share index has also plummeted from a high of 66,000 basis points to less than 22,000 points in the same period. It has also experienced a free fall downward movement with more than 60% of 300 quoted stocks. Consequently, many of the quoted stocks lack liquidity as their holders are trapped, not able to convert to cash to meet their domestic needs thereby creating a major problem. When this occurs, stockholders begin to withdraw and foreign investments are lost and this results to a negative development on the Nigerian economy.

### **1.3 OBJECTIVES OF THE STUDY**

The central objective of this study is to analyze the economic impact of stock market on Nigerian economy. The specific objectives include;

1. To examine the relationship between stock market and Nigeria's gross domestic product.
2. To assess the level of stock market stability in Nigeria.
3. To appraise the performance of the Nigerian stock market.
4. To make policy recommendations at the end of this study.

#### **1.4 RESEARCH HYPOTHESIS**

The research work is guided by the following hypothesis.

1. Ho: There is no significant relationship between stock market and Nigeria's gross domestic product.

H1: There is a significant relationship between stock market and Nigeria's gross domestic product.

2. Ho: Stock market does not have economic impact on the Nigerian economy.

H1: Stock market has economic impacts on the Nigerian economy.

### **1.5 SIGNIFICANCE OF THE STUDY**

The general relevance of the study lies in its understanding of the Economic Impact of Stock Market on Nigerian economy and so will be particularly relevant in the following areas.

A. In particular, by using Nigeria stock market as empirical evidence, the research will provide quantitative information which will enable us to ascertain whether or not stock price fluctuations have impact on the Nigerian economy. The finding of the study will reveal or will therefore be relevant to the government and policy makers in fine-tuning stock market policies that will be applied to ascertain sustainable in the Nigerian stock market.

B. Also, it will relevant to the stock market operators, monetary institutions or authorities and regulating agencies to harness and fine-

tune stock market prices to promote high performance level especially at this critical moment of global economic crises and the nation's economic circumstances.

C. The findings if the study will equally afford quoted companies the stock opportunity to assess whether or not they have been performing well in terms of price stability.

D. Finally, a further justification for the study is the benefit of applying the economic analysis of the impact of stock market in Nigeria to economic and financial analysis kits and increases the stock of knowledge in both the stock market and the Nigerian economy.

## **1.6 SCOPE AND LIMITATIONS OF THE STUDY**

This work is a study of economic impact of stock market on the Nigerian economy. The study employs empirical evidence from both stock market using the Nigerian stock exchange and Nigerian economy as whole. The choice is made out of the researcher's interest in the given country's stock market and economic circumstances. The period

covered by the research is twenty-five (24) years period 1986-2010. The availability of uniform data on the variables informed the researcher's choice of the period of analysis.

This study is limited by the following factors;

- 1. Paucity of materials:** Materials for the study were not adequate which could not allow for an in-depth study.
- 2. Inaccessibility of data:** Difficulty in accessing data for the study was yet another limitation.
- 3. Financial constraint:** Lack of adequate funds on the part of the researcher constituted another problem.

## CHAPTER TWO

### 2.0 LITERATURE REVIEW

#### 2.1 THEORETICAL LITERATURE

The stock market can be defined as the market where medium to long term finance can be raised. The market is the market for dealing (that is the lending and borrowing) in long term loan able funds. Mbat (2001) described it as a forum through which long term funds are made available by the surplus to deficit economic units. It must be however be noted that though all surplus economic units have access to the stock market not all the deficit economic units have the same easy access to it.

Under the stock market, the Nigerian stock exchange is one of the constitutiences of the Nigerian stock market. The Nigerian stock exchange (NSE) is the center point of the Nigerian stockmarket while the Securities and Exchange Commission (SEC) serves as the apex regulatory body. The NSE provides a mechanism for mobilizing private

and public savings, such funds available for productive purposes. The exchange also provides a means for trading existing securities. It also encourages large scale enterprises to gain access to public listing. The NSE operates the main exchange for relatively large scale enterprises, the Second Tier Securities Market (SSM) where listing requirements are less stringent for small and medium scale enterprises. (SMSIES).

The stock market is the long term end for financial market. it is made-up of market and institutions which facilitate the issuance and secondary trading of long term financial instruments. Unlike the money markets, this functions basically to provide short term funds. The capital market to funds provided for the industries and government to meet their long-term requirements. Capital requirements such as financing for fixed investments, buildings, plants, bridges e.t.c.

### **2.1.1 HISTORY OF THE NIGERIAN STOCK EXCHANGE**

The Nigerian stock exchange was founded in 1960 as the Lagos

Stock exchange. It started operations in Lagos in 1961 with 16 securities listed for trading. In December 1977, it became known as the Nigerian Stock exchange based on the report and recommendation of Pius Okigbo financial system review commission with branches established in some of the commercial cities of the country. The branch in Lagos was opened in 1961, Kaduna 1978, port-Harcourt 1980, Kano 1969, Onitsha February 1990, Ibadan august 1990, Abuja October 1999 and Yola April 2002. Lagos serves as the headquarters of the exchange.

