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IMPACT OF FINANCIAL MELTDOWN ON THE EFFICIENCY OF THE NIGERIAN CAPITAL MARKET: A THEORETICAL REVIEW

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Abstract: *This paper examined the impact of financial meltdown on the efficiency of the Nigerian capital market and in an effort to carry out atheoretical analysis.Most of the literature reviewed showed that the employment of money supply as percentage of GDP, exchange rate, interest rate as well as inflation rate on market capitalization in Nigeria within their different period of studies used mostly the Autoregressive Distributed Lag (ARDL) technique in their analyses. Most of the authors established that the relationship that existed between financial meltdown on the efficiency of the capital market in Nigeria had a negative one showing that in Nigeria, capital market has an indirect relationship to financial meltdown and that performance of the capital market are seriously affected as a result of financial meltdown in all economies. The authors argued that increase in money supply directly decreases investment in the capital market. Their results showed that money supply, interest and exchange rate had negative and statistically insignificant in determining the performance of the Nigerian capital market. Though, inflation was positive but had statistically insignificant impact on capital market performance in Nigeria. All their variables used in the model were jointly statistically.*

KEYWORDS: *NCM,GDP, EM, MP, FM, INVESTMENT, CAPITAL*

I. Introduction

The development of any economy in the world depends on the development and effectiveness of policies that affects the level of economic activities. The policy direction of the economy determines the rate at which the real sector of the economy is affected. These actions affect the rational expectation of people within that economy which in turn affect the investors as the action of the monetary authority affects the output level of the economy. Monetary policy plays a major role in the determination of capita market growth. To this end, the prices of securities in the stock market are determined by the manipulation of monetary instrument.

Every year, the government authorities set macroeconomic targets, and these targets are usually tied to two principal macro policy frameworks (fiscal and monetary). The uncertainty over policy direction from the government has continued to influence the performance of the nation's capital market. Monetary policy is said to be forward-looking economic modification tool specially applied to expand or contract money supply or achieve price stability.

As pointed out by Mishkin (2007), a functional capital market is a key factor in promoting sustainable economic growth, while poorly performing capital markets is one reason why many countries in the world remain desperately poor.

This is because the capital market is not just a primary source of income and retirement savings to many, but also an engine of growth through its indispensable role in capital accumulation. The growth of capital market can have a major impact on the whole economy as it influences real activities such as savings, consumption, investment, level of employment, export, etc. (Turner, 2002).

Worldwide, the concern about the interaction between financial meltdown and the capital market has been on the increase since the collapse of major capital market boom of 2000 and 2007 (Yoshino, Hesary, Ali & Ahmad; 2014). The capital market crash of 2008 resulted in failure of key businesses, decline in consumer wealth and downturn in economic activities which led to the great recession of 2008 and contributed to the

European sovereign-debt crisis. Consequently, it is asserted to be the worst financial meltdown after the terrible experience of the great depression of the 1930s (Eigner, Peter, Umlauft& Thomas; 2015); Temin & Peter, (2010).Though, the ratio of market capitalization recorded a slight improvement in 2012 and 2013, there was a sharp decline in 2013 and 2014, the problem has been found to be more serious with the liquidity of the stock market in the ratio of the total value operated to Gross Domestic Product (GDP)which was approximately 1% in 2015 (Nwokoye&Otu, 2018).

The stock market therefore is expected to establish the price which includes the monetary policy actions (Abaenewe&Ndugbu ;2012). Nigerian Stock Market being an emerging market has its own behaviour due to the changes in the structural economic conditions (caused by financial crisis) in the Nigerian economy, via under developed nature of the stock market, poor banking and saving habit.It has performed below expectation which has slowed down the growth and development of the economy over time. Therefore, this study seeks to investigate the effect of financial meltdown on the performance of the Nigerian capital market.

II. Literature Review and Theoretical Framework

The development of the world revolves around the development of the financial system of the economy. The system plays a key role in the development of different sectors of the economies. This section deals with the review of concepts, theories and empirical literatures as they relate to financial meltdown and capital market in Nigeria.

2.1 Concept of the Capital Market (Stock Market)

The Capital Market ismade up of markets and institutions, which assist in the issuance and secondary trading of long-term financial instruments.Capital market is the long-term segment of the financial system. It is comprised of markets and institutions, which facilitate the issuance and trading of the long-term financial instruments.

