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Impact of Financial Intermediation on Capital Formation in Nigeria

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Abstract
This study investigates the impact of financial intermediation on capital formation in Nigeria, focusing specifically on insurance sector investment, stock market capitalization, and broad money supply. Employing an ex-post facto research design, the study analyzes secondary data from the Central Bank of Nigeria's Statistical Bulletin covering the period from 1993 to 2023. Using Ordinary Least Squares (OLS) in E-Views 10.0, the findings reveal that insurance sector investment does not significantly impact capital formation, suggesting limitations in the scale or regulatory support of such investments, stock market capitalization is found to be statistically insignificant, indicating that the current state of the Nigerian stock market may lack the depth and investor confidence required to drive capital formation independently. In contrast, broad money supply has a significant positive effect, on capital formation through increased liquidity and credit accessibility. These results conclude that the need for targeted reforms to enhance insurance sector investment, strengthen stock market liquidity and investor confidence, and maintain balanced monetary policy to foster sustainable capital formation in Nigeria and it recommend that the regulatory bodies should implement measures that will boost liquidity and investor confidence, the Central Bank of Nigeria should maintain a balanced approach to monetary policy that promotes credit availability while controlling inflation.

Keywords: *Financial intermediation, broad money supply, stock market capitalization and capital formation*

INTRODUCTION

In order to promote economic growth and development, capital production is crucial. It entails accumulating capital assets, which are the engines that propel production and revenue creation, such buildings, machines, and infrastructure. An adequate infusion of capital is essential for emerging nations like Nigeria to fill infrastructural gaps, spur industrialisation, and ensure long-term economic progress. Investment in productive activities is stimulated by high levels of capital formation, which in turn creates jobs, increases income distribution, and decreases poverty. Rising living standards are a result of this process, which aids in economic and social growth (Ogbuagu & Ewubare, 2021). However, many developing nations still struggle to achieve desirable levels of capital formation because of things like low savings rates, limited access to credit, and poorly established financial institutions. As a result, financial intermediation is pivotal to the process of capital formation.

Institutions both inside and outside of banks engage in financial intermediation when they facilitate the transfer of savings from depositors to investors. It makes sure that money is going into productive investments by acting as a bridge between those with surpluses and those with deficits

(Okoye & Nwaeze, 2019). Investment initiatives are supported by intermediaries like commercial banks and microfinance organisations through fund mobilisation, which helps to overcome capital shortages by easing loan availability. Capital creation can't be fostered without efficient financial intermediation, which reinvests savings in growth-inducing investments. Because of their dual role as money-movers and credit-creators, the banking industry plays a pivotal role in this process, increasing the rate of capital formation (Ajide & Raheem, 2020). Thus, a country's capacity to create and accumulate capital is highly dependent on the efficacy and quality of its financial intermediation.

Substantial changes have been implemented in Nigeria's financial sector throughout the years with the goals of improving the efficiency of financial intermediation and expanding access to financial services. The sector's contribution to capital formation is limited, nevertheless, because it continues to encounter constraints. Barriers to efficient money mobilisation include issues such as poor financial literacy, restricted access to banking services in rural areas, and ineffective regulations. Also, a lot of people in Nigeria's informal sector don't have bank accounts, which means less money is coming in through the official financial systems (Adeola & Evans, 2021). Consequently, the inefficiency of the country's financial system in linking saving and investors is a major drag on capital development in Nigeria. Capital accumulation and economic growth can only be driven by a robust and inclusive financial intermediation system.

How easy it is to get a loan affects investment decisions further demonstrates the connection between financial intermediaries and capital creation. Banks and other financial intermediaries make it possible for people and companies to borrow money to buy capital assets like technology, infrastructure, and more, all of which boost productivity. Capital accumulation is encouraged by banks through lending and credit facilities, which in turn promotes innovation and an increase in productive capacity (Iheanacho, 2022). But, economic growth and poverty reduction targets are obstructed in the absence of an efficient financial intermediation system, which leads to the underutilisation of savings and a slowdown in capital accumulation. This is particularly true in Nigeria, where a lack of accessible financing continues to be a big obstacle that limits the growth of businesses and entrepreneurs as well as their ability to invest in assets that increase productivity (Usman, 2023).

