



**MEASURING THE DIRECTION OF CAUSALITY BETWEEN FOREIGN
DIRECT INVESTMENT AND STOCK MARKET PERFORMANCE:
ECONOMETRIC EVIDENCE FROM NIGERIA**

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Abstract

The study wants to measure the direction of causality between Foreign Direct Investment and Stock Market Value in Nigeria, 1986-2016 using granger causality tests as the method of estimation. The analyses of result showed evidence in favour of bidirectional Relationship existing between Foreign Direct Investments and Stock Market Value in Nigeria. Similarly, estimates from the result provide evidence to show that Foreign Direct Investment had causality on stock market value and the stock market value returns the cause called effect to Foreign Direct Investment. Hence, there is no causality existing between Foreign Direct Investment and all share indexes in Nigeria. Also, there is no causality existing between Foreign Direct Investment and Total Market Capitalization in Nigeria but a unidirectional relationship existed between Stock Market Value and, The result points to the fact that the Foreign Direct Investment if well managed can propel the Stock Market Value in Nigeria which will in turns improve economic growth both in the short run and long run.

Keywords: Foreign Direct Investment, Stock Market Value, granger causality test, Bidirectional Relationship, Economy Growth.

1 Introduction

Mojekwu and Ogege (2012) Foreign Direct Investment is an investment that provides capital for investment, increases competition in the host country industries and encourages local industries to become more productive by adopting more efficient technologies or by investing in human and/or physical capital. Foreign Direct Investment (FDI) is an important component of international capital flows and this type of capital can be owned by an individual, a corporate body or a government.

Amos (2009) Nigerian Capital Market is a market that is responsible for mobilizing medium and long term funds for development purposes. The capital market consists of the Primary Market for new issues of securities and the Secondary Market for trading in existing securities. Capital Market helps to channel capital or long-term resources of FDI to firms with

relatively high and increasing productivity, thus, enhancing economic growth. The capital market is obviously crucial to any nation because it facilitates economic growth by mobilizing savings from numerous economic units such as governments, individuals and institutional investors for users. Foreign direct investment is increasing the global economy due to the additional resources they pooled for development in the host country (Mojekwu and Ogege, 2012).

FDI is future looking activity which is based on the expectations of investors for future returns and confidence to place these returns and these variables enhance the uncertainty and slow down the investment (Samran, Iqra, Brusha, & Marria, 2013). FDI has contributed rapidly to the economic growth of a country especially Nigeria. This is because it has a great impact in sourcing of resources across borders, accounting for a large share of net flows, especially from developed to developing countries and are becoming increasingly and relevant over time (Chiara, 2009). FDI can also serve as an engine of technological development with much of the benefits arising from positive spillover effects and such positive spillovers include transfers of production technology, skills, innovative capacity, organizational and managerial practices (Ajayi, 2006). Javed and Farooq (2009) stated that In developing economy like Nigeria, domestic investment has proven to be insufficient in giving the economy the required momentum to enable it meet its growth target due to the gap between their capital requirements and saving capacity (Muhammad & Ijirshar, 2015). He also stated that FDI is a manner from heaven and thus good for speedy economic development of developing countries in particular, opponents contend that, FDI leads to increased poverty, isolation and neglect of local capabilities. FDI accesses one of the modes of capital market and international activities. Mohammad et' al (2014) stated, Foreign direct investment is thought to be more useful to a country than investments in the equity of its companies because equity investments are potentially "hot money" which can leave at the first sign of trouble, whereas FDI is durable and generally useful whether things go well or badly. FDI depends upon non-economic factors such as macroeconomic variability, political instability which activity is based on the expectations of investors for future returns and confidence to place these returns (Samran, Iqra, Brusha & Marria, 2013).

FDI inflows have direct and indirect effects on economic growth and are the least volatile of capital flows (Sadik & Bolbol, 2001). Furthermore, foreign direct investment has attracted the attention of most governments. First is the desire to extend the market system because many developing countries are heavily indebted externally. The problem of external debt burden is

not solved by borrowing more but by attracting more private flows in the form of FDI. This enhances the market systems, secondly deals with the need to fill the capital market gaps (Mojekwu and Ogege, 2012). In order to be a relevant force in the global economy, Nigeria must devise a means of effectively and efficiently maximizing their numerous economic potential and improving their productive capacity without that, Nigeria economy will remain in the poor and low economic state (Uzoma, Aliemen and Okorie, 2016). The host countries benefits from capital from foreign investors since the increase on domestic savings supply especially in countries that are attracts foreign investors Feldstein (2009).

