

Foreign Direct Investment, Stock Market Performance and Economic Growth: Evidence Form Nigeria

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Abstract

The slow pace of economic growth in most developing economies over the years has attracted the attentions of governments of those economies to different ways of finding solutions. Among other factors, the gap between domestic savings and domestic investment has been identified as a major drag to economic prosperity in the developing economies including Nigeria. To better understand the nexus, this study investigates causal-link between amongst foreign direct investment, stock market performance and economic growth in Nigeria. Using annual series data from 1990 – 2026. Three macroeconomic variables were selected based on theoretical and empirical evidences. The study conducted pre-estimation tests such as Augmented Dickey-Fuller (ADF) and Phillips-Perron (PP) unit root tests. The test results revealed that, the variables under study were properly screened for more advanced statistical regressions. The study employed Pairwise-Granger causality test in order to capture the objectives for which the study is poised to achieve. From the result, the study revealed that, there is two-way causal link amongst foreign direct investment (FDI), stock market performance proxied by market capitalization (MCAP) and economic growth proxied by GDP in Nigeria. Therefore, the study recommends that, there should be promotion of stock market development as this will lead to the flow of funds from private savings and this could be used to finance revenue generating government enterprises.

Keywords: Foreign Direct Investment, Stock Market, Economic Growth, Causality

1.1 Introduction

The poor growth experience in the past and the recent surge in growth of many developing economies in Sub-Saharan Africa deserve research attention (Adeola, 2017). Accordingly, the need for inflow of foreign capital to developing countries to supplement their domestic savings for investment and economic growth becomes very paramount. However, although capital flows

are often sought to supplement domestic savings not all types of private capital contribute to economic growth (Aurangzeb & Haq, 2012). This is evident in the mixed result of many studies on the relationship private capital contributes to economic growth. Thus, it is still in doubt if foreign capital flows have been partly responsible for the growth pattern experienced in the region. Given the inconsistent view reflected in the literature, the question is whether the various capital flows into Nigeria's economy have contributed less to growth or were indeed part of the cause of the present level of growth of processes of developing economies. This theoretical controversy has attracted several empirical studies (Levine & Zervos, 1998; Bailliu, 2000; Reisen & Soto, 2001; Chinn & Ito, 2006; Klein & Olivei, 2008; Aizenman et al., 2013). However, these studies generally tend to reflect conflicting results. The review of several studies on foreign capital flows focusing on globalization and financial integration and economic growth by Kose et al. (2009) also emphasizes the inconsistency in the literature and inconclusiveness of the growing literature. Plethora of scholars has devoted attention to one particular form of foreign capital inflow rather than comparing its contribution to economic growth of the alternative forms of capital inflows. For instance, Balasubramanyam et al. (1996); Borensztein et al. (1998); Carkovic and Levine (2002); Hermes and Lensink (2003) and Alfaro et al. (2004) explored FDI and found conflicting results. Levine and Zervos (1998), Reisen and Soto (2001), Chinn and Ito (2006), Klein and Olivei (2008) focused on foreign portfolio investment with inconsistent findings. Also, Pradhan et al. (2008); Barajas et al. (2009), and Giuliano et al. (2009) focused on remittances, also with ambiguous results. Burnside and Dollar (2000); Easterly et al. (2003), Bulir and Hamann (2008) focused on foreign aid, yet again with mixed findings.

A few exceptions though are Reisen and Soto (2001) that studied FDI, equity flows, and long- and short-term bank lending; Aizenman et al., (2013); and Driffield and Jones (2013), who examined the effects of remittances, ODA and FDI together. However, there is dearth of scholarship links foreign direct investment to stock market performance.

