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# Impact of the Post Financial Crises Activities on Capital Market Development in Nigeria

Usman, O.A., Onayemi M. A., & Alimi A. A.

Department of Management and Accounting,

Faculty of Management Sciences,

Ladoke Akintola University of Technology,

Oyo State, Nigeria.

[mabowale@gmail.com](mailto:mabowale@gmail.com), [alimabass2014@gmail.com](mailto:alimabass2014@gmail.com)

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## Abstract

*In the middle of 2008, the world experienced financial and economic crises leading to degrading value in investments and money loss by investors. In the light of gradual global economic recovery from the effect of the financial crisis in recent times, this paper intends to explore the impact of the post financial crises activities on capital market development in Nigeria. Secondary data were used. The data were sourced from the Nigerian Stock Exchange (NSE) for the period 2008 to 2017. Descriptive statistics used included tables while Econometric Statistics such as Ordinary Least Square regression analysis (OLS) was adopted to analyze the study hypothesis. Findings revealed that all the variables of post financial crises activities (Value of Traded Securities, All Share Index and Market Capitalization) have influence on Capital Market Development. It was therefore recommended that the Securities and Exchange Commission (SEC) should strive to restore confidence to the capital market due to the discouragement in stock investment posed by the global financial crises through transparency and fair trading transactions.*

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**Keywords:** Financial Crisis, Capital Market, Securities and Exchange Commission (SEC) Nigerian Stock Exchange.

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## 1. Introduction

As an oil dependent nation, the state of the Nigerian capital market was largely dictated by the aftermath of the global financial crisis. The crisis resulted in decline in oil revenues leading to revenue attrition for all tiers of government; reduced capital inflows into the economy; depletion of external reserves; demand pressure in the foreign exchange market; substantial decline in capital market capitalization and share prices. The capital market lost about 70 per cent of its market value in 2008. The price collapse within the market resulted in massive wealth destruction, credit contraction, impairment of banks, assets liquidation and loss of confidence in the global financial markets (CBN, 2010).

The first financial crisis was the Great Depression which occurred between 1929 and 1933. The recent financial crisis which originated in the US was preceded by over a hundred episodes of financial crises (CBN, 2009). Thus, it is pertinent to note that 75 per cent of these crises had either been caused by the capital market or had affected the capital market. Prior to 2008, the capital market enjoyed a decade of unprecedented growth. This is evident in the rise of Market Capitalization (MC) from N2.90 trillion in December 2005 to N12.13 trillion in March 2008, and the All-Share Index (ASI) from 24,085.8 in December 2005 to 63,016.56 in March 2008 (NSE, 2008).

According to Ayuba (2011), he asserted that the recent global economic melt-down was traceable to the sub-prime mortgage crisis and rising home foreclosures, which commenced in August 2007 in the United States (US). Sub-prime mortgages were granted to borrowers whose credit history was inadequate to attract conventional lending. The mortgages were packaged by banks into Mortgage Backed Securities (MBS) and sold to financial institutions created by the US government, namely: Federal National Mortgage Association and Federal Home Loan Mortgage Corporations, who in turn repackage the loans and sold them to individual investors and financial institutions around the world.

However, certain factors, including rising fuel prices, the hurricane Katrina, global food crisis, amongst others led to rising domestic unemployment in the US which occasioned massive mortgage defaults and foreclosures. This development negatively affected the US capital markets and those of other economies worldwide with the consequential on-set of the global financial crisis.

### **Statement of the problem**

According to Ujunwa *et al* (2011), the immediate past governor of Central Bank of Nigeria was puerile in preventing the global financial crisis from having adverse effect on the Nigerian economy. As a result, the Nigerian capital market was seriously hit by the crisis. The prices of shares in the market nose-dived and investors lost huge sum of money. The crisis also crept into the banking sector as a result of excess exposure to the capital market as well as the oil gas sector.