The capital market is pivotal to the level of growth and development of the economy. Chinweuba and Amos, (2011) noted that capital market is one of the major institutions that act in propelling a prostate economy for growth and development. This can be enhanced through foreign direct investment. Nyong, (2003), sees capital market as a complex institution imbued with inherent mechanism through which long term funds of the surplus sector any economy are mobilized, harnessed and make available to deficit sector of the economy. Osaze and Amos (2009) assert that capital market is the cornerstone of any financial system since it provides the funds needed for financing not only business but also government programmes while Ilaboya and Ibrahim, (2004) stress that capital market functions as an economic barometer for galvanizing economic activities. The stock market prices in nominal terms should fully reflect expected rate of some macroeconomic indicators and the relationship between these variables should be found positively correlated (Mondher, and Omar, 2013). The preposition that capital market returns serves as a hedge against macroeconomic variables, implies that investors are fully compensated for increases in nominal capital market returns and thus, the real returns remain unaffected. Thus, the real value of the stock market is immune to inflation and monetary policy pressures (Godwin, 2010). Globally, capital markets are established for the purpose of facilitating, regulating and controlling the business of buying and selling securities that have been listed for trading on the exchange (Eze, 2011). The stock market is also defined by Emekekwe (2014) as part of the financial market that provides facilities for transfer of medium and long term funds to various economic units. In all, the surplus saving economic units have access to capital market but not all the deficit economic units have the same easy access to it. The Nigeria capital market has grown to being capable of providing facilities both to the private and public sectors to raise long term capital used in executing development programmes as well as finance the expansion and modernization of projects which is one of the characteristics of FDI. However, how these

reforms have influenced economic growth over the years still remains unexplored by previous studies. Stimulating economic growth and development requires long term funding, far longer than the duration for which most savers are willing to commit their funds and this constitutes a barrier to economic growth. In this regard, the capital market provides an avenue for the mobilization and utilization of long-term funds for development and hence it is referred to as the long term end of the financial system. Over the past few decades, globally there has been an upsurge in capital market activity, and emerging markets have accounted for a large amount of this boom. This suggests the growing recognition of the capital market as a tool for fast-tracking economic progress in developing economies. However, critics have argued that the capital market might not perform efficiently in developing countries and that it may not be feasible for these countries to promote stock markets given the huge costs and the poor financial structures. In principle, capital markets are expected to accelerate economic growth by providing a boost to domestic savings and increasing the quantity and the quality of investment, provide individuals with additional financial instrument that may better meet their risk preferences and liquidity needs (Isenmila and Akinola, 2013). This study evaluates capital market and developing economies, challenges to capital market growth, the capital market in Nigeria, capital market and economic growth in Nigeria and policy directions for promoting capital market growth in developing countries.

Despite the popular assumption that capital market engenders economic growth and development, the growth of capital market in Nigeria is still very low in relation to the size of the economy. An analysis of equity market capitalization of the Nigerian capital market with some countries economic standing in Africa and Asia and Europe shows that the Nigerian capital market is relatively very small.

However, given this scenario, one begins to wonder if the Nigerian capital market has really fared well in terms of its impact on the growth of the Nigerian economy given the impact of selected capital market performance indicators. This makes foreign direct investment the best option in investing in Nigeria capital market. The broad objective of this study is to measure the cause and effect relationship between foreign direct investment and Stock market performance in Nigeria, 1981 – 2016

In carrying out this research Granger causality method will be used for the period of 1986-2016 to measure econometrically the cause and effect relationship between financial deepening and stock Market performance in Nigeria. The remainder of the work will contain a review of related literature that contains conceptual, theoretical and empirical review in the

second section, the third section will present the methodology applied, the empirical result will occupy the fourth section while the fifth will cover the conclusions.

11 REVIEW OF RELATED LITERATURE

Conceptual Review

Concept of foreign direct investment

Foreign direct investment is an investment in the form of a controlling ownership in a business enterprise in one country by an entity based in another country Zakari (2017). Foreign direct investment has been growing globally as double as the trade investment volume across the world (Meyer, 2003). The rapid growths of foreign direct investment inflows to the developing and developed countries demands an analysis of the impact or effect on economic output as the increase of foreign direct investment inflows makes huge impact or effect on local economic growth and their productivity due to their extra facilities by getting better technologies, manpower, human skills, conceptual skills and managerial skills. Foreign direct investment is generally considered to be an instrument of cash and non-cash inflow into the host countries from overseas.

