Foreign Direct Investment and Stock Market Performance in Nigeria

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Abstract

The study was carried out to examine the relationship between foreign direct investment and stock market performance in Nigeria. The study was anchored on Accelerator and Tobin q theories of investments. The study also adopted the ex post facto research design hence data covering the period 2000 to 2019 were obtained from secondary sources. Findings of the study revealed that trade openness and volume of stock market transactions have a significant positive association with foreign direct investment. The study further revealed that share price index has positive but insignificant association with foreign direct investment. Moreover, the study found that market capitalization has a significant negative relationship with foreign direct investment. The study, therefore, concludes that stock market performance influences the level of foreign direct investment in Nigeria.

Keywords: FDI, Market Capitalization, Share Price Index, Trade Openness, Stock Market.

Introduction

Finance is a major deterIntroduction Finance is a major determinant of the performance of any investment. Akpan (2004) states that finance constitutes the life wire or blood and soul of any business organization. Saving in the developing world has not matched up the investment needs, which has resulted to the demand for foreign borrowings and other foreign contributions to complement the domestic resources and stimulate development. In view of this, foreign capital inflow either by private or public interventions is imperative in promoting growth and development in developing countries like Nigeria. According to Adaramola and Obisesan (2015), the slow rate of development in the third world is attributed to the inadequate financial resource to speed up the economic growth and development. Capital flows are transmitted through foreign direct investment (FDI), foreign portfolio investment (FPI) and draw down on foreign reserves, foreign loans and credits and so on (Obadan 2004). The factors that usually determine the volume and flow of foreign capital include, among others, exchange rate policies, political instability, monetary and fiscal policies, domestic factors such as the investment environment, infrastructure and resources and the quality of institutions (Udoh & Egwaikhide 2008).

In Nigeria, although large market and abundant natural resources tend to attract foreign investors, certain factors still inhibit the inflow of foreign capital into the country. All over the world, the capital market has played significant roles in national economic growth and development. One intermediary in the market that operates as a rallying point for the overall activities is the stock exchange. It is a common postulation that without a functional stock market, the capital market may be very illiquid and unable to attract investment. Essentially, the stock market provides liquidity and contributes to capital formation and investment risk reduction by offering opportunities for portfolio diversification (Levine, 1991).

The Nigerian capital market provides the necessary lubricant that keeps turning the wheel of the economy. It not only provides the funds required for investment but also tries to efficiently allocate these funds to projects of best returns to fund owners. Foreign private investment, thus, augments domestic resources to

enable the country carry out effectively her development programmes and raise the standard of living of her people. Although foreign private investment is made up of FDI and FPI, FDI is often preferred as a means of boosting the economy. This is because FDI disseminates advanced technological and managerial practices through the host country and thereby exhibits greater positive externalities compared with FPI which may not involve positive transfers, just being a change in ownership. In addition, available data suggest that FDI flows tend to be more stable compared to FPI (Lipsey 1999).

The Nigerian stock market has experienced relative stability and recorded impressive growth. This growth has been most significant especially since the introduction of the structural adjustment programme (SAP) in the early 1980s, which brought about the privatisation, commercialisation and liberalisation programmes, all of which has helped in boosting activities in the stock market. However, as noted by Ogwumike and Omole (1997), when compared with other emerging and developed markets, it becomes evident that the Nigerian stock market is still relatively small in size and underdeveloped. For example, Osaze (2007) pointed out that less than 21 per cent of the over 400,000 registered companies in Nigeria are not currently quoted on the Nigerian Stock Exchange, a situation which he attributes to the unattractiveness of the market as well as the lack of incentives for more companies to go public. The Nigeria stock exchange has only about 304 companies listed on it and a total of 369 securities (CBN 2018). Series of problems have inhibited the growth and development of the stock market and foreign capital inflow. The Nigerian government is putting so much effort into attracting foreign investors and yet the economy is still dwindling. Against this background, this study is focused on examining the effect of foreign direct investment on the development of the stock market in Nigeria.