Arunma (2010) revealed that the global financial crisis triggered large portfolio outflows as international investors exited the Nigerian capital markets to address challenges in their home countries, stock prices started to decline, prompting margin calls and local investors who were unaccustomed to huge and persistent declines started to panic, fueling more sell orders, further depressing prices and eroding investor confidence. To him the situation was exacerbated by the huge borrowing and margin finance exposure of individual investors, brokers and banks. While the market recovery to date has been limited because different categories have taken advantage of any recovery to reduce their exposure, the recent establishment of the Asset Management Corporation promoted by the Ministry of Finance and the Central Bank of Nigeria is expected to make and sustain the recovery since AMCON will take over about USD 12 billion in non-performing assets and manage them through an orderly disposal of the assets. The crisis which manifested itself globally in the form of liquidity and credit crunch, breakdown of confidence in the banking system, de-leveraging and banks inability to improve capital adequacy, weak consumer demand, and fall in global output, affected Nigeria through both the financial and real (trade, remittances and aid) channels. The undiversified nature of the Nigerian economy and the high dependence on exports of crude oil as well as foreign capital inflows compounded the impact of the external shock arising from the crisis. In specific terms, Nigeria experienced low demand for its oil export due to recession in the economies of her major trading partners. This however, led to low accretion to foreign exchange reserves and demand pressure in the foreign exchange market followed by volatility and substantial depreciation of the naira exchange rate.

It is perhaps in the capital market that the greatest impact was felt. The prolonged downturn in the capital market induced by significant divestment by foreign investors and compounded by lingering liquidity tightness, waning public confidence, and panic selling by domestic investors led to significant losses by investors. The capital market which remained bullish between December 2005 and March 2008, suddenly became bearish in April 2008 and had remained nearly so since then with only marginal recovery (Sanusi, 2010).

The foregoing discussion evidently pointed to the fact that, all was not well with the Nigerian capital market. The Capital market as one of the financial hub of the nation could have consequential effect on the entire Nigerian economy. Consequently, this paper assesses the impact of the post financial crisis activities on the capital market development in Nigeria. The objectives of the paper is thus, to identify the determinants of capital market development and to examine the impact of the post financial crises activities on capital market development

### **Hypotheses of the Study**

H<sub>1</sub>: Post financial crises activities have influence on capital market development

H<sub>0</sub>: Post financial crises activities have no influence on capital market development

The paper is therefore divided into five sections. Section 1 is introduction, section 2 is review of empirical literature, section 3 is methodology, Section 4 is results and discussions, and section 5 is Summary of Findings and Recommendations

### **2. Literature Review**

The effect of different financial crises during the last two decades on capital markets has been explored by different researchers. Some of the studies considered contagion impact among different stock markets in the wake of Asian financial crisis 1997. Alper and Yilmaz (2004) investigated this relationship for Istanbul and other prominent stock markets with particular reference to financial crisis that began in Turkey in 1994, Asian financial crisis 1997 and Latin America crisis during 1998 - 2001. The study confirms that international contagion prevails among stock markets. Ravichandran and Maloain (2010) found that during recent financial crisis, stock markets of six Gulf countries faced negative pressure but these markets become strengthened during post crisis period.

Rafaqet and Muhammad (2012) and Jenrola and Daisi (2012) consider the 2007/2008 Global financial crisis that started from United States, the world's largest crisis after 1930s recession. Also, Njiforti (2015) considered the impact of the 2007/2008 global financial crises on the stock market in Nigeria using Vector Error Correction (VEC) model. Considering this, few studies have assessed the impact of the post financial crisis activities on capital market development in Nigeria. Using EGARCH model, Olowe (2009) studied the response of stock return and its volatility on Nigerian stock market and found that stock returns and its volatility in Nigeria are free from the severity of this crisis because of the low exposure of the Nigerian capital market to the international community. In contrast to this, Adamu (2010) takes same objective for Nigerian stock market with conventional statistical analysis i.e. standard deviation and variance analysis and divided the data into pre and post crisis period and found that during the financial crisis period, volatility in Nigerian stock market increased.

Jenrola and Daisi (2012) in another investigation on the implication of global financial crisis on Nigerian capital market performance, using time series data from 2000-2008 and employing a simple regression analysis revealed that the Nigerian Stock exchange downfall is not attributed to global financial crisis but the instability of macroeconomic variables in Nigeria like unfavourable exchange rate, inflationary pressure, problem of insecurity and inadequate infrastructural facilities. According to Abdul (2009), Nigeria relies on several foreign grants and funding from developed countries to complement public spending on education, health care delivery, and transportation, amongst others. The crisis may cause a squeeze on grants to Nigeria as some of the countries Nigeria rely on for funding are the worst hit by the crisis. Similarly grants from donor agencies such as the IMF, World Bank and USAID could also be affected as they in turn rely heavily on the contributions of the G7 states, which would reduce as the credit crunch persists.