Financial Market Performance

Nigerian Capital Market is a market that is responsible for mobilizing medium and long term funds for development purposes. The capital market consists of the Primary Market for new issues of securities and the Secondary Market for trading in existing securities. Capital Market helps to channel capital or long-term resources of FDI to firms with relatively high and increasing productivity, thus, enhancing economic growth. The capital market is obviously crucial to any nation because it facilitates economic growth by mobilizing savings from numerous economic units such as governments, individuals and institutional investors for users. Foreign direct investment is increasing the global economy due to the additional resources they pooled for development in the host country (Mojekwu and Ogege, 2012).

Theoretical Framework: Classical theory: The classical theory of FDI was propounded by Lensink and Morrissey in 2001. Classical theory view that foreign direct investment plays important role in economic growth of the host countries (Lensink & Morrissey, 2001, and Gorg & Strobl, 2002, Nabila, Samia, & Hafeez, 2011) (Oyatoye, (2011). According to the theory, foreign direct investment through positive spillover, competition and imitation enhance the transfer of capital, technology and skills to the host countries (Mody, 2004); and (Gao, 2005). Also, through backward and forward linkage foreign direct investment will lead to improved balance of payments, boost the gross national income, enhance improvement in

infrastructure and increases the production for export as well as capital market performance. (Gorg et, 2001), (Girma, 2003), Li & Liu, (2005), Chakraborty & Nunnenkamp, 2008, and Obida & Nurudeem, (2010).

Empirical Review: Nabila, Samia, and Hafeez (2011) examine the impact of foreign direct investment on economic output of selected Asian countries, 1980-2009. Using Fully Modified OLS. Results reveal that foreign direct investment and economic growth are co-integrated. Foreign direct investment has positive significant impact on economic growth.

Osuji and Ebiringa (2012) examined the long run relationship between some selected macroeconomic variables and EXTR management factors in Nigeria. The result of their vector auto regression (VAR) model indicated that exchange (EXTR) is significant in the current year but tends to converge in the previous years. On the other hand, the value of the joint significance indicates that the current values of gross domestic product (GDP), capital goods (CPG), non-CPG and EXCR are most influencing factors that determine the current values of EXTR.

Uwazie, Igwemma, and Nnabu, (2015) examined the impact foreign direct investment to economic growth of Nigeria, 1970 to 2013. Using vector error correction model method .Results reveals that foreign direct investment and economic growth reinforce each other in the short run in Nigeria. Based on these findings, the study advocated the adoption of aggressive policy reforms to boost investors' confidence and promotion of qualitative human capital development to lure foreign direct investment into the country Nigeria.

Miankhel, Thangavelu, and Kalirajan. (2009) investigated examine the relationship between export, foreign direct investment and GDP for six emerging countries of China, India, Mexico, Malaysia, Pakistan and Thailand over the period of 1970-2005 using vector error correction mechanism (VECM) Result suggests that export drives the economic growth of Pakistan and foreign direct investment drives the economic growth of India. On the other hand, they find a short run relationship for Mexico and Chile but export affects foreign direct investment growth among Latin American countries in the long run.

Sridharan and Khadaroo. (2009), on the other hand, examined the impact of foreign direct investment and economic growth of the developing countries from 1985-2007 based on the Johannes co-integration test and vector error correction model (VECM). They found co-integration relationship among the selected countries. However, the result, based on vector correction mechanism, suggested there were positive impact between foreign direct

investment and GDP for Brazil, Russia and South Africa and negative impact between foreign direct investment economic growth for India and China.

Duong, (2015) examined on the inter-relationship among foreign direct investment domestic investment and export in Vietnam. for the period 1985–2014 using Johansen co-integration approach .Result reveals that there was a long run relationship existing between domestic investment growth and export growth directionally caused FDI inflows growth .This study could not provide any further evidence concerning causal relationships running from exchange rate depreciation to export growth and foreign direct investment growth in the case of Vietnam.

Osigwe, and Uzonwanne (2015) examined causal relationship among foreign reserves, exchange rate and foreign direct investment, evidence from Nigeria. This study was scrutinized the Granger causality of foreign reserves, exchange rate (EXR) and foreign direct investment (FDI) in Nigeria. The Johansen co-integration test revealed long-run relationship among the variables. The results of the Granger causality test indicated unidirectional causality from EXR to foreign reserves. Consistently from lag one to lag two; unidirectional causality existed from FDI to foreign reserves. At lag three, bidirectional causality was discovered between foreign reserves and FDI.

Emmanuel, (2016) examined the effect of foreign direct investment on economic growth in Nigeria. The study covered the period 1981 to 2015 using OLS. The results showed that foreign direct investment has a positive and significant effect on gross domestic product. It was also found that exchange rate has a positive but not significant effect on gross domestic product.