The NSE continues to evolve to meet the needs of its valued customers and to achieve the highest level of competitiveness. With about 200 companies and 258 listed securities, the exchange operates fair, orderly and transparent markets that bring together the best of African enterprise and the local and global investor communities.

The Nigerian stock exchange has been operating on Automated Trading system (ATS) since April 27 1999, with dealers through a network of computers connected to a server. The ATS has remote trading and surveillance. The stock exchange is thus an institution of

the stock market, which provides trading floors where all dealing members operates on every business day. The Nigerian stock exchange is poised to champion the acceleration of African's economic development and to become the "the Gateway to African market.

Functions of the stock exchange includes

1. To enhance the mobilization of private and public investments through trading in shares and stocks.
2. To serve as a broad communication arena for its constituencies and the dual role of overseeing the markets and their member firm participants on one hand and self-regulating itself on the other hand.
3. To ensure fair dealing in securities through its rules, regulations and operational codes which help us protect the public from shady deals.
4. To maintain broad liquid secondary markets for corporate securities thereby helping to build public confidence and participation in the market.

5. To enhance issuers ability to raise capital in the primary market and understanding the importance of efficient capital management
6. To serve as a forum or mechanism for the implementation of the indigenization programme.
7. To provide opportunities for raising new capital.
8. To promote increasing participation by the public in the private sector of the economy.
9. To provide appropriate machinery to facilitate further offerings of stocks and shares to the public.
10. To provide a central meeting place for members to buy and sell shares to the public.

Along with its functions the Nigerian stock exchange is faced with its own problems. They include:

**-Lack of adequate and timely information**

The problem with the Nigerian stock exchange is that people are unable to take advantage of the information that passes through. This is because investors aren't trained enough.

**-Inefficient communication skills**

These are problems associated with the techniques or form of transfer of communication along with the technologies involved. When this problem arises, it results in misinterpretation and misunderstanding which creates an imbalance in the economy.

**-Inadequate skills among Nigerian stock brokers**

Some of the Nigerian stock brokers are not properly trained. This inadequacy can ruin the stock market.

**-Low level of automation****-Inability of enough participants in the markets**

### **2.1.2 THE NIGERIAN SECURITY AND EXCHANGE COMMISSION (NSEC)**

The Nigerian security and exchange commission (NSEC) is the apex institution for the regulation and monitoring of the Nigerian stock market. The commission was established under the security and exchange commission decree 1979, operating retrospectively from 1<sup>st</sup> April 1978.

Prior to the SEC, two bodies had in succession been responsible for the monitoring of the stock market activities in Nigeria. The first was Capital Issues committee, which operated between 1962 and 1972. It could not be seen as the superintendent of the stock market because its functions were more or less advisory without the force of instruction even though its functions included in the coordination of stock market activities. The next body was Capital market Issues Commission (CIC) which came into being in March 1973. The C.I.C, unlike its predecessor, had full powers to determine the price, timing and volume of security to be issued. Despite this wider power, the CIC could not be seen as the apex capital market because it concerned itself with public companies

alone and its activities did not cover the stock exchange and government securities.

The enabling Act of Securities and Exchange Commission specifies its overriding objectives as investors protection and development while its functions were divided into two regulatory and development.

The functions of the commission are extensively spelt out in Nigeria Securities Decree(Decree no 29) of 1983 and the Nigerian enterprises Promotion Decree 1990. According to Section 96) subsection (9) to (10) the commission is charged with the following duties and functions.

1. Determining the amount of price and time when securities of companies are to be sold to the public whether through offer for sale or subscription.
2. Registering all securities proposed to be offered for sale to or for subscription by the public.

3. Maintaining surveillance over the securities market to ensure orderly, fair, and equitable dealing in securities.
4. Protecting the integrity of the security market against any abuses arising from the practice of insider trading.
5. Acting as regulatory apex organization for the Nigerian Stock market including the Nigerian Stock Exchange and its branches to which it would be at liberty to delegate power.
6. Creating the necessary atmosphere for the orderly growth and development of the stock market.
7. Reviewing, approving, and regulating merger acquisition and all forms of business combination.
8. Registering Stock Exchange or their branches, registers investment advisers, securities dealers and their agents and controlling and supervising their activities with a view to maintaining proper standards of conduct and professionalism in the business.

Undertaking such other activities as are necessary or expedient for giving for giving fall effect to the provision of this decree. By understanding the Nigerian Stock Exchange and the Securities Exchange commission, one can be able to analyze the impact of the stock market on the Nigerian economy.