2.2 Functions of the Nigeria Capital Market

The primary objective of the Nigerian capital market is to mobilize long term funds for investment to boost the nation’s economic growth and development. The functions of the are in line with the objectives and the missions of the capital market as shown below:i) Provision of an additional channel for engaging and mobilizing domestic savings for productive investment. ii) Promotionof the development of the internal financial services sector vis-a-vis various forms of institutional savings such as life insurance and pension funds. iii) Improving the gearing of the domestic sector as well as helping in reducing dependence on borrowing. iv) Improving the efficiency of capital by providing market measure of returns on capital and a market mechanism for management changes as compared with the administrative or political mechanism of public sector corporations. v) Encouraging privatization by increasing the marketability of new issues and vii) Providing access to finance for new and smaller companies and encourage institutional development in facilitating the setting up of Nigeria’s domestic funds, foreign funds, and venture capital funds.

2.3Performance of the Nigerian Capital Market

Presumably, as a result of technological innovation and globalization as well as economic reforms, Nigerian capital market has experienced considerable growth and development in recent years since 1986. As part of the Nigerian monetary reforms, CBN liberalized operation in the banking sector, leading to the rise of number of commercial banks from 40 banks in 1986 to 120 banks in 1992 (Osakwe & Chukwunulu;2019). Also, the reforms led to the emergence of other financial institutions such as discount houses and Bureau De Change which were non-existent prior to 1986. Importantly, CBN has been increasing the capital base of banks since the introduction of reforms, for instance, capital base of all bank financial institutions was raised in 1998 from 10 million to 500 million.

According to Nigerian Stock Exchange, (NSE, 2006), the market registered a total trading value of 262.937 billion. This performance contrasts with N265.5 million total trading volumes registered in 1990, N1.8 billion in 1995 and N11.1 billion in 1997. Thus between 1990 and 2005, the value of trading had risen astronomically and the growth in the value of equities is also remarkable during the period (NSE, 2006). Reiterating further, Akanbi (2013) observed that the declining trend of investment flow continued in 2013. According to Akanbi,(2013), the nominal figure of investment flow in 2008 was N787.4 billion while the total transactions on the NSE were N4, 758.27 trillion. In 2009, it was slightly lower but its contribution to the activities in the stock market was ironically higher than the two previous years at N424 billion. For the year 2010, he put investment inflow at N577.3 billion out of N1.6 trillion transactions and in 2011, it was N847.9 billion out of N1.3 trillion transactions for the year. More so, in 2012, N808.4 billion worth of investment inflow was made by foreign investors in a year when the total transaction was put at N1.3 trillion. The above data trends depict the inconsistence in the growth path of capitalization for Nigerian capital market growth expectation as a result of the continuous instability in the financial system of the country precipitated by financial meltdown or crisis.

2.4 Concept of Financial Meltdown

Global economic meltdown is a current issue since it has a worldwide consequence, it indicates near calamitous situation demanding insufficiency or unavailability or else available utilizable resources, thus weakening governments or political leaders from meeting their crusade pledges, objective, strategy and programmers. It has much repercussion for both developed and developing and underdeveloped economies.

2.5 Causes and Challenges of Financial Meltdown in Nigeria

The following causes can be adduced to financial meltdown in Nigeria.