Policy efforts have been put in place to bridge the gap between financial intermediation and capital production. For example, the Central Bank of Nigeria has been supporting micro, small, and medium companies (MSMEs) and promoting financial inclusion. Osuagwu and Egbulonu (2023) note that more improvements are necessary to tackle systemic challenges and expand the role of financial intermediation in capital formation, but these changes show promise. To ensure that savings are efficiently steered into productive investments, it is necessary to build a resilient financial system with increased infrastructure and regulatory support. Therefore, we will examine the influence of financial intermediation on capital formation in Nigeria.

Statement of problems

Building productive capacity, creating jobs, and assuring long-term growth are all pillars of economic development, which in turn depends on capital accumulation. Nigeria has been working hard to alleviate poverty and make great economic growth, but its capital formation levels are noticeably low. Several reasons contribute to the low level of capital formation. Foreign investments make up a large portion of the capital, businesses have a hard time getting loans, and

the domestic savings rate is rather low. Further inhibiting both domestic and international investment is the fact that Nigeria's investment climate is characterised by instability and insecurity. Consistent growth and development in Nigeria are hindered by capital constraints, which persist despite efforts to enhance economic infrastructure (Adeola & Evans, 2021; Iheanacho, 2022). Therefore, in order to build a more robust economic foundation in Nigeria, it is essential to address these restrictions.

One possible way to increase capital production is through financial intermediation, which is when banks and other financial organisations facilitate the movement of funds from savers to borrowers. More access to capital, as measured by financial intermediation indicators like stock market capitalisation, insurance sector investments, and wide money supply, may promote investment at home and bolster capital accumulation (Okoye & Nwaeze, 2019). However, because there are still obstacles to completely capitalising on the advantages of the financial sector, it is unclear how much progress in financial intermediation may affect capital formation in Nigeria. Accordingly, the purpose of this research is to find out whether increasing the size of the money supply, the value of the stock market, and investments in the insurance sector can help Nigeria's economy grow and develop (Usman, 2023; Ogbuagu & Ewubare, 2021).

1.5 Aims and objectives of the Study

The main aim of this study is to investigate the impact of financial intermediation on capital formation in Nigeria. Specifically, the objectives of the study are to examine:

1. To determine the extent to which Insurance sector investment impact on capital formation in Nigeria
2. The extent of to which Stock market capitalization impact on capital formation in Nigeria
3. To what extent does broad money supply Impact on capital formation in Nigeria

Research Hypotheses

To achieve the objectives of the study and answer the research questions, the following null hypotheses are postulated for testing:

1. Insurance sector investment has no significant impact on capital formation in Nigeria
2. Stock market capitalization has no significant impact on capital formation in Nigeria
3. Broad money supply has no significant impact on capital formation in Nigeria.

LITERATURE REVIEW

Financial intermediation

The phrase "financial intermediation" describes the way in which banks and other lending institutions help move money from those with extra cash on hand (savers and households) to those with more substantial financial needs (businesses and governments). Financial intermediation improves the allocation of resources across various economic sectors, which is a crucial component of economic growth (Levine, 2005). It is defined by Mishkin (2016) as the mechanism by which financial institutions mediate between savers and investors, such as banks, insurance, and investment businesses. Mobilising savings, lowering risk, and increasing liquidity are all outcomes of these institutions' actions. In a similar vein, Merton and Bodie (2020) define financial intermediation as an interconnected structure of institutions that facilitates lower transaction costs, more efficient markets through resource pooling, reduced risk exposure, and improved access to and stability within the financial system through the provision of financial services.