### **2.1.3 AN OVERVIEW OF THE STOCK MARKET.**

Primarily a stock market is a place where companies can raise money to make their business bigger and better. Companies raise money by selling shares of stocks to investors. At the same time, the stock market gives investors an opportunity to invest in these companies and benefit from any profit they make.

A stock market can also be called a capital or securities market as it encompasses the stock exchange, the branches, and the stockbrokers. An organized securities market requires a securities exchange, a securities commission or other regulatory agencies, and intermediaries such as dealers, brokers, securities analysts, e.t.c.

Virtually all costs are borne by those who benefit. The intermediaries receive their fees from issuers or investors to whom they provide a service. The stock market is usually funded through fees paid by investors and issuers; even the expenses of the securities commission may be partially paid for by registration fees rather than being a major burden on the government budget. Companies which go public are subject to continuous cost of providing information, transferring shares, paying dividends and other aspects of shareholder relations. The stock market is the aspect of the financial system which mobilizes and channels long term funds for economic growth. The stock market embraces trading in both new issues (primary) and old issues of stocks (secondary). Securities are primarily of two (2) types: Debit and Equity. Debit securities include federal government development stock (GDS), industrial loans, preference stocks, bonds, e.t.c., while

Equity securities mainly concern ordinary stocks which impose higher liabilities on holders.

Portfolio investment in the capital market is the acquisition of financial assets (which includes stocks, bonds, deposits, and currencies) from one country to another. It is a form of investment that attempts to achieve a mixture of income and capital growth. It deals with an institutional arrangement involving the Securities and Exchange Commission (SEC), the Nigerian Stock Exchange (NSE) the operators and the investors. Stock market is viewed as a medium to encourage saving, help channel savings into productive investments and improve the efficiency and productivity of investment. The emphasis on the growth of stock markets for domestic resource mobilization has also been strengthened by the need to attract foreign capital in non-debt creating forms. A viable equity market can serve to make the financial system more competitive and efficient. Without equity markets, companies have to rely on internal finance through retained earnings.

Without being subjected to the scrutiny of the stock market, big firms get bigger, and for the emerging smaller companies, retained earnings and fresh cash injections from the controlling shareholders may not be

able to keep pace with the needs for more equity financing which only an organized market place could provide. The corporate sector would also be strengthened by the requirements of equity markets for the development of widely acceptable accounting standards, disclosure of regular adequate and reliable information.

The capital market in any country is one of the major pillars of long term economic growth and development. The market serves a long range of clientele including different levels of government, corporate bodies and individuals within and outside the country. For quite some time now, the stock market has become one of the means through which foreign funds are being injected into most economies and the tendency towards a global economy is more feasible.

The development of the securities market could help to strengthen the corporate capital structure (i.e the composition of the capital firms) and efficient and competitive financial system. In a well developed stock market, share holding provides individuals with a relatively liquid means of sharing risks in investment projects.

Stock market development has an important role to play in economic development. Shabaz (2008) argue that the stock market is an important wheel for economic growth as there is a long run relationship between stock market and economic growth.

Gerald (2006) states that stock market development is important because financial intermediation support the investment process by mobilizing household and foreign savings for investment by firms. It ensures that funds are allocated to the most productive use and providing liquidity so that firms can operate the new capacity efficiently.

In view point of Sharpe, et al (1999), stock market is a mechanism through which the transaction of financial assets with life span of greater than one year takes place. Financial assets may take different forms ranging from long term government bonds to ordinary shares of various companies. Stock market is where the shares of various firms are traded, trading of shares may take place in two different forms in stock market. When the issuing firms sells its shares to the investors, the transaction is said to have taken place in the primary market but

when already issued shares of firms are traded among investors the transaction is said to have taken place in the secondary market.

It is therefore quite valid to state that the growth of the stock market has become one of the barometers used for measuring overall economic growth of a nation.

#### **2.1.4 OVERVIEW OF THE IMPACT OF THE STOCK MARKET ON THE NIGERIAN ECONOMY.**

The major impact of the stock market on any given economy is said to be the economic growth and development of that economy. The growth and development of an economy depends on the suppliers of long term funds (Nwankwo 1991). Based on its importance the stock market can be an important facilitator of accelerating economic growth and development (Applegarth, 2004).

Economic growth in a market has been identified as an institution that the modern economy hinges on as an efficient financial sector that

contributes to the socio-economic growth and pools domestic savings and mobilizes foreign capital development for productive investments (Bekaert and Harvey, 1997).

In principle, the stock market is expected to accelerate economic growth, by providing a boost to domestic savings and increasing the quantity and the quality of investment.

The Nigerian stock market provides the necessary lubricant that keeps turning the wheel of the economy. It not only provides the funds required for investment but also efficiently allocates these funds to projects to fund owners. The Nigerian stock market was established due to the following reasons.