1) **Inconsistency in interest rate**: Any developing country like Nigeria has numerous problems that in various ways weakenthe smooth transmission of monetary policy. The economy has witnessed varieties of instability due to management of interest rate and other policy instruments.
2) **Government intervention**: This circumstancepivots on the peculiar nature of the Nigerian economy that is dominated by rural areas which are devoid of efficient banking sector and the interference of the government on the apex banking operation. More so, prior to Structural Adjustment Programme (SAP), monetary policy instrument such as interest rate, liquidity ratios of banks and credit allocation were mainly used to support the fiscal operations of the existing government (Okonkwo, Godslove&Mmaduabuchi, 2015). The independence of the Central Bank of Nigeria was still unattainable. Consequently, the major monetary regulatory role of the Central Bank was thwarted by the Nigerian government decisions on fiscal activity.
3) **Fiscal device complementarities:**Ndekwu (1990) pointed out that monetary policy was just designed to satisfy the fiscal operations of government and to allocate inflationary pressures and exchange rate regulation in operation was specifically for the parameterwhich is related to capital drive with respect to foreign exchange resources. Instead of exchange rate to be managed to transmit in the economy, government directed what transpired. This actdeterioratesthe effective monetary transmission apparatus in Nigeria.
4) **Inefficient operation of the Nigerian banking system:** The ineptitude in the operation of the banking sector devoid of information communication technology had its adverse effect which later developed giving room for efficiency and effective banking operation internally as well as worldwide. Post consolidation of bank brought with it a lot of changes such as stabilization of money market rate; proper liquidity management approach and replacement of minimum rediscount rate with monetary policy rate. Inadequate supervisionthat gave rise to some features in the banking sector affected financial dealings in the financial system. A situation where borrowed money could not readily be repaidresulted to challenges to the apex bank far back in 2009 subsequently leading to actions such as 'bail out' to remedy the situation and also embark on activities to avert such happening such as proper supervision and guide lines.
5) **Weak institutional framework:**Central Bank of Nigeria has delved into different approaches to ensure fulfilling the objectives establishing it in spite of weak institutional frame work and inability of the financial markets to play required roles. The performance of monetary operation and its transmission to the economy has experienced difficulties since the military regime until this present period.
6) **Dearth of data:**The quality of data in the country has hindered the performance of monetary policy on stock growth. The poor quality of data is a major constraint in the formulation of monetary policy in Nigeria. The lack of high frequency and reliable data renders econometric analysis difficult. Similarly, fiscal shocks give rise to parameter uncertainly which also undermines the setting of accurate targets.
7) **Inefficient payments system in Nigeria has remained largely cash based:** The instrument of payment in Nigeria is still predominantly cash based. The dominant use to cash for transactions increase the monetary base (high powered money), which renders monetary control difficult. Cash based payment system distorts the transmission mechanism of monetary policies.

2.6Government Efforts in Cubing Financial Meltdown and Ensuring Capital Market Growth in Nigeria

Nwokoye and Otu (2018) in their empirical study concluded that monetary policy has overall significant effect on stock market performance in Nigeria. This implies that monetary policy could have a great effect on stock market performances in Nigeria.The interaction between monetary policy and stock market growth in Nigeria has attracted the attention of scholars. Many studies on the relationship between monetary policy and stock market growth have empirically ascertained that monetary policy transmission mechanism affects stock market prices which in turn affect the growth and development of the market. The mobilisation of resources for investment within the capital market is determined by the interplay of the monetary tools, especially, interest rate. The direction of monetary policy change in Nigeria has affected the flow of Direct Foreign Investment (DFI) in the economy which affects the availability of funds for investment purposes (Chukwuemeka, 2018).

Therefore, exchange rate of the currency has been on the rise and reaching an all-time hike of N305.58 kobo to a dollar in the year 2018. This shows that money policy in Nigeria have not been stable in determining

the rate trend of stock market activities in the economy thereby making it difficult for investment growth in the economy in general.

2.7 Theoretical Review

The development of theories revolves around the causes and effects of a particular phenomenon. Theories explain the direction to which particular economic phenomenon flows. Different theories have argued as to what effect money has on the capital market and the economy at large. Based on the aforementioned, this section of the study reviewed relevant theories which connect financial meltdown and capital market growth. Thus, the following theories of money and stock market are reviewed in this study.

2.7.1 Quantity Theory of Money

The quantity theory of money; often referred to as monetarism, through their hypothesis that shifts in the money supply schedule have been large relative to shifts in the money demand schedule. Their hypothesis possesses two distinct parts. The first is that large shifts in the money supply schedule have destabilized the behaviour of nominal and real income. Their empirical evidence for this part is twofold. They showed that turning points in the rate of growth of the money stock have preceded turning points in the business cycle. They also argue that shifts in the money supply schedule can often be attributed to specific historical circumstances rather than to contemporaneous changes in economic activity. The second part of their general hypothesis is that much of the observed variability in real money demand has resulted from prior actions of the monetary authority. Specifically, destabilizing shifts in the money supply schedule have produced destabilizing shifts in the money demand schedule. This empirical generalisation led Friedman (1959) to recommend moderate, stable money growth which determines the level of economic activities in an economy.

The quantity theory of money explains the useful framework of money in explaining the long-run behaviour of prices. The monetary authority can shift the money supply schedule independently of the money demand schedule so that it can control the long-run behavior of the price level. The magnitude of secular shifts in the money demand function is limited by real factors like growth in real income and payments technology. There is no such limitation on the behavior of the money supply. Over long periods of time, inflation has reflected the behaviour of the money supply. There is less consensus over Friedman and Schwartz's hypotheses about the monetary causes of the business cycle and the stability of money demand. The basic quantity theory assumed that the price level is a monetary phenomenon which does not require acceptance of these latter two hypotheses. However, interest rate targeting encourages the public to confuse the role of the monetary authority, which is to control the nominal quantity of money and the price level, with the role of commercial banks, which is to set a real rate of interest that rations available resources to investors (Hetzel, 1993).