More effective allocation of capital is one of the many benefits that economies reap from financial intermediation, which in turn boosts innovation, entrepreneurship, and productivity. Financial institutions may help disadvantaged sectors overcome limited access to finance in emerging economies, making this process all the more important (Demirgüç-Kunt et al., 2021). To promote capital creation and stimulate economic growth within Nigeria's financial sector, this research defines financial intermediation as the behaviours of financial institutions that help move funds from savers to borrowers.

Broad Money Supply

A country's broad money supply includes all of its liquid and near-liquid assets, not just currency. Broad money supply, commonly known as M2 or M3, is defined by the International Monetary Fund (IMF) as the sum of all money in circulation plus additional liquid assets such as savings accounts, time deposits, and other similar instruments (IMF, 2021). The term "broad money supply" is defined similarly by Mishkin (2016); it encompasses not just "narrow money" (cash and bank accounts), but also a variety of assets that contribute to the financial system's liquidity. Inflationary pressures and economic stability are both indicated by this widely used metric, which assesses the liquidity of an economy.

According to Mankiw (2022), central banks rely heavily on the broad money supply since changes in it have a direct impact on inflation, interest rates, and economic activity as a whole. Policymakers have the power to control demand levels by expanding or contracting the money supply, which affects economic growth. The total of all money in circulation, demand deposits, and other near-money assets makes up the broad money supply for this research. It shows the liquidity available in Nigeria's financial system and how it may affect capital creation.

Stock market capitalization

You can measure the size and health of the stock market by looking at stock market capitalisation, which is also called market capitalisation. It indicates the total value of a company's outstanding shares. An easy way to find out how much a firm is worth in the market is to multiply its share price by the number of outstanding shares. This formula, as explained by Mishkin (2016), is called stocks market capitalisation. Another important metric for gauging the depth and maturity of a nation's financial markets is the stock market capitalisation, which is defined as the total value of all listed shares on a stock exchange (World Bank, 2022). Investors and policymakers frequently look at market capitalisation levels as a measure of market success since high levels are generally associated with stable economies and high levels of investor confidence.

According to Bodie et al. (2021), stock market capitalisation is a reflection of larger economic patterns. Changes in this number may tell us a lot about economic cycles and the possibilities for investment. Stock market capitalisation, as used in this study, is the collective market value of all publicly traded shares on the Nigerian stock exchange. It is an important measure for gauging the availability of capital in the financial market and how it might affect the creation of capital.

Capital formation

An rise in a nation's stock of physical assets—including machinery, infrastructure, and buildings—that facilitate production and economic expansion is known as capital formation. The process of capital creation, as outlined by Todaro and Smith (2020), is the accumulation of savings via investments that lead to industrialisation and the expansion of a nation's economic capability. Mankiw (2022) offers a similar definition of capital formation, stating that it is the process by

which an economy's physical capital stock grows. This stock serves to both sustain and enhance production, as well as to provide the basis for future expansion. A higher level of investment in capital assets results in higher levels of productivity and national revenue, as emphasised by Solow's growth theory (Jones, 2019), which in turn drives economic development.
Because it facilitates productivity improvements across sectors, generates employment, and supports sustainable development, capital creation is important because of the multiplier effect it has on the economy. Capital creation is the process of putting money into physical assets in order to boost Nigeria's production capacity and provide the groundwork for future development and expansion.