1. To overcome the difficulties of selling government stock.
2. To provide local opportunities and lending for long term purpose.
3. To enable authorities mobilize long term capital for economic growth and development.

4. To enable foreign business the chance of offering their shares to interested Nigerians to invest and participate in the ownership of these foreign business.

In view of this the major participants in the stock market are

- Government
- Quoted companies (listed companies)
- Stock brokers
- Central Bank of Nigeria (CBN)
- Banking and non banking financial institutions
- Nigerian Stock Exchange
- Nigerian Securities and Exchange Commission

Functions of the stock market include:

1. The promotion of rapid capital.
2. It serves as machinery for mobilizing long term financial resources for industrial development.
3. The provision of an alternate source of fund other than taxation for the government.

4. The mobilization of savings from numerous economic units for growth and development.
5. The provision of liquidity for any investor or group of investors.
6. The broadening of ownership base of assets and the creation of a healthy private sector.
7. It serves as an avenue for effecting payment of debts.
8. The encouragement of a more efficient allocation efficiency of new investment through the pricing mechanism.
9. The creation of a built in operational and allocation efficiency within the financial system to ensure that resources are optimally utilized at relatively little cost.
10. It is a necessary liquidity mechanism for investors through a formal market for debt and equity securities.

The stock market is very vital to the Nigerian economy because it supports the government and incorporates initiatives, finances the exploitation of new ideas and facilitates the management of financial

risks. The stock market impacts on the Nigerian economy in the following ways

1. The stock market encourages the inflow of foreign companies or investors to invest in domestic savings and securities.
2. It reduces the over-reliance of the corporate sector on short term financing for long term projects and also provides opportunities for government to finance project aimed at providing essential amenities for socio-economic development.
3. The stock market aid the government in privatization program by offering her shares in public enterprises to members of the public through stock exchange.
4. It impacts positively by providing avenue for marketing of shares and other securities in order to raise fresh fund for expansion of operations leading to increase production/output.

The stock market provides means for allocating the nation real and financial resources between various sectors, industries and companies.

Through capital formation and allocation mechanism, the market efficiently distributes the scarce resource for the optimal benefit to the economy.

## **2.2 EMPIRICAL LITERATURE**

Adam and Sanni(2005) examined the role of stock market in Nigeria's economic growth using Granger causality test and regression analysis. The study discovered a one way causality between GDP growth and market for capitalization and a two way causality between growth and market turnover. They also observed a positive significant relationship between GDP and market turnover.

Nishat (2004) analyzed the long term relationship between macroeconomics variables and stock market. He used the INT, INF, VOT, moneysupply and foreign exchange rate as explanatory variables. The result of his study indicated that there is a causal relationship between stock market and the economy.

Osinubi and Ameghionyeoduwe (2003) examined the relationship between the Nigerian stock market and economic growth during the period 1980-2000. Unfortunately, their results do not support the claim that stock market development promotes economic growth.

Mohtadi and Agarwal (2004) examined the capital market and economic growth in developing countries using a panel data approach that covers 21 emerging stock markets over the 21 years (1977-1997), they found out that their turnover is important and that their investment is a significant determinant of aggregate growth. Foreign direct investment is also found to have a strong positive influence on aggregate growth. The result of their study indicates that both turnover and market capitalization are important variables as determinants of economic growth

Ewah et al (2009) appraised the impact of the stock market on the Nigerian economy using time series data from 1961 to 2004. They found that the stock market in Nigeria has positive effect but cannot

contribute meaningfully to the economy because of low market capitalization, illiquidity, misappropriation of funds e.t.c.

Ezeoha et al(2009) investigated the nature of the relationship that exists between the stock market development and level of investment (domestic private investment and foreign private investment) flows in Nigeria. The study discovered that the stock market development promotes the economy promotes domestic private investment flows, thus suggesting the enhancement of the economy's production capacity as well as promotion of the growth of national output. However, the results show that stock development has not been able to encourage the flow of foreign private Investment in Nigeria.

Afees and Kazeem (2010) critically and empirically examined the causal linkage between stock market and economic growth In Nigeria between 1970 and 2004. The indicator of the stock market used are the market capitalization ratio, total value traded ratio and turnover ratio while the growth rate of gross domestic product is used as proxy for economic growth, using the Granger causality (GC) test, the empirical evidence

obtained from the estimation process suggests a bidirectional causality between turnover ratio and economic growth, a unidirectional relationship from market capitalization to economic growth and no causal linkage between total value traded. The result of the causality is sensitive to the choice of variable used as proxy for stock market.

Niewerburgh, et al (2005) investigated the long term relationship between stock market and economic growth in Belgium. Their result shows that the market causes economic growth in Belgium.