Okoro, and Atan (2014) investigated on the impact of foreign direct investment on economic growth 1981-2013 using ordinary least square technique (OLS). Result reveals that there was a long run relationship existing between domestic investment growth and export growth directionally caused FDI inflows growth

Adegbemi (2012) studied foreign direct investment as it relate to GDP growth in Nigeria for the period 1970-2010 with the help of a three-stage least square (3SLS). The result opines that foreign direct investment leads to growth but varies across sectors.

Olawoye, (2011) further used the multiple regression analysis to test whether the capital market performance indicators impacted on the economic growth of Nigeria proxy by Gross Domestic Product (GDP) and discovered that the Capital Market and Economic Growth have

strong significant impact and that the total listing of equity and government stock are spent on productive sector which enhance economic growth.

Fase & Abma, (2003) investigate the association between financial development and economic growth for more developing countries in Asia using data of varying lengths and error correction framework. Their result shows that financial development matters for economic growth and that causality runs from the level of financial intermediation and sophistication to economic growth.

Abu (2009) examined the effect of stock market development on economic growth in Nigeria using vector error correction method. The study finds that stock market development promotes economic growth in the long run.

Owusu and Odhiambo (2014) employed the ARDL bounds testing approach and multi-dimensional stock market development proxies to examine the relationship between stock market development and sustainable economic growth in Ghana, They find that stock market have no positive effect on economic growth both in the short and long run. However, the study concludes that an increase in credit to the private sector, rather than stock market development is the driver of the real sector economic growth in Ghana.

Onyekachi and Odi (2013) examined the impact of capital market reform on the growth of Nigerian economy. The scope of the study spanned from 1990-2011. The Johansen Co-integration technique also applied Vector Error Correction Model (VECM) to determine the short-run relationship between capital market reform and economic growth in Nigeria. The result of the analyses shows that capital market reform significantly influences the rate of economic growth in Nigeria. The study also found that long-run relationship exists between capital market reform and economic growth in Nigeria.

Oluwatosin (2013) examined the impact of Nigerian capital market on economic growth and development from 1999-2012 using Ordinary Least Square method of regression, The result shows that capital market indices have not significantly impacted on the GDP. It was concluded that capital market in Nigeria has the potential of growth inducing but has not contributed significantly to the economic growth of Nigeria because of low market capitalization, low absorptive capitalization, illiquidity and misappropriation of funds among others.

111 METHODOLOGY

This study adopts the *ex-post-facto* research design, complemented as well as the analytical research designs. The *ex-post-facto* research design is described as *After-the-fact research*

(Akuezilo, 1993; Heppner, 2008 and Onwumere, 2009). This is suitable for the work given that it is based on an already completed event and the researcher is meant to analyse the outcomes and draw reasonable conclusions. The data to be employed for this work are time series, secondary and purely quantitative. They are drawn from sources such as The Statistical Bulletins of Central Bank of Nigeria.

Model specification

The variables under study are fitted into the Granger causality equation to produce an aggregated model thus: $FDI = \beta_0 + \beta_1TMC_t + \beta_2NASI_t + \beta_3SMV_t + \varepsilon_t$

Where: FDI = Foreign Direct Investment, TMC = Total market Capitalization

ASI = All share Index, SMV = Stock Market Value, ε = Error Term

IV Data Presentation

The proxies for the variables under study are drawn from different sources and arranged in a manner good enough for empirical analysis. Presented below is the data set in growth series.

Table 1. Foreign Direct Investment and Capital Market Performance in Nigeria, 1985-2016.

YR	LNFDI	LNTMC	LNASI	LNSMV
1985	20.00086	1.8870696	4.8465465	5.75763914
1986	19.07931	1.9169226	5.0986461	6.16940150
1987	20.22987	2.1041323	5.2517497	6.74558929
1988	19.75217	2.3025850	5.4536100	6.41395063
1989	21.3568	2.5494451	5.7847478	5.41787660
1990	20.19204	2.7911650	6.2418340	5.48935086
1991	20.38411	3.1398326	6.6631326	6.19786877
1992	20.61417	3.4404180	7.0099507	6.69009667
1993	21.01993	3.8607290	7.3420021	6.89355492
1994	21.39581	4.1941898	7.6984827	7.51686846
1995	20.79955	5.1951766	8.5354650	8.85074688
1996	21.18917	5.6552922	8.8525362	9.24285596
1997	21.15469	5.6415523	8.7703610	9.51569781
1998	20.77332	5.5706319	8.6434204	9.55194228
1999	20.72817	5.7037824	8.5691022	10.24541278
2000	20.85441	6.1576143	9.0009764	10.96273165
2001	20.89775	6.4960205	9.3022903	10.99216229
2002	21.35136	6.6397451	9.4040715	11.69859147
2003	21.4191	7.2147251	9.9099138	12.32749350
2004	21.35136	7.6556273	10.079308	12.47966517
2005	22.3292	7.9725004	10.089377	13.06102697
2006	22.30315	8.5410854	10.409982	13.88877997
2007	22.52084	9.4865847	10.968029	14.33379451
2008	22.82699	9.1657195	10.356179	13.43822072
2009	22.86976	8.8580557	9.9440136	13.59225575
2010	22.51939	9.2021267	10.1174095	13.36754345
2011	22.90268	9.2374982	9.93936750	13.60344467
2012	22.67912	9.6028485	10.2427704	14.67029845
2013	22.43938	9.8872260	10.6293243	14.10427936
2014	22.26139	9.7334996	10.4532570	13.77596015
2015	21.86385	9.7411686	10.2626381	13.89516980
2016	22.21588	9.5925641	10.2989494	14.01350818