This theory of money is relevant to this study because it explains the relationship between money supply and its impact on the economy. The theory explains the fact that changes in real money demand resulting from the actions of the monetary authority such as the Central Bank of Nigeria influences the national output level which destabilizes the money demand schedule. In this case, the supply of money affects the price of stocks in the capital market and hence, its changing growth nature.

2.7.2 Liquidity Preference Theory

This liquidity preference theory was propounded by Keynes (1936). The theory explains why people individually express demands for money; that is, the motives for money as liquid asset (Lewis & Mizen; 2000). In this theory, the demand for money is determined by interactions between income and interest rate that is, the price of demand. Thus, Keynesians argue that, to influence the demand for money, we should either control directly the price for money or indirectly by inducing changes through real income. It is theoretically ascertained that a change in interest rate, other things being equal, affects individual preferences for holding liquid (cash) and illiquid assets.

Keynesians recognize the importance of the role of money, because it is "first and foremost a financial asset" (Lewis & Mizen, 2000). Money does not affect only the absolute price and quantity of trade, but it affects also the level of financial intermediation, stock prices, and its' own price -interest rates- (Knoop, 2008). Although there is a clear recognition for active roles of money in the money market, Keynesians assume that money is exogenous. This is usually demonstrated with the two graphs that depict a downward money demand curve and a vertical money supply curve –the later represents the monetary policy instrument in the hand of monetary authority to manipulate it at its own wills. The Keynesian demand for money is divided into three components, although there should not be a sharp divide in the mind of the holder of money (Lewis & Mizen, 2000). These reasons are transaction motives; the precautionary motives, and the speculative motives.

This theory is important to this study because it explains the motive for which money is held by people. In this case, it shows the interaction between income and interest. Therefore, money does not affect only the absolute price and quantity of trade, but it affects also the level of financial intermediation, stock prices, and its' own price -interest rates. The theory's relevance of interest rate as the key determinant of real money demand cannot be overemphasized as it plays a significant role in the determination of security interest rate and the price levels of companies' stocks in the stock market.

2.7.3 Efficient Market Theory

The efficient market theory (Fama, 1976) establishes that securities prices in the stock market fully reflect all the available information. It is based on the assumption that information is freely available to all market participants at negligible costs and this information trickles in randomly, thus, prices are rightly priced always (where mispricing exists, arbitrage activities quickly adjust the price to the right level). The market players are also assumed to be rational and seek to maximize their returns; thus, the stock market allocates funds from surplus units to deficit units in an efficient and effective manner.

The efficient market theory provides a good explanation on the role of stock market, especially market capitalization, plays in promoting economic growth in a country. Since resources are efficiently allocated, wasteful use is minimized in the economy; where such efficient allocation and use of scarce resources occurs, economic growth is positively impacted. However, some proponent argued that stock market is prone to a number of inefficiencies in practice (information may not be freely available, investors might often behave irrationally) (Ross, Westerfield& Jordan;2013), these inefficiencies hamper efficient allocation of resources in the economy thereby adversely affecting economic growth.

The theory's relevance to the study lies in the efficient and effective allocation of stock market funds from surplus units to deficit units. The theory considers the rationality of investors which is a key component of investment that allows for information usage of the business and hence, profitability in Nigeria. In this case, complete information about market capitalization allows investors to invest their resources in the most profitable investment thereby minimizing the losses that may arises from inadequate information in Nigeria.

2.7.4 The Mckinnon-Shaw Hypothesis

McKinnon (1973) and Shaw (1973), in separate but identical works, developed a theory of finance in the context of developing countries within the neo-Classical framework. They advanced three major propositions regarding finance and long-term growth. First, financial deepening, through growing financial intermediation and monetization of the economy, aids economic development. Second, financial repression, whereby in many third world countries the governments hold the interest rates in the organized banking sector artificially low and provide subsidized credits either to favored sectors or to themselves, is inimical to long-term economic growth. This phenomenon is termed as 'financial repression' by McKinnon. Financial repression restrains domestic savings within LDCs and generates pressure for reliance on foreign capital to supplement domestic savings and to provide intermediation services capable of identifying high return investment opportunities.