Theoretorical Framework

Economist John Maynard Keynes presented the Keynesian principle in his 1936 book The General Theory of Employment, Interest, and Money. This concept questions the classical view of economics, which holds that markets have an intrinsic tendency to self-regulate and may reach full employment without outside interference. On the contrary, Keynes contended that markets may not be able to self-correct during economic downturns, which might result in ongoing unemployment and wasted resources. The main factor that drives economic activity and employment, according to him, is aggregate demand, which is overall spending in the economy. A downward economic cycle occurs during recessions when insufficient demand leads to reduced production, increased unemployment, and falling earnings.
Government spending and tax adjustments, along with other fiscal measures, are essential to Keynesian economic theory in order to stabilise the economy. In order to stimulate economic activity and promote recovery during economic downturns, Keynes argued that government expenditure should be raised. This view differs from traditional economics, which maintains that demand will naturally adapt in response to changes in supply and that economic output is determined by supply-side variables. Fiscal policy, according to Keynes, could "prime the pump" by raising demand, which in turn would incentivise firms to spend and recruit, setting in motion a cycle that would further boost demand (Blinder, 2008).
The relevance of the Keynesian concept to this research lies in the fact that it stresses the need for adequate capital expenditures and investment to propel economic expansion. The idea explains how investments, whether made by private companies or by the government, may boost production, which in turn increases wages, job opportunities, and economic security. Using the Keynesian principle as a framework, this research investigates the ways in which institutions and financial systems can encourage investment and increase the availability of capital, leading to economic growth and stability—particularly in situations where market forces are inadequate to realise economic potential.

Empirical review

Kuloga and Perpetua (2021). The purpose of this research was to examine the relationship between GFCF and Non-Life Insurance Claims in Nigeria from 1986 to 2018. The study employed a post hoc research strategy and tested for causal linkages using the Granger causality test and the Autoregressive Distributed Lag (ARDL) econometric model. A number of non-life insurance claims, including those for general accident, fire, and motor vehicle insurance, were found to

favourably impact GFCF. The report suggests rules to make sure insurance claims are settled quickly and supports obligatory fire and car insurance to boost capital creation.

Yusuf, Russell, and Somoy (2019). The effect of financial intermediation on the stock prices of Nigerian Deposit Money Banks (DMBs) from 2009 to 2016 was examined in this research utilising panel data. Using Fully Modified Ordinary Least Square (FMOLS) methods, the research concluded that capital, deposits, and loans all had a beneficial effect on stock values over the long term, but leverage had the opposite effect. Financial intermediation may boost stock values, it says, and when choosing DMB equities, investors should think about things like deposits and capital basis.

Kocha, Amadi, and Dibia (2018). This study examined the functions of money and capital markets in Nigeria as instruments for financial intermediation. It employed variables such as interest rates, money supply, and private sector savings as proxies. Johansen co-integration and multiple regressions were used to analyse time series data from 1980 to 2015. This study shed insight on the impact of monetary policy factors on corporate financing in Nigeria by revealing a substantial link between money supply, savings, and corporate finance. There should be more variety in the financial instruments available in Nigeria's capital market, as the study did not discover any correlation between interest rates or inflation and company financing.

Adekunle and Aderemi, (2012). In this study, data on capacity utilisation, government expenditure, and bank credit from the Central Bank of Nigeria were used to examine the link between domestic investment, capital formation, and population growth in Nigeria. Government spending and bank lending have a favourable effect on income levels, but investment rates do not directly drive per capita GDP growth, according to the findings. While the study found that a growing population had a detrimental effect on capital formation, it did find that investment may progressively promote growth.

METHODOLOGY

This study employs a research strategy that is based on secondary sources, namely the Statistical Bulletin of the Central Bank of Nigeria, which covers the years 1993–2023. This data set is derived from banking sector measures and it employs insurance sector investments, stock market capitalisation, and broad money supply as proxies for financial intermediation. The dependent variable is capital creation in Nigeria. Using E-Views 10.0 software for estimate, descriptive statistics and the Ordinary Least Squares (OLS) approach were used to complete the data analysis. At a defined significance level, the findings will be reviewed using established criteria.

By delving into the connections between financial variables and Nigeria's capital accumulation, this analytical technique seeks to uncover the effects of financial intermediation on capital creation.