Demetriades, et al (2001) utilized time series data from five developed country, to examine the relationship between stock market and economic growth, controlling for other effect of the banking the banking system and stock market volatility. Their results support the view that although bank and stock market may promote economic growth, the effect of bank is more. They suggested that the contribution of stock market to the economy may have been exaggerated by studies that uses cross country regressions.

Mishra et al (2010) examined the impact of stock market efficiency in India using time series data on market capitalization, total market turnover and stock price index over the period spanning from first quarter of 1991 to the first quarter of 2010. Their study reveals that there is a linkage between stock market efficiency and growth in India. This linkage is established through high rate of market capitalization and total market turnover. The large size of the stock market as measured by market capitalization is positively correlated with the ability to mobilize capital and diversify on an economy wide basis.

Obamiro (2005) investigated the role of the Nigerian stock market in the Nigerian economy. The author reported a positive effect of stock market on the Nigerian economy.

## **CHAPTER THREE**

### **3.0 RESEARCH METHODOLOGY**

#### **THE RESEARCH DESIGN**

This study will use data collected from the periods ranging from 1986-2010 a period of twenty-five years. In the view of the fact the objectives of this study involve the testing of hypothesis and making inferences based on the findings, this research adopts the ordinary Least square equation technique will be used.

The data will be evaluated using both statistical and econometric criteria.

#### **3.1 MODEL SPECIFICATION**

The first and most important step the econometrician has to take in attempting the study of any relationship between variables is to express this relationship in mathematical formation that is to specify

the model with which the economic phenomenon will be explored empirically (koutsoyiannis 1997:12).

In the model specification below, the researcher intends to the economic investigate the economic impact of stock market on Nigerian economy using the Gross domestic Product. The explanatory variables include the price indices of ordinary shares listed on the Nigerian stock exchange and the functional form is stated below.

$$GDP=a_0+a_1mc+a_2INT+a_3INF+a_4VOT+U_i$$

Where

GDP=Gross domestic product

MC= Market Capitalization

INT= Interest Rate

INF= Inflation Rate

VOT= Value of trade

U<sub>i</sub>=Stochastic variable or error term

a<sub>0</sub>=Intercept

a<sub>1</sub>,a<sub>2</sub>,a<sub>3</sub>,a<sub>4</sub>=parameter estimates

The following criteria will be adopted in the evaluation of the regression result.

- 1. ECONOMIC CRITERIA:** This is also the apriori criteria, which describes the apriori expectation. The apriori expectation refers to the expected economic relationship that exists between the dependent variable and the expected variable and the explanatory variable. Possible and positive relationship is expected between the dependent variable and the explanatory variables.
- 2. STATISTICAL CRITERIA:** This criterion is concerned with the size, sign and values of parameter estimates and other relevant statistic values of the model.
- 3. ECONOMETRIC CRITERIA:** The economic criteria looks at the level of significance of the estimated parameters and other relevant values of the estimated equation, this will involve the various test of significance.

Therefore, the technique for evaluation of results implies the use of the following standard criteria:  $R^2$  (adjusted  $R^2$  for degrees of freedom) for testing goodness of the fit of the estimated regression equation; F-

ratio for testing the significance of the regression co-efficient; and 'dw' statistic (Durbin Watson) for testing the randomness of residuals.

Finally, apriori sign and magnitude of the co-efficient will be used to evaluate the results and test conducted to ensure that the assumptions of the ordinary least square method are fulfilled.

### **3.3 JUSTIFICATIONS OF THE MODEL**

The ordinary least square single equation technique is the estimation procedure chosen for this study. It will be used for estimating the equation. As a justification for this method, it has been identified that the ordinary least square is more robust against specification errors than many of the simultaneous equation method and also that predictions from equation estimated by ordinary least squares often compare favorably with those obtained from equations estimated by the simultaneous equations method.

Among other reason is the simplicity of it computational procedure in conjunction with optimal properties of the estimates obtained and

these properties are linear, unbiased and minimum variance among a class of unbiased estimators.

Now, for the ordinary least square method which depends on the minimization of the sum of squares of the error term to be applied, certain explicit assumptions must be made about the behavior of non observable error term (koutsoyiannis, 1997:118).

### **3.4 SOURCES OF DATA FOR THE STUDY**

Annual time series data on the variables under study covering twenty-four (24) years period 1986-2010 are used in this study for the estimation of functions. Indices of ordinary shares listed on the Nigerian stock market are the relevant explanatory variables. These are inflation rate, value of trade, market capitalization and interest rate.

Equally, the gross domestic product is the dependent variable. Data were collected from various editors of the various issues of Central bank of Nigeria Economic and Financial Review, Annual Reports and

Statements of Accounts, Principal economic and Financial Indicators, Security and Exchange commission market bulletins and relevant journals, the Nigerian stock exchange fact books, Central Bank of Nigeria Statistical Bulletin and publications of the Nigerian stock exchange.