Literature Review

Foreign Direct Investment

International capital flows majorly consist of foreign direct investment (FDI), portfolio equity and debt investment, commercial lending and official flows (Razin, Sadka & Yuen, 1998). FDI may be broadly defined as the establishment of, or acquisition of substantial ownership in a commercial enterprise in a foreign country, or an increase in the amount of an already existing investment abroad to achieve substantial ownership. It must be stated that FDI involves more than just ownership, as in the case of portfolio investment. It also includes direct involvement in the management of the enterprise

There are two major features of FDI. First, it involves the movement of resources other than capital, such as technology, management, organisational and marketing skills. Secondly, the resources are transferred internally within the firm, rather than externally between two independent forces. According to Orji, Orji and Ogbuabor (2018) FDIs are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. FDI is an investment made by a company or entity based in one country, into a company or entity based in another country. It differs substantially from indirect investments such as portfolio flows, wherein overseas institutions invest in equities listed on a nation's stock exchange. Entities making direct investments typically have a significant degree of influence and control over the company into which the investment is made (Abel & Nikki, 2011)

Stock Market Performance

Stock market performance is the indicator of the stock market as a whole or of a specific stock. It gives signal to the investors about their future moves. The movement in the price of a stock and the indexes gives the idea of the near future trend of the stock, sector or the economy as a whole (Investopedia, 2020). As financial domain is the most important one of an economy, so the stock market performance works as an

indicator of the overall health of the economy" (Economy Watch, 2010).

Stock market is the market in which shares of publicly held companies are issued and traded either through exchanges or over-the-counter market. Also known as the equity market, the stock market is one of the most vital components of a free-market economy, as it provides companies with access to capital in exchange for giving investors a slice of ownership in the company. The stock market makes it possible to grow small initial sums of money into large ones, and to become wealthy without taking the risk of starting a business or making the sacrifices that often accompany a high-paying career (Investopedia, 2020). The Nigerian Stock Exchange provides the only trading floor to transact in stocks in the Nigerian capital market. It was set up in 1960 as the Lagos Stock Exchange, a private sector entity, and metamorphosed into the Nigerian Stock Exchange

Theoretical Framework

This study will be anchored on two theories: The Investment theory and Accelerator theory and Tobin q theories of investments. Firstly, the Accelerator theory of investment was developed in 1917 by Thomas Nixon Carver and Albert Aftalion. Although this theory was conceived before Keynesian economics, it emerged just as the Keynesian theory came to dominate the economic mindset of the twentieth century. The accelerator theory sees net investment as dependent on the growth of aggregate demand assuming that there is fixed ratio of current desired capital stock to current output. Thus, the simplest accelerator model predicts that investment is proportional to the increase in output in the coming period. The dependence of investment on expectations is both realistic and central to Keynes' ideas. However, since we cannot observe expectations of firms about future output, this feature of the accelerator model posed problems for those who wished to implement it. The most common way of resolving this difficulty was to assume those firms expect the change in output in the coming period to be equal to the change in the current period. Secondly, the Tobin's q theory of investment was developed by James Tobin in 1969 as the ratio between the market value and replacement value of the same physical asset. Based on financial markets, he argued that firms' investment level should depend on the ratio of the present value of installed capital to the replacement cost of capital. The q theory of investment believed that firms will want to increase their capital when q is greater than one and decrease their capital stock when q is less than one, and then a firm can buy one dollar's worth of capital (at replacement cost). On the numerator is the market valuation, the going price in the market for exchanging existing assets, and the other, the denominator, is the replacement or reproduction cost, the price in the market for the newly produced commodities, believing that the ratio has considerable macroeconomic significance and usefulness as the nexus between financial markets and markets for goods and services.