Against this backdrop, this study intends to investigate the causal-link between amongst foreign direct investment, stock market performance and economic growth in Nigeria. Using annual series data from 1990 – 2026; a sample size of 36 years which is enough for time series. The choice of these years is largely influenced by data availability. The data was collected from World Bank national account database, Central Bank of Nigeria (CBN) Statistical Bulletin and Nigeria Stock Exchange accounts data files. The choice of this time period is largely influenced by data availability. Findings from this study would will serve as a reference guide to central bank of Nigeria and Nigeria stock exchange as well as other relevant government ministries, departments, agencies and Non-Governmental Organizations (NGOs) interested in foreign direct investment and stock market performance in particular and the Nigerian economy in general.

2.1 Literature Review

Empirical Literature Review

The contradictory results regarding the existence of relationship and the direction of relationship amongst foreign direct investments, Stock market performance on economic growth have promoted many studies to investigate the relationship in both developed and developing economics. There have been several empirics on foreign direct investment, stock market performance and economic growth using time series, and panel data. These studies have come with mixed results. Some of these studies are selected and reviewed as follows.

For instance, Chigbu et al. (2015) examine the impact of capital inflows on economic growth of Nigeria, Ghana and India from 1986-2012. This is necessitated by the doubts being raised as to

whether the huge inflows of foreign capital in developing economies over the years have transmitted to real economic growth. The study uses the Johansen Co-integration, Granger Causality test to estimate the relationship among the variables. Findings from the study reveal that capital inflows have significant impact on the economic growth of the three countries. In Nigeria and Ghana, foreign direct and portfolio investment as well as foreign borrowings have significant and positive impact on economic growth. It was also evident from the study that workers' remittances significantly and positively related to the economic growth of the three countries. Similarly, Agbloyor et al. (2014) examine the relation between private capital flows and economic growth in Africa during the period 1990–2007. The authors estimate the empirical relation using panel Instrumental Variable Generalized Method of Moments (IV-GMM) estimator which allows for arbitrary heteroskedasticity and endogeneity. Decomposing private capital flows into its component parts, the study shows that foreign direct investment, foreign equity portfolio investment and private debt flows all have a negative impact on economic growth. The result also reveals that countries with strong domestic financial markets, however, benefit more by being able to transform the negative impact of private capital flows into a positive one. Narayan (2013) studies the causal relationship between foreign capital inflows and economic growth in India. The study uses the pair-wise Granger causality test on a time series data covering the period of 1969 to 2012. The result of pair-wise Granger causality test shows that there is the long-run equilibrium relationship between the following pairs of variables viz., economic growth and Foreign Direct Investment (FDI), economic growth and Foreign Portfolio Investment (FPI). Obiechina and Ukeje (2013) examine the impact of capital flows (foreign direct investment), exchange rate, export and trade openness on economic growth of Nigeria as well as the causal long-run relationship among the variables, using time series data from 1970 – 2010. Using Engle-Granger 2-Step procedure, it was observed that all the variables, except the FDI are statistically significant and influence economic growth in the short-run dynamic equilibrium model. Exogeneity test confirmed that FDI has weak exogeneity with economic growth. In addition, the Pairwise Granger causality revealed the existence of uni-directional causality between economic growth and FDI, and uni-directional and bi-directional causality among some of the variables. The study by Fambon (2013) capture the impact of foreign capital inflows (which include foreign aid and foreign direct investment) on economic growth in Cameroon. Using the autoregressive distributive lag approach to Co-integration and time-series data for the period 1980–2008, the results of the study indicate that the domestic capital stock and foreign direct investment have positive and significant impacts on economic growth in the short and long terms, while the impact of the labour force on growth was significantly negative in both terms, a result that may be attributable to the fact that Cameroon is a developing country with an unlimited supply of labour whose increase has a detrimental effect on the country's growth. Furthermore, Olusanya (2013) takes a look at the impact of Foreign Direct Investment inflow and economic growth in a pre and post deregulated Nigerian economy, a Granger causality test was use as the estimated technique between 1970-2010. However, the analysis de-aggregates the economy into three period; 1970 to 1986, 1986 to 2010 and 1970 to 2010, to test the causality between foreign direct investment inflow (FDI) and economic growth (GDP). However, the result of the causality test shows that there is causality relationship in the pre-deregulation era that is (1970-1986) from economic growth (GDP) to foreign direct investment inflow (FDI) which means GDP causes FDI, but there is no causality relationship in the post-deregulation era that is (1986-2010) between economic growth (GDP) and foreign direct investment inflow (FDI) which means GDP causes FDI. However, between 1970 to 2010 it