McKinnon-Shaw propositions are based on the underlying classical assumptions that savings determine investment and that a full utilization of resources is always guaranteed, and hence subjected to severe criticism from the Keynesian economists. They also point out that higher interest rates following liberalization may not always increase aggregate savings. Later empirical studies also show that in many countries which have liberalized their credit markets and increased real interest rates, does not registered a systematic rise in aggregate savings as indicated in M-S propositions.

This theory is relevant to this study because it laid emphasis on the importance of interest rate and savings relationship which serves as major factors in the determination of investment for economic growth in an economy. In this case, interest rate determination by the Central Bank of Nigeria plays a vital role in the growth of the stock market. This affects the rate at which people mobilized their resources for investment purposes. In this case, complete information about stock market growth lies in the determination of interest rate by the monetary authority which allows deficit spenders and surplus spenders' interaction determine the growth path of the stock market in Nigeria.

2.7.5 Arbitrage Pricing Theory

The arbitrage pricing theory was developed by Ross (1976). The Centre-piece of the theory lies in stock prices and non-correlated factors. The theory stock price is determined by non-correlated factors such as macroeconomic variables. With the arbitrage theory, the expected return in an efficient market is a linear combination of each factor's beta cited in David & Leonard).

In effect, the risk associated with holding a particular security comes from the macroeconomic factors that affect all securities and the idiosyncratic elementopined that an efficient market is capable of rewarding the risks associated with the macroeconomic factors.

The arbitrage pricing theorisation upholds the fact that arbitrage profit opportunities are quickly eliminated through competitive forces. In effect, this means that an investor cannot earn a positive expected rate of return on any combination of assets without incurring some risks and without making some net investments (Husni, Walid, & Mohammad; 2010). Theoretically, it is expected that the variation in interest rate will impact negatively on stock market performance because an increase in interest rate prevents investors from making high risk stock market investments compare to low risk interest bearing. (Aydemir&Demirhan, 2009). The arbitrage pricing theory gives a characterization of expected returns on assets based on the assumptions that there are no arbitrage opportunities and it is such that returns follow a factor structure and there are homogenous expectations (David & Leonard, 2014).

Arbitrage theory is relevant to this study as it recognized the importance of uncorrelated factors in the determination of stock prices. Macroeconomic factors such as interest rate, exchange rate and inflation. Also, it relates the expected rate of return on a sequence of securities such as treasury bills, bonds and shares. Therefore, the returns which accrued to stocks are determined by investors risk taking ability. Thus, high risk investment attracts higher returns in the stock exchange market in Nigeria.

2.7.6 Modern Portfolio Theory

Modern portfolio theory (MPT) was developed by Markowitz (1952). The theory was based on the assumption that; investors are risk averse, rational, have access to the same information and returns are normally distributed. Modern portfolio theory is relevant to this study because it stressed the need for investors to consider the weighted returns of investment. It considered the cumulative returns gotten from investment based on the level of risk taken by the investors. This implied that, as investors expect returns on their investments, they looked as it from a holistic point of view instead of considering the expected return of each security in the stock market.

III. Conclusions

The theoretical analysis showed thatfinancial meltdown has significant and negative impact on the performance of the Nigerian capital market. It was found that a negative relationship existed between financial meltdown and capital market in Nigeria. This means that financial meltdown influences the nature and direction of capital market performance in Nigeria negatively. This indicates that in Nigeria, capital market adjusts negatively to financial meltdown. This implies that financial meltdown in Nigeria reduces the performance of capital market.

IV. Recommendations

It is pertinent to make viable suggestions as to proffer solutions to future happening with regards to financial meltdown as it affects the Nigerian capital market as follows.

1. The application of rate cuts by the Central Bank of Nigeria is essential in case of future occurrence. Central banks in England, China, Canada, Sweden, Switzerland and **the** European Central Bank (ECB) also resorted **to** rate cuts **to** aid **the** world economy. However, cut in ratesusually known as cuts rate as well as liquidity support had been found not to be sufficient enough **to** stop such a widespread financial meltdown.
2. Greater risk-taking operation among banks and the Securities and Exchange Commission (SEC) in October 2004 were capable of relaxing the net capital requirements for five investment banks—Goldman Sachs (NYSE: GS), Merrill Lynch (NYSE: MER), Lehman Brothers, Bear Stearns, and Morgan Stanley (NYSE: MS). This could also be applied to the Capital market in Nigeria.
3. Finally, it is pertinent to producea Budget –The idea is to spend money in a way that is expected to help in solving the problem.It is adjudged as one of the best weapons for combating **financial** problems is a budget. A budget is a monthly spending plan for your money. Creating a budget is like turning the lights on **to** find your way around a dark room.

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