## **The Nigerian Capital Market**

Capital market provides long term capital to government and corporate bodies with maturity over a year, and often prone to greater risk of default. The capital market comprises of equity (stock) market and debt (bond) market and can be classified into the primary and secondary markets. While primary market is concerned with the raising of new funds, the secondary market exists for the sale and purchasing of existing securities that are already in people's hands, thus, enabling savers who purchased securities when they had surplus funds to recover their money when they are in need of cash (Afolabi, 1991). Organizations and institutions both in private and public sectors often sell securities on the capital markets in order to raise funds. Apart from playing central role of generating and facilitating capital formation; capital market also provides the stock exchange with the environment to implement its functions. The Securities and Exchange Commission (SEC) serves as the apex regulatory institution in the market while the Nigerian Stock Exchange (NSE) provides the issuing facilities and avenue for transactions in the market. These are done through intermediaries called stockbrokers who gather on the exchange. Dealers in the market are mainly merchant banks, development banks, and institutional saving units such as the National Provident Fund (NPF), Pension Funds, Unit Trusts, Investments Corporations, Insurance Companies Security Registrars, and Issuing House. Capital market instruments include; stocks/shares, debentures, bonds, and mortgages. Capital markets are perhaps the most widely followed markets. Both the stock and bond markets are closely followed and their daily movements are analyzed as proxies for the general economic condition of the world markets. Hence, capital market leads to economic growth only when there are enough savings and finances (Usman, 2011). As a result, the institutions operating in capital markets include; stock exchanges, commercial banks and all types of corporations, including non-bank institutions such as insurance companies and mortgage banks - are carefully scrutinized. The institutions operating in the capital markets access them to raise capital for long-term purposes, such as for a merger or acquisition, to expand a line of business or enter into a new business, or for other capital projects. Entities that are raising money for these long-term purposes come to one or more capital markets.

In the bond market, companies may issue debt in the form of corporate bonds, while both local and federal governments may issue debt in the form of government bonds. Similarly, companies may decide to raise money by issuing equity on the stock market. Government entities are typically not publicly held and, therefore, do not usually issue equity. Companies and government entities that issue equity or debt are considered the sellers in these markets. The buyers, or the investors, buy the stocks or bonds of the sellers and trade them. If the seller, or issuer, is placing the securities on the market for the first time, then the market is known as the primary market. Conversely, if the securities have already been issued and are now being traded among buyers, this is done on the secondary market. Sellers make money off the sale in the primary market, not in the secondary market, although they do have a stake in the outcome (pricing) of their securities in the secondary market. The buyers of securities in the capital market tend to use funds that are targeted for longer-term investment (Kristina, 2015).

## **Evolution and Development of the Nigerian Capital Market**

In 1946, securities were first floated in Nigeria, although there was no systematic and organized capital market with all the attendant institution until the establishment of the Central Bank of Nigeria (CBN) in 1959 and the launching of the Lagos stock exchange in 1961. Before the establishment of CBN, a number of challenges accrued, which include; difficulty to raise fund locally for the sale of stocks, difficulty in mobilizing adequate local savings even though the volume of such savings was increasing, and also it was difficult to provide facilities for the government to sell part of the increasing volume of industrial shares that it was holding through

its participation in joint ventures. As a result of the establishment of the Central Bank of Nigeria, there came into existence a wide variety of domestic securities such as Bonds, Shares, Development stocks and premium Bonds which were issued and offered for sale to the public (Usman, 2011).

Prior to 1959, almost all formal savings and deposits in Nigeria were in the banking system. The country's major capital balances were invested on the London Stock Exchange usually via London-based stockbrokers. The Nigerian capital market effectively came into being with the establishment of the Lagos Stock Exchange in 1960, which began actual trading in 1961 (SEC Report, 2009).

The NSE was incorporated under the Companies' Ordinance as an association, limited by shares initially, but became a company limited by guarantee in 1990. It received initial financial support from the CBN through an annual subvention. The Lagos Stock Exchange's name was changed to The NSE in 1977 following recommendations by the Government Financial System Review Committee of 1976. In addition to the Lagos bourse (by far the preponderant stage for trading activity) the NSE opened trading floors in Port Harcourt and Kaduna in 1980 and has since added Kano, Yola, Calabar, Ilorin, the latest being the Abeokuta branch commissioned in November 2008 (SEC Report, 2009).