shows that is causality relationship between economic growth (GDP) and foreign direct investment inflow (FDI) that is economic growth drive foreign direct investment inflow into the country and vice versa.

Uwubanmwun and Ogiemudia (2016) examined the effect of foreign direct investment on economic growth in Nigeria using annual time series data covering the period 1979 to 2013. The data were analyzed using Error Correction Model. The results reveal that FDI has both immediate and time lag effect on Nigeria economy in the short run but has a non-significant negative effect on the Nigeria economy in the long run.

Pulstova (2016) studied the effects of foreign direct investment and firm export on economic growth in Uzbekistan. The study covered the period 1990 – 2014 and descriptive method was adopted. He found that an increase in FDI may cause firms to increase their export of products.

Muntah et al. (2015) studied the impact of foreign direct investment on economic growth of Pakistan covering the period 1995 to 2011. The data were sourced from World Bank, Economy of Pakistan Books, Index Monde and Economic Survey of Pakistan. Regression analysis was used in the study. They found that FDI impacts positively on economic growth of Pakistan.

Agrawal (2015) assesses the relationship between foreign direct investment and economic growth in the five BRICS economies, namely, Brazil, Russia, India, China and South Africa over the period 1989 – 2012. Co-integration and Causality analysis were applied. The results indicate that foreign direct investment and economic growth are co-integrated at the panel level, indicating the presence of long run equilibrium relationship between them. Results from causality tests indicate that there is long run causality running from foreign direct investment to economic growth in these economies.

Melnyk et al. (2014) examine the impact of foreign direct investment on economic growth in post-communism transition economies. The study used neoclassical growth theory to analyze the effect of FDI on economic growth. They found a significant FDI influence on economic growth of host countries. They concluded that in addition to the direct capital financing it supplies, FDI can be a source of valuable technology and know-how while fostering linkages with local firms, which can help to jumpstart an economy. Based on these arguments, industrialized and developing countries have offered incentives to encourage foreign direct investments in their economies.

Moreover, Otto and Ukpere (2014) assessed foreign direct investments and economic development and growth in Nigeria over a 41 year period. They observed that there is a positive relationship between foreign direct investments and economic growth in Nigeria. They suggested that policies are required which will facilitate foreign direct investments into Nigerian economy.

Koojaroenprasit (2012) explored the impact of foreign direct investment on economic growth of South Korea using secondary data for the period 1980–2009. Multiple regression analysis was employed in the study. This study found that there is a strong and positive impact of FDI on South Korean economic growth. Furthermore, the study indicated that human capital, employment and export also have positive and significant impact, while domestic investment has no significant impact on South Korean economic growth. He argued that the interaction effects of FDI human capital and FDI-export indicated that the transfer of high technology and knowledge has an adverse impact on South Korean economic growth.

Mucuk, et.al (2014) examined the long run relationship between foreign portfolio investment and economic growth for Turkish economy over the period 1990-2012 within framework of cointegration. The cointegration test findings indicate that there is no relationship between these variables in the long run. According to this result, foreign portfolio investments should not only

support consumption but also should be used in more productive areas.

Coulibaly, Gakpa and Soumare (2018) study the role played by the quality of property rights in the linkages of international capital flows into sub-Saharan African (SSA) economies. Using panel data of 36 SSA countries over the period 1996–2017 and the ARDL procedure with the Pooled Mean Group regression method. The study uncover the existence of a property rights quality threshold beyond which property rights either amplifies the spillovers effects or attenuates the negative effect of capital flows on economic growth.