Model Specification

The relationship between the dependent and independent variables were analyzed using the model below:

$GFCF = \beta 0 + \beta 1insi + \beta 2mcap + \beta 3m2 + \mu$

β = parameters to be estimated

$\beta 0$ = intercept (constant)

$\beta 1 .. \beta 3$ = coefficients (estimates /slope) of the explanatory variables

$Yt = f(LGGFCF)$ ……. (2)

Xt = f (LGINSI, LGMCAP, LGM2) ……..(3)
Where; LGGFCF = Gross Fixed Capital Formation
LGINSI = Insurance Sector Investment
LGMCAP = Stock Market Capitalization
LGM2 = Broad Money Supply

Descriptive Statistics

	LGGFCF	LNINSI	LNM2	LNMCAP
Mean	14.06476	4.837367	7.823601	7.708906
Median	14.25152	5.376897	8.242204	8.541085
Maximum	16.25314	7.669430	10.60456	10.64672
Minimum	10.93036	2.056685	3.443618	3.139833
Std. Dev.	1.898441	1.913201	2.274532	2.311432
Skewness	-0.210569	-0.076646	-0.467904	-0.510653
Kurtosis	1.573730	1.496190	1.871676	1.933557
Jarque-Bera	2.856655	2.951386	2.775601	2.816310
Probability	0.239709	0.228620	0.249624	0.244594
Sum	436.0075	149.9584	242.5316	238.9761
Sum Sq. Dev.	108.1223	109.8102	155.2049	160.2815
Observations	31	31	31	31

Source: E-views 10.0

Based on 31 data points each, the table summarises the statistics for four variables: LGGFCF, LNINSI, LNM2, and LNMCAP. On average, LGGFCF, LNINSI, LNM2, and LNMCAP all have values of 14.06, 4.84, 7.82, and 7.71, respectively. There is a little left-skew in the distributions of the variables, as the medians are somewhat higher than the means. Depending on the variable, the range can be somewhat broad (10.93 to 16.25) for LGGCF and quite narrow (2.06 to 7.67) for LNINSI. According to the standard deviations, there is a considerable spread, with the most dispersed groups being LNM2 and LNMCAP.

Distributions tilting to the left are indicated by somewhat negative skewness scores, especially for LNM2 and LNMCAP. Kurtosis values below 3 indicate flatter-than-normal distributions, which are consistent with lower-tail trends in the data, and are indicative of platykurtic distributions. No significant departure from normalcy is shown by the Jarque-Bera test results and corresponding p-values ($p > 0.05$). In sum, these variables exhibit modest variability among observations, a flat distribution, and a small left skewness.

Dependent Variable: LGGCF
Method: Least Squares
Date: 10/29/24 Time: 14:59
Sample: 1993 2023
Included observations: 31

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	8.077929	0.347396	23.25278	0.0000
LNINSI	0.269202	0.163287	1.648638	0.1108
LNM2	0.624489	0.225792	2.765766	0.0101
LNMCAP	-0.026093	0.213450	-0.122243	0.9036

R-squared	0.966541	Mean dependent var	14.06476
Adjusted R-squared	0.962823	S.D. dependent var	1.898441
S.E. of regression	0.366044	Akaike info criterion	0.947786
Sum squared resid	3.617674	Schwarz criterion	1.132816
Log likelihood	-10.69068	Hannan-Quinn criter.	1.008101
F-statistic	259.9852	Durbin-Watson stat	1.006855
Prob(F-statistic)	0.000000		

Source: Eviews 10.0 output

The dependent variable, LGGCF, is compared to three predictors, LNINSI, LNM2, and LNMCAP, using 31 observations in the regression analysis. When all other variables are set to zero, the intercept term (C) has a coefficient of 8.08, which is statistically significant and suggests that LGGCF is typically about 8.08. A positive and statistically significant effect of LNM2 on LGGCF (coefficient = 0.6245, p = 0.0101) indicates that an increase in LNM2 is linked to an increase in LGGCF, among the predictors. However, at the standard significance thresholds, LNINSI and LNMCAP do not have any relevant influence on LGGCF as they are not statistically significant (p=0.1108 and 0.9036, respectively). With an R-squared value of 0.9665, the model shows that the independent variables explain 96.65% of the variation in LGGCF, suggesting good explanatory power. The model's robustness is further supported by the high adjusted R-squared value of 0.9628. The overall statistical significance of the model is confirmed by an F-statistic of 259.99 (p = 0.0000). Nevertheless, the coefficient estimates might be impacted by possible positive autocorrelation in the residuals, as shown by the Durbin-Watson value of 1.0069.