### **The Regulatory Bodies of the Nigerian Capital Market include:**

#### **1. The Federal Ministry of Finance**

The Federal Ministry of Finance owes its origin in part to the Finance (Control & Management) Act, Cap.144 of 1958. The enactment of this Act created the ministry as a replacement for the then Finance Department and conferred on it the responsibility for the control and management of Public Finances of the Federation. The Act became operational from July 31, 1958. The broad functions and responsibilities of the Ministry as provided by the Act fall into the following categories:

- a. General supervision and control of public funds of the Federation, including Development and Contingencies Funds;
- b. Management and control of Consolidated Revenue Fund;
- c. Securing and managing the investments of the Federation;
- d. Preparation of Annual (budgetary) estimates in Appropriation Bill including Supplementary and Unexpected votes;
- e. Control and management of public expenditures;
- f. Control and management of external finances of the federation (SEC Report, 2009).

#### **2. The Central Bank of Nigeria (CBN)**

The Central Bank of Nigeria began operations on July 1, 1959. Some of the roles of the CBN are to:

- a. Establish the Nigerian currency
- b. Control and regulate the banking system
- c. Serve as banker to other banks in Nigeria
- d. Carry out the government's economic policy in the monetary field.

The government economic policies included control of bank credit growth, credit distribution by sector, cash reserve requirements for commercial banks, discount rates-interest rates the Central Bank charges commercial and merchant banks, and the ratio of banks' long-term assets to deposits. Consequently, the government, through the central bank, has been actively involved in building the nation's money and equity centers, forming securities regulatory board and introducing treasury instruments into the capital market (SEC Report, 2009).

### 3. The Securities & Exchange Commission (SEC)

The SEC is the apex regulatory body in the Nigerian capital market and is supervised by the Federal Ministry of Finance. In 1962, the CBN established a Capital Issues Committee in order to regulate public issues of securities. Its mandate was to examine applications from companies seeking to raise capital from the market and to recommend the timing of such issues. The Committee, however, had no legal backing, but operated unofficially as a capital market consultative and advisory body within the CBN. An increase in the level of economic activities, after cessation of the civil war hostilities, coupled with the promulgation of the Nigerian Enterprises Promotion (Indigenization) Decree in 1972 which mandated minimum Nigerian equity participation in some classes of enterprises broadened public participation in the stock market and significantly increased capital market activities. To provide stronger institutional support to the securities issuance process, primarily to regulate the pricing and timing of securities to be offered to the public, necessitated the creation of another body, the Capital Issues Commission in March 1973 to take over the activities of the Capital Issues Committee. The growth in market activities received a further boost from the promulgation of the Nigerian Enterprises Promotion Decree 1977, the second indigenization exercise, which expanded mandatory local equity participation in Nigerian enterprises. It is historically significant that like the Committee, the Commission had on its Board representation from The Lagos Stock Exchange. Neither the Committee nor the Commission was conceived as the apex regulatory agency for the market. These were the precursors to the Securities and Exchange Commission (SEC). As a result of this historical antecedents, The Lagos Stock Exchange (now the NSE) has been perceived as the premier capital market institution (SEC Report, 2009).

Following the acceptance of the recommendations of the Financial System Review Committee led by Dr. Pius Okigbo in 1976, the Federal Government endorsed the establishment of the SEC to supersede the Capital Issues Commission. The SEC was established in 1979 by the Securities and Exchange Commission Act 1979 (re-enacted as Decree No. 29 1988) and became the apex regulator for the market with a mandate to:

- a. Regulate and develop the Nigerian Capital Market
- b. Determine the prices of securities, and
- c. Set the basis of allotment of securities

### 3. Methodology

The type of data used in this research work is the secondary data. The relevant data for the study was obtained from publications from Security and Exchange Commission (SEC) and Statistical Bulletin of Central Bank of Nigeria (CBN) between 2008 and 2017. This is so because this is the period that the global financial crises took place.

Based on the concept of this study, the model is structured to use turnover ratio as proxy for capital market development. Hence, turnover ratio is the dependent variable while the independent variables are; market capitalization, value of traded securities and all share index.