## CHAPTER FOUR.

### PRESENTATION AND ANALYSIS OF RESULT.

#### 4.0 Presentation and Interpretation of Result:

#### 4.1 Presentation of regression result

<b>Dependent variable: GDP.</b> <b>Method: Ordinary Least Square (OLS).</b> <b>Period of study: 1986 – 2010</b> <b>Included Observations: 25</b>					
Variable	Coefficient	Standard error	t-statistics	t-prob.	PartyR <sup>2</sup>
Constant	-137340	250570	-0.548	0.5897	0.0148
MC	0.98203	0.58117	1.690	0.1066	0.1249
VOT	-4.3769	5.1747	-0.846	0.4077	0.0345
INF	5719.2	61837	0.092	0.9272	0.0004
EXR	101370	24321	4.168	0.0005	0.4648
$R^2 = 0.688544$ $F\{4, 20\} = 11.054 \{0.0000\}$ $\hat{\alpha} = 5.18732$  $DW = 1.57$ $RSS = 5.381665753$ for 5 variables and 25  observations.					

## 4.2 Interpretation of regression result

From the above, the interpretation of the result as regard the coefficient of various regressors is stated as follows:

The value of the intercept which is -1.3734 shows that the Nigerian economy will experience a -1.3734 decrease when all other variables are held constant.

The estimate coefficients which are

MC shows that a unit change in MARKET CAPITALISATION will cause a 0.98203 decrease in GDP.

VOT shows that a unit change in VALUE OF TRADE will lead a -4.3769 decrease in GDP.

INF shows that a unit change in INFLATION willlead to a 5719.2 increase in GDP.

EXR shows that a unit change in EXCHANGE RATE will lead to a 1.0137 increase in GDP.

#### 4.2.1 Economic Apriori Criteria:

The test is aimed at determining whether the signs and sizes of the results are in line with what economic theory postulates. Thus, economic theory tells us that the coefficients are positively related to the dependent variable, if an increase in any of the explanatory variables leads to a decrease in the dependent variable.

Therefore, the variables under consideration, their parameter and priori signs have been summarized in the table below.

Variables	Expected signs	Estimate	Remark
MC	+	$\beta > 0$	Conform
VOT	+	$\beta < 0$	Conform
INF	-	$\beta > 0$	Not Conform
EXR	+	$\beta > 0$	Conform

From the above table, it is observed that all except VOT actually conforms to the economic theories.

A positive relationship which exists between MC, INF, EXR, and GDP indicates that an increase in MC, INF and EXR will result in a positive change in the Growth Rate of GDP. This conforms to the priori criteria because an increased or high MC and EXR over the years will increase Inflation in the economy.

#### **4.2.3 Statistical Criteria {First order test}**

##### **1. Coefficient of Multiple Determinants $\{R^2\}$ :**

The  $R^2$  {R-Squared} which measures the overall goodness of fit of the entire regression, shows the value of 0.688544 = 68.8544% approximately 69%. This indicates that the independent variables accounts for about 69% of the variation in the dependent variable.

## 2. The Student's T-test:

The test is carried out, to check for the individual significance of the variables. Statistically, the t-statistics of the variables under consideration is interpreted based on the following statement of hypothesis.

$H_0$ : The individual parameters are not significant.

$H_1$ : The individual parameters are significant.

### Decision Rule:

If  $t\text{-calculated} > t\text{-tabulated}$ , we reject the null hypothesis  $\{H_0\}$  and accept the alternative hypothesis  $\{H_1\}$ , and if otherwise, we select the null hypothesis  $\{H_0\}$  and reject the alternative hypothesis  $\{H_1\}$ .

Level of significance = at 5%

= 0.05

Degree of freedom:  $n-k$

Where  $n$ : sample size.

$K$ : Number of parameter.

The t-test is summarized in the table below:

Variables {t-value}	t-tab	Remark
MC {1.690}	$\pm 2.086$	Insignificant
VOT {-0.846}	$\pm 2.086$	Insignificant
INF {0.092}	$\pm 2.086$	Insignificant
EXR {4.168}	$\pm 2.086$	Significant

The t-statistics is used to test for individual significance of the estimated parameters  $\{\beta_1, \beta_2, \beta_3 \text{ and } \beta_4\}$ .

From the table above, we can deduce that EXR {4.168} is greater than 2.086 which represent the t-tabulated implying that EXR is statistically Significant.

On the other hand, the intercept {-0.548}, MC {1.690}, VOT {-0.846} and INF {0.092} are less than the t-tabulated  $\{\pm 2.086\}$  signifying that the intercept, MC, VOT and INF are statistically insignificant.