Sağın (2019) analyze whether or not foreign capital movements, which have increased along with globalization, have contributed to economic growth for countries. For this purpose, analyzing the effect of these variables on economic growth is attempted by using data from 1994-2017 on the fixed capital investments, labor-force participation rate, foreign direct investments, net foreign-trade revenues, and short-term foreign debt of Turkey's economy alongside those of Brazil, Russia, India, China, and South Africa (known as BRICS countries in the literature) . In the short term within the six countries that the analysis has been performed, coefficient values belonging to short-term foreign resources are positively estimated only for Russia, Turkey, and China. Of these countries, however, while the analysis results have been found to be statistically significant for the economies of Russia and Turkey, the results obtained for China could not be surmised as statistically significant.

Musibau et al. (2020) investigate whether external debt cause economic growth. This study employed panel data from 1980 to 2019 to investigate causal effect between external debt and economic growth among ECOWAS member countries using Debt Overhang Theory. The result shows the existence of long and short run causality between external debt and economic growth economic integrated member countries.

Meivitanwani (2020) in his investigation examine the effect of FDI in tourism on economic growth. The study analyzes panel data of 18 OECD countries from 2005 to 2018 using system GMM. The results show that FDI in tourism industry does not significantly affect economic growth. Furthermore, the absorptive capacities, human capital and trade openness, that are proven to work for aggregate FDI do not work for tourism-related FDI.

Raheem, Roux, and Asongu (2020) examine the asymmetry between capital flows and economic growth in 42 countries for the period 1995-2019. The Generalised Method of Moments is used as an empirical strategy. The existence of an asymmetry is confirmed by the findings as capital flows are more reactive to economic drag when compared to economic growth.

Research Gap

Base on the review of relevant literatures, the study has identified the following flaws:

Most of the previous works were not able to capture the composite and adequate measurement of the stock market performance. For instance, Agbloyor et al. (2014) and Ekeocha et al. (2018) wrongly used weak proxies of stock market performance by decomposing its components into foreign equity portfolio investment, private debt flows, trade openness, real exchange rate and real interest rate. Moreover, previous studies such as Maazouz (2013), Atalay (2015) Pelinescu (2015), ignored the unit root characteristic of the underlying data series, they rely on the assumption of cross-sectional independence. The unit root characteristic of a data series is essential as it revealed the stationarity status of the series data. This is because when series data are non-stationery and regression is conducted, it will lead to a problem of spurious regression (Dimitriuous and Stephen, 2007). It is envisaged by satisfying the aforementioned gaps; this work will become relevant and add value in the field of foreign direct investment, stock market

performance and economic growth.

3.1 Methodology

Granger Causality Model

To investigate the causality between foreign direct investment, stock market performance and economic growth in Nigeria as pointed in objective three. The study relies on the granger causality test. The choice of the test is based on the necessity to understand and identify the existence, nature of the direction of cause and effect relationship among the variables. Granger-causality is normally tested in the context of linear regression models. For illustration, consider a bivariate linear autoregressive model of two variables X_1 and X_2 .

The test equation takes the following form:

$$X_1(t) = \sum_{j=1}^p A_{11,j} X_1(t-j) + \sum_{j=1}^p A_{12,j} X_2(t-j) + E_1(t) \dots \dots \dots 3.8$$

$$X_2(t) = \sum_{j=1}^p A_{21,j} X_1(t-j) + \sum_{j=1}^p A_{22,j} X_2(t-j) + E_2(t) \dots \dots \dots 3.9$$