Empirical Review

Omodero and Ekwe (2016) in a study examined the impact of foreign direct investment (FDI) on the stock market performances in Nigeria, from1985 –2014. The secondary data used were collected from IMF, International Financial Statistics (2015), CBN Statistical Books (2015). Multiple regression of least square estimation was the tool used to analyze the data. In the model, the FDI was regressed on RGDP, Consumer Price Index, Real effective exchange rate, Money supply (M2), Share price index, Treasury bill, Nigerian stock exchange transactions. The study revealed that FDI has an insignificant and negative impact on the economy and the macroeconomic variables that determine the performances of the Nigerian stock market. Orji, Orji and Ogbuabor (2018) estimated the impact of stock market development and foreign private investment on economic growth in Nigeria over the period of 1985–2016, using secondary data from various publications of the Central Bank of Nigeria. The ordinary least square (OLS) technique was employed in this study, while the Engel and Granger cointegration approach was applied to determine the long-run relationship between the variables. The result showed that market capitalisation, all share index and real exchange rate have statistically significant impact on economic growth, while foreign direct investment, trade openness and gross national savings have insignificant impact on growth. The study also

showed that there is a long-run relationship among stock market development, foreign private investment and economic growth in Nigeria. The error correction model (ECM) results showed that the model adjusts to equilibrium in the short run and that about 51 per cent of the disequilibrium between gross domestic product and the independent variables is corrected each year.

Abel and Nikki (2011) investigated the impact of financial development, macroeconomic and institutional factors on the flow of foreign direct investments to the Sub-Saharan African region. Panel data from 1995 to 2008 were drawn from 30 Sub-Saharan African countries. The study revealed that financial development, the countries' market size, and corruption among others adversely affect FDI in the region. That means, the absence of infrastructure, trade openness and financial development discourage foreign direct investment in the region. Oseni and Enilolobo (2011) examined the effect of FDI and stock market development on economic growth in Nigeria from 1980 to 2009. Econometric techniques such as Unit root test, cointegration and error correction mechanism were the statistical tools for data analysis. The result showed cyclical movement for both the FDI and stock market development. The study also revealed that lagged exchange rate could have positive effect on growth. Okwuchukwu (2015) studied the impact of exchange rate volatility, stock market performance and foreign direct investment in Nigeria. Ordinary least square technique was used to analyse the data. The result showed a significant negative effect on FDI inflow to Nigeria. It was concluded that a stable and well developed capital market will attract FDI to Nigeria. Ezeoha, Ogamba and Onyiuke (2009) examine the nature of relationship existing between stock market development and the level of investment flows in a country with a high degree of macroeconomic instability and whether the stock market plays a uniform role in attracting both domestic and foreign investments in such economic situation. The study showed that development in the Nigerian stock market over the years was able to spur growth in domestic private investment flows, but unable to do so in the case of foreign private investment; and that development in the country's banking system rather had some destabilising effects on the flows of private investments. This study, according to the researcher, is among its kind to have empirically sought for and established some discriminate effects of stock market development in the flows of domestic and foreign private investment. This study tries to link the relationship among the variables to spur economic growth with stock market development.

Ayashagba and Abachi (2002) carried empirical investigation on the effects of FDI on economic growth in Nigeria from 1980 to 1997. The result showed that FDI had significant impact on economic growth in Nigeria. They therefore concluded that the presence of FDI in the LDCs particularly in Nigeria is not totally useful. Adelegan (2000) explored the seemingly unrelated regression model to examine the impact of FPI on economic growth in Nigeria and found out that FPI is pro consumption and pro-import and negatively related to gross domestic investment. Akinlo (2004) also investigated the impact of FDI on economic growth in Nigeria, for the period 1970–2001. The ECM results showed that both private capital and lagged foreign capital have small and not a statistically significant effect, on the economic growth. The results seem to support the argument that extractive FDI might not be growth enhancing as much as manufacturing FDI.