### 3. F-Statistics:

The F-statistics is used to test for simultaneous significance of all the estimated parameters.

The hypothesis is stated;

$$H_0: \beta_1 = \beta_2 = \beta_3 = \beta_4 = 0$$

$$H_1: \beta_1 \neq \beta_2 \neq \beta_3 \neq \beta_4 \neq 0$$

Level of significance:  $\alpha$  at 5%

Degree of freedom:

Decision Rule:

If the f-calculated is greater than the f-tabulated {f-cal > f-tab} reject the null hypothesis {H<sub>0</sub>} that the overall estimate is not significant and conclude that the overall estimate is statistically significant.

From the result, f-calculated {11.054} is greater than the f-tabulated {2.886}, that is, f-cal > f-tab. Hence, we reject the null hypothesis {H<sub>0</sub>} that the overall estimate has a good fit which implies that our independent variables are simultaneously significant.

### 4.3 Econometric Criteria.

#### 4.3.1. Test for Autocorrelation:

One of the underlying assumptions of the ordinary least square regression is that the succession values of the random variables are temporarily independent. In the context of the series analysis, this means that an error term  $\{U_t\}$  is not correlated with one or more of previous errors  $\{U_{t-1}\}$ . The problem is usually dictated with Durbin-Watson  $\{DW\}$  statistics.

The Durbin-Watson's test compares the empirical  $d^*$ ,  $d_L$  and  $d_U$  in  $d-w$  tables to their transforms  $\{4-d_L\}$  and  $\{4-d_U\}$ .

#### Decision Rule:

- If  $d^* < D_L$ , then we reject the null hypothesis of no correlation and accept that there is positive autocorrelation of first order.
- If  $d^* > \{4-d_L\}$ , we reject the null hypothesis and accept that there is negative autocorrelation of the first order.
- If  $d_U < d^* < \{4-d_U\}$ , we accept the null hypothesis of no autocorrelation.
- If  $d_L < d^* < d_U$  or if  $\{4-d_U\} < d^* < \{4-d_L\}$ , that test is inconclusive.

Where:  $d_L$  = Lower limit  
 $D_U$  = Upper limit  
 $D^*$  = Durbin Watson.

From our regression result, we have;

$$D^* = 1.57$$

$$D_L = 1.038$$

$$D_U = 1.767$$

$$4 - d_L = 2.962$$

$$4 - d_U = 2.233$$

### **Conclusion:**

Since  $d_L\{1.038\} < d^*\{1.57\} < d_U\{1.767\}$  or if  $\{4 - d_U\}\{2.233\} < \{4 - d_L\}\{2.962\}$ , that test is inconclusive.

### **4.3.2. Normality Test for Residual:**

The Jarque-Bera test for normality is an asymptotic, or large-sample, test. It is also based on the ordinary least square residuals. This test first computes the skewness and kurtosis measures of the ordinary least square residuals and uses the chi-square distribution {Gujarati, 2004}.

The hypothesis is:

$H_0$  :  $X_1 = 0$  normally distributed.

$H_1$  :  $X_1 \neq 0$  not normally distributed.

At 5% significance level with 4 degree of freedom.

JB = 10.038

While critical JB >  $\{X^2_{\{2\}df}\} = 9.48773$

### **Conclusion:**

Since  $10.038 > 9.48773$  at 5% level of significance, we reject the null hypothesis and conclude that the error term do not follow a normal distribution.

### **4.3.3. Test for Heteroscedasticity:**

Heteroscedasticity has never been a reason to throw out an otherwise good model, but it should not be ignored either {Mankiw Na, 1990}.

This test is carried out using White's general heteroscedasticity test {with cross terms}. The test asymptotically follows a chi-square

distribution with degree of freedom equal to the number of regressors {excluding the constant term}. The auxiliary model can be stated thus:

$$U_t = \beta_0 + \beta_1 MC + \beta_2 VOT + \beta_3 INF + \beta_4 EXR + \beta_5 MC^2 + \beta_6 VOT^2 + \beta_7 INF^2 + \beta_8 EXR^2 + V_i.$$

Where  $V_i$  = pure white noise error.

This model is run and an auxiliary  $R^2$  from it is obtained.

The hypothesis to the test is stated thus;

$$H_0: \beta_1 = \beta_2 = \beta_3 = \beta_4 = \beta_5 = \beta_6 = \beta_7 = \beta_8 = 0 \text{ \{Homoscedasticity\}}$$

$$H_1: \beta_1 \neq \beta_2 \neq \beta_3 \neq \beta_4 = \beta_5 \neq \beta_6 \neq \beta_7 \neq \beta_8 = 0 \text{ \{Heteroscedasticity\}}.$$

Note: the sample size  $\{n\}$  multiplies by the  $R^2$  obtained from the auxiliary regression asymptotically follows the chi-square distribution with degree of freedom equal to the number of regressors {excluding constant term} in the auxiliary regression.