Where p is the maximum number of lagged observations included in the model (the model order), the matrix A contains the coefficients of the model (i.e., the contributions of each lagged observation to the predicted values of $X_1(t)$ and $X_2(t)$, and E_1 and E_2 are residuals (prediction errors) for each time series. If the variance of E_1 (or E_2) is reduced by the inclusion of the X_2 (or X_1) terms in the first (or second) equation, then it is said that X_2 (or X_1) Granger-causes X_1 (or X_2). In other words, X_2 Granger-causes X_1 if the coefficients in A_{12} are jointly significantly different from zero. This can be tested by performing an F-test of the null hypothesis that $A_{12} = 0$, given assumptions of covariance stationarity on X_1 and X_2 . The magnitude of a Granger causality interaction can be estimated by the logarithm of the corresponding F-statistic (Geweke 1982). Note that model selection criteria, such as the Bayesian Information Criterion (BIC, (Schwartz 1978)) or the Akaike Information Criterion (AIC, (Akaike 1974)), can be used to determine the appropriate model order p .

Description and Measurement of variables

Dependent Variable

Economic Growth proxied by Gross Domestic Product (GDP): This is the monetary value of final goods and services produced in a country over one year by the residents within the country irrespective of their nationality. It is a measure of the domestic capacity of an economy. When we add to the GDP, net income abroad, we obtained the gross national product (GNP) (Dwivedi, 2004).

Independent Variables

Foreign Direct Investment (FDI)

FDI being Foreign Direct Investment is measured as a percentage of GDP i.e. the net foreign direct investment inflow as a percentage of GDP. According to Dunning and Lundan (2008) "Foreign Direct Investment is net inflows of investment to acquire a lasting interest in or management control over an enterprise operating in an economy other than that of the investor". Thus, in this study FDI is used as investment into the economy.

Stock Market Performance

Stock market performance proxied by market capitalization (MCAP) is the aggregate market value of a company's outstanding shares. This figure is determined by multiplying the number of

outstanding shares by the current market price for one share. For example, a business with 1,000,000 shares outstanding and a current market price per share of ₦15 has a market capitalization of ₦15, 000,000.

The market capitalization concept only works well when a company's shares are publicly traded on a stock exchange, since it requires a significant amount of trading volume to arrive at a reasonable determination of the value of a business. Conversely, if a company's shares are thinly traded, the current market price could gyrate wildly based on a small number of recent sale transactions. The concept is least effective when a business has a small number of investors and its shares are not registered for sale with the Securities and Exchange Commission; in this case, no market value can be established, so some other valuation technique must be used (Spiegel, 2007).

Result and Discussions

Unit Root Test

Augmented Dickey–Fuller (ADF) and Phillips–Perron (PP) unit roots test was conducted on the variables, to determine whether they are stationary or non-stationary. The tested null hypotheses for both unit root test is to determine the presence of a unit root. The decision rule is to reject the null hypothesis when the test-statistical value is less than the probability value or posits higher negative values (William, Hill, and Lim, 2008).

The unit root test was done at levels and at first difference as presented in Table 4.1. The result shows that GDP and FDI are stationary at level while MCAP is not; this suggests the need to difference the other variable to achieve stationarity. Upon taking the first difference, the other variable (MCAP) became stationary. This means that, the variables, foreign direct investment (FDI) and growth domestic product (GDP are integrated at 1(0) while market capitalization (MCAP) is integrated at 1(1). We can therefore conclude that the series is significantly reliable for further analyses.

Table 4.1 Unit Root Test Results

Variable	LEVELS		FIRST DIFFERENCE		Order of Integration
	ADF	Prob.	ADF	Prob.	
GDP_t	-4.192	0.012	-	-	I (0)
FDI_t	-3.122	0.118	-	-	I (0)
MCAP_t	-0.644	0.968	-4.320	0.009*	I (1)
Variable	LEVELS		FIRST DIFFERENCE		Order of Integration
	PP	Prob.	PP	Prob.	
GDP_t	-4.145	0.013	-	-	I (0)

FDI_t	-2.975	0.154	-	-	I (0)
MCAP_t	-0.644	0.968	-4.271	0.010**	I (1)

Source: Computed and Compiled by the Researcher using E-views 12 (2026)

Note: *, **, *** denotes significance at 1%, 5% and 10% respectively.