Arikpo and Ogar (2018) examined foreign direct investment and capital market development in Nigeria for the period 1972 to 2016. The study was specifically designed to assess the relationship between foreign direct investment and market capitalization, foreign direct investment and number of listed companies, foreign direct investment and all share index, foreign direct investment and turnover ratio and foreign direct investment and value of transaction FDI in Nigeria. Secondary time series data were collected using desk survey approach and analysed using Vector Auto Regression (VAR) method.

The result of the analysis revealed that there is a significant positive relationship between foreign direct investment and market capitalization; also, there is a significant positive relationship between foreign direct investment and number of listed companies; again, the study shows that foreign direct investment has a significant positive relationship with all share index; lastly it was revealed that foreign direct investment has

a significant positive relationship with turnover ratio and value of transaction in Nigeria.

Soumyananda (2010) empirically investigated the factors that determine FDI to Nigeria. Applying the co-integration technique, it was revealed that the endowment of natural resources, trade intensity, macroeconomic risk factors like inflation and exchange rates are significant determinants of FDI flow to Nigeria. The study also showed that in the long run market size is not a significant factor for attracting FDI to Nigeria. Umar, Ismail and Sulong (2015) studied the impact of the stock market development on foreign direct investment using autoregressive distributed lag (ARDL) in the presence of structural breaks (dummies) in Nigeria. The study utilized annual time series data from 1970 to 2013. The data were generated from World Bank and Central Bank of Nigeria (CBN). The result suggests that the foreign direct investment (FDI) has a significant positive long-run impact on the value of the total stock transaction but has a negative and significant effect on the rate of stock returns. However, the relationship between FDI and market capitalization ratio is not statistically significant

Methodology

Research Design

Data for the study were retrieved from archives hence the study adopted the ex-post facto research design. The design uses data already occurred but not necessarily amassed for research purposes (Otuya, 2020). The design is considered suitable for this study because it can be used to test the correlational relationships between and among the variables of the study.

Sources of Data

The data used for this study were obtained from the CBN Statistical Bulletin and the Nigerian Stock Exchange Bulletin. The data covers the period 2000-2018.

Data Analytical Techniques

The Ordinary Least Square (OLS) regression analysis was adopted as the data analytical method. The technique was adopted because it is one of the most appropriate methods for examining the relationship between variables. It is also built on the postulation that it is the Best Linear Unbiased Estimator (BLUE) that is appropriate for estimating a model of this nature. To confirm the statistical validity of the models, other analytical examinations were conducted.

Model Specification

The focus of the model is to examine to what extent foreign direct investment affects the stock market performance in Nigeria. Foreign direct investments is used as the dependent variable in this model. The independent variables for the model are the stock market performance elements such as market capitalization, trade openness, share price index and volume of transaction. The models are expressed as: FDI t = f (SMP) Thus, linear equation we obtain: FDI t= β_0+β_1CAPt+ β_2TOPt+ β_3DEXt + β_4VOLt +et Appriori Expectation: β_1; β_2, β_3 , β_4>0

Where: FDI = Foreign Direct Investment; CAP = Market Capitalization; TOP = Trade Openness; DEX = Share Price Index; VOL = Volume of Transaction; t = represent the time dimension β_0 = Intercept; β_1 – β_4, = Parameter to be estimated, and e = Stochastic or Disturbance term

Empirical Analysis

To obtain an effective empirical result, some diagnostics checks were conducted before the regression estimates. These include unit root, co-integration, normality and multicollinearity tests. For emphasis, the unit test was conducted to test how stationary the properties of the time series data are while the co-integration test was done to control for the long-run relationship between variables. Descriptive statistics were used to test for normality using the Jarque-Bera statistics. The results are presented thus:

Table 2: Unit Root Test

Variables	At Level Decision		At First Difference	
	ADF	Lag Length	ADF	Lag Length
FDI	-0.8157 1(1)	1	-3.5876*	1
CAP	-3.4934 1(1)	1	-10.0347***	1
TOP	-2.8025 1(1)	1	-4.0508**	1
DEX	-2.1221 1(1)	1	-3.8875*	1
VOL	-3.8543 1(1)	1	-4.0594*	1

NB: *, ** & *** represent significance at 1%, 5% and 10% level respectively.