Thus, the model is given as;

$$CMD = f(TOR)$$

$$TOR = f(VOTS, MC, ASHI)$$

Where

CMD = Capital Market Development

TOR = Turnover Ratio

VOTS = Value of Traded Shares

MC = Market Capitalization

ASHI = All Share Index

#### 4. Results and Discussions

Table 1 presents the descriptive statistics for the indices of capital market development. The table depicts that the maximum value of TOR and VOTS are 29.30447 and 2350876.0 respectively with minimum value of 0.00 and 638925.7 respectively. The mean value of TOR and VOTS during the study period is 10.12161 and 1185478.0 respectively. Likewise, MC and ASHI showed maximum value of 19077.42 and 605096.4 respectively with mean value of 12505.83 and 310910.7 respectively during the study period. Finally, all variables of the series showed that they were positively skewed as their mean values were greater than their median values for all the series.

Table 2 shows the effect of the post financial crises activities on capital market development. The result shows a positive relationship between Value of Traded Securities (VOTS) and All Share Index (ASHI) with Turnover Ratio (TOR). This implies that as VOTS increases, TOR will also increase and that as ASHI increases, TOR also increases. However, MC displayed an inverse relationship with a negative sign, indicating a negative relationship with TOR. The result revealed absence of auto correlation with the high positive value of Durbin Watson statistics. The adjusted R<sup>2</sup> of 55.5% indicates that 56% of the variations in the dependent variable are explained by the independent variables. Hence, the hypothesis that states that the post financial crises activities do not affect capital market development is rejected.

The research result agrees substantially with the research findings by Brickler *et al* (2011) that following the financial crises in 2008, there was shift in investor's desire from capital market to money market investments.

**Table 1: Descriptive Statistics of the determinants of Capital Market Development**

	TOR	VOTS	MC	ASHI
Mean	10.12161	1185478.	12505.83	310910.7
Median	9.212270	808991.4	10275.34	281191.5
Maximum	29.30447	2350876.	19077.42	605096.4
Minimum	0.000000	638925.7	7030.840	472.9170
Std. Dev.	9.849702	640707.2	4431.904	183171.3
Skewness	0.941335	0.895027	0.333517	-0.078061
Kurtosis	3.231853	2.421132	1.663378	2.938768
Jarque-Bera	1.049475	1.032319	0.650852	0.008203
Probability	0.591711	0.596808	0.722220	0.995907
Observations	10	10	10	10

**Source:** Author's Research, 2018 using E-views 9

**Table 2: Regression result**

Dependent Variable: TOR

Method: Least Squares

Sample: 2008 2017

Included observations: 10

Variable	Coefficient	Std. Error	t-Statistic	Prob.
MC	-0.001851	0.000868	-2.131541	0.1228
VOTS	4.19E-08	8.56E-06	0.004892	0.9964
ASHI	4.39E-05	3.38E-05	1.299467	0.2846
C	16.60826	12.39082	1.340368	0.2726
R-squared	0.777764	Mean dependent var		10.12161
Adjusted R-squared	0.555529	S.D. dependent var		9.849702
S.E. of regression	6.566665	Akaike info criterion		6.897448
Sum squared resid	129.3633	Schwarz criterion		6.866540
Log likelihood	-20.14107	F-statistic		3.499730
Durbin-Watson stat	2.063232	Prob(F-statistic)		0.165482

Source: Author's Research, 2018 using E-views 9

## 5. Summary of Findings and Recommendations

The study examined the impact of the post financial crises activities on capital market development between 2008 and 2017. The study used Ordinary Least Square regression analysis (OLS) technique to estimate the empirical models of the study using E-views 9.

The study revealed that the post financial crises activities have effect on the capital market development. This is evident in the positive relationship that existed among market capitalization, All Share Index and Turnover ratio. All these measures have nosedived from year 2008. For instance, market capitalization fell from ₦13,294.6billion in 2007 to ₦9,563.0billion in 2008 representing 28% decrease. In other words, the market was bearish, representing a downward market trend since the inception of the global financial meltdown.

Hence, this paper recommends the need to restore confidence to the capital market in particular by Securities and Exchange Commission (SEC) due to the discouragement in stock investment posed by the global financial crises through ensuring transparency and fair dealings in the capital market.

Also, in order to boost the value of transactions in the Nigerian capital market, there is need for the availability of more investment instruments such as derivatives, convertibles, future, swaps and options as we have in the developed countries.

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