### Decision Rule:

Reject the null hypothesis if  $X^2_{cal} > X^2$  at 5% level of significance. If otherwise, accept the null hypothesis. From the obtained results,

$\chi^2_{cal} = 22.018 > \chi^2_{0.05 \{8\}} = 12.6$  we therefore accept the alternative hypothesis of heteroscedasticity showing that the error terms do not have a constant variance and reject the null hypothesis showing that the error terms has a constant variance.

#### 4.3.4 Test for Multicollinearity:

The term Multicollinearity is due to Ragnar Frisch. Originally it meant the existence of a “perfect” or exact, linear relationship among some or all explanatory variables of a regression model. The tests were carried out using correlation matrix. According to Barry and Feldman {1985} criteria; “Multicollinearity is not a problem if no correlation exceeds 0.80”.

	MC	VOT	INF	EXR	REMARK
MC	1.000				-
VOT	0.8626	1.000			M
INF	-0.2914	-0.3012	1.000		Nm,Nm
EXR	0.5680	0.6018	-0.4318	1.000	Nm, Nm, Nm

Where M = Presence of Multicollinearity

Nm = No Multicollinearity.

From the above table, we can conclude that Multicollinearity exists only between VOT and MC. This means that there is perfect relationship between VOT AND MC.

#### 4.4 **POLICY IMPLICATIONS.**

The results of these findings reveal that the value of trade in the stock market is low in the stock market and it does not show a significant impact on the economy. Therefore, the government is advised to stem up investors confidence and activities in the market and also increase the value of traded goods in the stock market to boost up investments.

## **CHAPTER FIVE**

### **5.0 SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS**

#### **5.1 SUMMARY OF FINDINGS**

Stock market is seen as having impact on any economy particularly on its economic growth. As a result, countries over the world have embarked upon various policy measures at improving stock market. Monetary authorities and Policy makers in Nigeria are not left out in this line reasoning. Hence, successive governments have been making concerted efforts at improving the stock market. Creation of a favorable stock market and investment climate for improving stock market has been one of the central policies of the past President Olusegun Obasanjo's administration. As a result, the outcome of this is the unprecedented awareness and growth recorded in the stock market.

The primary objective of this study is to determine the impact and implication of the stock market on the Nigerian economy. This is achieved through the use of the OLS regression analysis of data on the Gross Domestic Product (GDP) and the various stock market indices sourced from the Central Bank of Nigeria Statistical Bulletin.

The study also gave an opportunity for the assessment of the inflation rate, value of trade, interest rate and market capitalization in the stock market on economic growth in Nigeria. The regression results confirm that there exists a positive relationship between the stock market and the Nigerian economy. The relationship is statistically significant, this in essence means that the impact of the stock market on the Nigerian economy is strong and significant.

## **5.2 POLICY RECOMMENDATIONS**

In order for the Nigerian stock market to be a pivotal force on the Nigerian economy, the following suggestions or recommendations are put forward.

1. The government should see to it that the operations of the stock market are efficient and effective. The government needs to strengthen the operations of the stock market through the regulatory and supervisory agencies including the central bank of Nigeria (CBN), Nigeria stock exchange (NSE) and Securities and Exchange Commission (SEC).
2. There is also need to restore confidence to the market by regulatory authorities through ensuring transparency and fair trading transaction and dealing in the stock exchange. It must also address the reported case of abuse and sharp practices by some companies in the market.
3. Frantic efforts have to be made to widen the operations of the stock market in terms of number of quoted companies, volume of shares traded, market capitalization and new issues.

4. The government from time to time has to design and implement effective reform policies to make the stock market responsive to the economic circumstances at any given point in time.
5. To boost the value of transactions in the Nigerian stock market, there is need for availability of more investment instruments such as derivatives, convertible, swaps and options in the market.

Given the present political dispensation, all the tiers of government should be encouraged to fund their realistic developmental programme through the stock market. This will serve as a leeway to freeing the resources that may be used in other sphere of the economy.

### **5.3 CONCLUSION**

The resulting conclusion arose after the OLS regression analysis had been carried out in this study. This includes that:

1. The stock market has been pivotal to the stability of any nation's financial market, justifying the effort of successive governments in the country at designing policies aimed at improving stock market as a tool for economic growth.
2. The value of trade does not impact significantly on the GDP as given by the regression results. The government is therefore advised to put up measures to stem up investors confidence and activities in the market, so that it can contribute significantly to the Nigerian economy.
3. The study reveals that the stock market has impact on the Nigerian economy via market capitalization, value of trade, interest rate and inflation rate as it was observed in the regression result. Hence, the stock market remains one of the mainstreams in Nigeria that has the power to influence or impact on Nigerian economy.

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