From the result obtained in table 2 using the Augmented Dickey-Fuller (ADF), the unit root test suggests that all the variables are not stationary at their original nature but stationary at first difference. To confirm this, the ADF statistical values with zero lag are higher than the test critical value at the acceptable 1%, 5% t and 10% significant level

Table 3: Co-integration Rank Test (Trace & Maximum

Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Trace Statistic	0.05 Critical Value	Prob.*
None *	0.999275	192.2995	69.81889	0.0000
At most 1 *	0.913782	76.62069	47.85613	0.0000
At most 2 *	0.762700	37.40674	29.79707	0.0055
At most 3	0.542301	14.39186	15.49471	0.0728
At most 4	0.111257	1.887151	3.841466	0.1695

* denotes rejection of the hypothesis at the 0.05 level

Co-integration Rank Test (Maximum Eigenvalue)

Hypothesized No. of CE(s)	Eigenvalue	Max-Eigen Statistic	0.05 Critical Value	Prob.*
None *	0.999275	115.6788	33.87687	0.0000
At most 1 *	0.913782	39.21395	27.58434	0.0010
At most 2 *	0.762700	23.01489	21.13162	0.0269
At most 3	0.542301	12.50471	14.26460	0.0931
At most 4	0.111257	1.887151	3.841466	0.1695

* denotes rejection of the hypothesis at the 0.05 level Results from the co-integration trace and Max- Eigen statistics suggests that there is a cointegration among the variables. The results imply that in the long run, all the variables move together.

Table 4: Descriptive Statistics

	FDI	CAP	TOP	DEX	VOL
Mean	998265.0	29.23000	35.38750	27093.06	826625.5
Median	989053.0	32.50000	33.98500	24770.50	742814.2
Maximum	1899651.	55.40000	68.61000	57990.20	2350876.
Minimum	134189.9	5.000000	10.19000	8111.000	28153.10
Std. Dev.	659735.4	12.61870	18.77202	11643.30	694580.4
Skewness	0.081663	0.072755	0.380728	0.714177	0.927450
Kurtosis	1.637032	2.903242	2.045133	3.788446	3.109353
Jarque-Bera	1.491783	0.025446	1.242988	2.218202	2.877177
Probability	0.474311	0.987357	0.537141	0.329855	0.237262
Sum	18967034	584.6000	707.7500	541861.1	16532511
Sum Sq. Dev.	7.83E+12	3025.402	6695.389	2.58E+09	9.17E+12
Observations	19	20	20	20	20

The table above displays the descriptive statistics for the data. As observed, foreign direct investment has a mean value of 998265 for the time examined. The maximum and minimum values for FDI for 20 years are 1899651 and 134190 billion Naira respectively. The standard deviation measuring the spread of distribution stood at 659735 indicating considerable variations in the data series. The Jarque-Bera statistics is 1.491 indicates that the data series satisfies normality criterion and is suitable for further analysis. Similarly, market capitalization (CAP) showed mean of 29.23. The maximum and minimum amount of CAP for the