DISCUSSION

Effects of Investment in the Insurance Industry on Nigeria's Capital Formation

With the aim of evaluating the insurance industry's influence on capital creation, this study put out the hypothesis that "Insurance sector investment has no significant impact on capital formation in Nigeria." Investments in the insurance industry did not significantly affect capital creation, as the research revealed that their coefficient was statistically insignificant. This indicates that the insurance industry might not be able to directly contribute to increasing capital creation due to reasons like the size of insurance investments or regulatory constraints. Nonetheless, according to Perpetua and Kologa (2021), non-life insurance claims for things like accidents, fires, and cars actually helped Nigeria's gross fixed capital creation. The need of tailored policies to maximise the insurance sector's involvement in capital creation is highlighted by their study, which reveals that efficient management of particular insurance kinds might greatly improve it.

Effect of Stock Market Capitalisation and the Capital Formation in Nigeria

Stock market capitalisation has no significant impact on capital formation in Nigeria the study hypothesised, in an effort to probe the stock market's function in encouraging capital outlay. The results demonstrated that there was no statistically significant relationship between stock market capitalisation and capital formation. Based on these results, it seems that measures aimed at increasing market participation may be necessary to fix the liquidity and investor trust issues plaguing the Nigerian stock market. Yusuf, Russell, and Somoy (2019) found that financial intermediation greatly affected stock prices across Nigerian banks, which led to capital expansion in the banking industry. This conclusion contradicts their findings. This disparity implies that financial intermediation in banking might indirectly assist economic development, even though stock market capitalisation may not directly effect capital production.

Broad Money Supply on the Country's Capital Formation

Broad money supply has no significant impact on capital formation in Nigeria, was the study's working hypothesis. It sought to explore the relationship between money supply and capital investment. The results showed that wide money supply positively and considerably influences capital creation, which goes against the theory. This finding lends credence to the idea that easing credit restrictions brought about by an increase in the money supply might encourage capital investment, which could lead to an increase in capital assets. An rise in the money supply makes it easier to finance capital creation, which is in line with the findings of Dibia, Kocha, and Amadi (2018), who found a substantial correlation between the two. The importance of a controlled money supply in promoting economic growth in Nigeria was further highlighted by Adekunle and Aderemi (2012), who discovered that capital spending and credit availability both had substantial impacts on capital creation.

CONCLUSION

Financial intermediation, investment in the insurance industry, stock market capitalisation, and broad money supply were the variables examined in this study as they pertain to capital creation in Nigeria. Capital formation is unaffected by investments in the insurance business, and stock market capitalisation is also unaffected. Given its current state, the Nigerian stock market might not be able to attract enough investors or generate enough cash on its own. The favourable effect of a large money supply on capital creation, on the other hand, highlights the importance of monetary policy in stimulating economic growth by making credit and liquidity more widely available. These results stress the importance of smart monetary regulation, focused efforts to improve the efficacy of insurance investments and stock market rules, and other measures to boost capital formation in Nigeria's economy.

RECOMMENDATION

1. Reforms should be made by policymakers to increase the efficiency, regulatory flexibility, and size of insurance investments.
2. Market liquidity and investor confidence can be enhanced if regulatory authorities take action.
3. A well-rounded monetary policy that promotes access to credit and efficiently manages inflation should be maintained by the Central Bank of Nigeria.

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