Granger Causality Test

The choice of this test is to understand and identify the existence and nature of the direction of the causal link amongst foreign direct investment (FDI), stock market performance proxied by market capitalization (MCAP) and economic growth proxied by GDP in Nigeria as specified in objective three; taking GDP as the dependent variable; and equally, to indicate if the direction is uni-directional (one-way causal link) or bi-directional (two-way causal link). The decision rule is to reject the null hypothesis if the F-Statistical value is greater than the probability value. Otherwise do not reject (Wooldridge, 2009).

As envisaged in Table 4.2, the result shows that there is bi-directional causality (two-way causal link) between FDI and GDP at 95% confidence level, as evidenced by their F-statistics and Probability values. In the same vein, there is an evidence of bi-directional causality (two-way causal link) between MCAP and GDP at 95% confidence level. The general note finding as regards this result is that, foreign direct investment (FDI) and stock market performance proxied by market capitalization (MCAP) accelerates economic growth proxied by GDP in Nigeria. Similarly, economic growth proxied by GDP accelerates foreign direct investment (FDI) and stock market performance proxied by market capitalization (MCAP) in Nigeria.

Table 4.2 Granger Causality Test Result

Null Hypothesis:	Obs	F-Statistic	Prob.
LOGFDI does not Granger Cause LOGGDP	30	3.55556	0.0308**
LOGGDP does not Granger Cause LOGFDI		3.35316	0.0759**
MCAP does not Granger Cause LOGGDP	30	2.02316	0.0740**
LOGGDP does not Granger Cause MCAP		4.81568	0.0538**

Source: Computed and Compiled by the Researcher using E-views 12 (2026)

The asterisks ** indicate rejection of null hypothesis at 5% level of significance

Discussion of the Major Findings

The Granger causality result depicted that FDI, MCAP expands GDP; similarly, GDP expands FDI and MCAP. The central finding is that, there is the existence of two-way causal link amongst FDI, MCAP and GDP. The result corroborates to the theoretical foundations of Mundell-Fleming's model (1961) and McKinnon theory (1963) who's reveals that FDI and MCAP have a great effect on welfare and hence GDP. The finding is also consistent to that of

Augustina (2019).

5.1 Conclusion and Recommendations

The general conclusion with regard to the findings from the Pairwise-Granger causality test result is that, there is the existence of two-way causal link amongst FDI, MCAP and GDP in Nigeria. Thus, any policy toward positive commitment on FDI and MCAP would have significant positive impact on economic growth in Nigeria.

In line with the research findings as embedded in the study, it becomes expedient that deductions from the findings be made to advice policymakers and implementers on the best way to handle policy issues and programs regarding foreign direct investment and stock market performance. In the light of this, the following policy recommendations and suggestions are necessary to ensure progress and growth of the Nigeria's capital inflows:

- i. **Diversification of foreign direct investment:** Policies that will encourage the diversification of FDI into other sectors of the economy should be introduced. Oil and Telecommunication sectors presently enjoy major stakes of FDI into Nigeria. This explains its little impact to economic growth in the country. Therefore, FDI should be targeted into other sectors (such as Agriculture, education, etc.) which have been identified to bring about growth in the economy. This will bring about employment opportunities and increased income. Thus, leading to increases in the level of output.
- ii. **Promotion of stock market development:** There should be promotion of stock market development as this will lead to the flow of funds from private savings and this could be used to finance revenue generating government enterprises. However, too much focus should not be placed on portfolio investments as it is highly volatile and easily reversible in times of crisis.
- iii. **Fine-tuning of macro-economic policies:** Another pre-requisite recommendation for Nigeria to achieve economic growth is the continuous fine-tuning of macro-economic policies to converge with development in her major trading partners' economies in particular and the global trend in general. If all these policies are put in place, the chances of achieving economic growth would be increased and exactly possible.

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