period was 55.4 and 5.00 respectively. The standard deviation measuring the spread of the distribution stood at 12.618 which is very large and indicates considerable dispersion from the mean and that the distribution is inclusive of years with significant variations in their market capitalization. The Jarque-Bera- statistic stood at 0.254 and indicates that the data is normally distributed. Further, the descriptive statistics result from the table on the trade openness (TOP) and share price index (DEX) point to the fact that while the trade openness stood at an average of about 35.387, the share price index was 27093. The descriptive statistics also show that the trade openness also recorded the lowest spread of 10.19 and the highest spread of 68.61 during the period. The share index also recorded minimum and maximum rates of 8111 and 57,990 respectively. The standard deviation of 18.772 for TOP and 11643 for DEX shows that there is a wider dispersion. For the normality in distribution, the TOP and DEX recorded JarqueBera statistics of 1.24 and 2.218 respectively which indicates that the series satisfies the normality criterion and that selection bias is unlikely in the sample. The descriptive statistics of VOL (volume of transactions) as indicated in the table shows the mean of 82,6625. Results from the table further indicate a maximum and minimum VOL of between the period of 23,50876 and 28,153. The Jarque-Bera value of 2.877 further indicates that financial data is normally distributed. The analysis of the descriptive statistics indicates that all the variables satisfy the normality criterion as their respective Jarque-Bera were all significant

TABLE 5: Regression Statistics for the Model

Dependent Variable: FDI

Method: Least Squares

Date: 07/10/20 Time: 12:26

Sample: 2000 2019 Included

observations: 19

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	622071.4	531310.7	1.170824	0.2612
CAP	-15681.09	9895.664	-1.584643	0.0354
TOP	16642.22	7291.443	2.282431	0.0386
DEX	0.574328	15.08645	0.038069	0.9702
VOL	0.318016	0.256249	1.241044	0.0050

R-squared	0.580615	Mean dependent var	998265.0
Adjusted R-squared	0.460791	S.D. dependent var	659735.4
S.E. of regression	484449.4	Akaike info criterion	29.24035
Sum squared resid	3.29E+12	Schwarz criterion	29.48888
Log likelihood	-272.7833	Hannan-Quinn criter.	29.28241
F-statistic	4.845556	Durbin-Watson stat	1.620504

Prob(F-statistic)   0.011556

Table 5 shows the summarized regression results for the model. The regression estimates indicate that we can explain 46.1% of the foreign direct investment using stock market performance measures as determinants while 51.9% of the variation is expounded by other factors outside the model and the error term. The Prob of 0.01155 (P0.05). The regression estimate also shows CAP to have a negative coefficient -15681 with a p-value of 0.0354 which is statistically significant at 5% (p>0.05). The F-stat (4.845) and pvalue (0.0115) indicate that the hypothesis of significant linear relationship between the dependent and independent variables cannot be rejected at a 5% level.

Discussion of Findings

Results from previous studies on the association between stock market performance and foreign direct investment have never been in agreement. Some studies revealed a negative correlation, some positive, while others found no correlation at all. In this study, it is observed that the link between stock performance measures and foreign direct investment tends to vary concerning the particular type of variable that is examined. As regards individual stock market performance measures, TOP and VOL have a positive and significant association with foreign direct investment at 5% significant level. The result meets our appriori expectation and consistent with prior studies such as (Orji, Orji & Ogbuabor, 2018). Also, the coefficient of the variable DEX is observed to be positive for FDI but not significant. The result did not meet our a priori expectation but is consistent with prior studies like Ayashagba and Abachi (2002). For CAP, the results show a negative and significant association with foreign direct investment this result did not meet our expectation. We expected a significant positive association based on the fact that a higher market capitalization enhances foreign direct investment.

Conclusion and Recommendations

The study examined stock market performance and level of foreign direct investment in Nigeria. The study adopted the ex post facto research design and obtained data from secondary sources. The data covers the period 2000-2019. The analysis indicated that trade openness and volume of transactions have a significant positive association with foreign direct investment. Findings of the study further revealed that share price index has positive but insignificant association with foreign direct investment. Moreover, the study found that market capitalization has a negative and significant relationship with foreign direct investment. The study, therefore, concludes that stock market performance influences the level of foreign direct investment in Nigeria. In line with the findings, the study recommends as follows:

1. Government should consider the maintenance of prudent macroeconomic policies and also continue to create conducive environment to stimulate the flow of foreign direct investment.
2. There is the need to revamp the stock market and reinforce institutional and regulatory framework to support FDI flow in the long run.

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