Sources: CBN Statistical Bulletin (2016)

Where: FDI= Foreign Direct Investment. TMC= Total Market Capitalization.

ASI= All share index. SMV=Stock market values

Table 1 contains Foreign Direct Investment selected capital market Performance indicators such as Total Market Capitalization, All share index, Stock market values collected from the central bank of Nigeria statistical bulletin covering the period of 1985-2016. The data is a set of log transform annualized time series required for empirical analysis as adopted from the model which was specified in chapter three. Hence, the variables were log transformed for linearity.

Data Description and Analysis

Stationary Tests using Philip and Peron

In an attempt to confirm the order of integration of the series under study thereby confirming their suitability for a linear combination in the form of a model, the unit root test following the form specified as Philip and Peron Test is used. Table 4.2 below presents a summary of the unit root result that is stationary.

Summary of Unit Roots Test Results

Variable	PP Statistic	Critical Values @ 5%	Probability Value	Inference
LNFDI	-6.3322	-3.5485	0.0000	I(1)
LNTMC	-4.5526	-3.5485	0.0048	I(1)
LNASI	-6.9268	-3.6121	0.0000	I(1)
LNSMV	-3.8754	-3.5443	0.0240	I(1)

Source: Extract from Appendix One e-view 10.

From the result of the unit root test contained in table above foreign direct Investment, Total market capitalization, all share indexes are all integrated of order 1(1). On the other hand, Stock Market value is also integrated at 1(1) and also integrated of order 1(1).

Basic Descriptive Statistics/ Standard tests for Normality

The statistical properties of the data sets are seen as vital determinants of their behaviors when used in econometric analyses. On the basis of this, the researcher presented in this section, the basic descriptive statistics called Normality test of the variables under study.

Basic Descriptive Statistics/ Standard tests for Normality:

	FDI	LNTMC	LNASI	LNSMV
Mean	21.38361	6.285548	8.630295	10.46574
Median	21.35136	6.326817	9.151633	10.97745
Maximum	22.90268	9.887226	10.96803	14.67030
Minimum	19.07931	1.887070	4.846547	5.417877
Std. Dev.	1.008363	2.788374	1.891290	3.247940
Skewness	-0.187743	-0.202460	-0.739577	-0.263870
Kurtosis	2.230248	1.628364	2.177151	1.503042
Jarque-Bera Probability	0.978010	2.727130	3.819969	3.359191
	0.613236	0.255747	0.148083	0.186449
Sum	684.2756	201.1375	276.1695	334.9038
Sum Sq. Dev.	31.52070	241.0259	110.8863	327.0225
Observations	32	32	32	32

Source: Author's Computation e-view 10

Table above contains the basic measures of central tendency, spread and variations calculated on the level series of the dataset. Of particular interest is the Jacque-Bera (JB) statistics which is a test for normality. It is a combined test of skewness (S) of zero (0) and a kurtosis (K) of three (3), which are signs of a mesokurtic distribution. In this case, however, the JB statistics shows that the variables are positively and negatively skewed and are leptokurtic.

Granger Causality Estimation Results

Pairwise Granger Causality Tests

Date: 05/11/18 Time: 10:18

Sample: 1985 2016

Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
LNFDI does not Granger Cause LNSMV	30	3.47111	0.0467
LNSMV does not Granger Cause LNFDI		5.09719	0.0139
LNASI does not Granger Cause LNFDI	30	0.70553	0.5034
LNFDI does not Granger Cause LNASI		0.45821	0.6376
LNSMV does not Granger Cause LNFDI	30	2.11558	0.1416
LNFDI does not Granger Cause LNSMV		0.24414	0.7852
LNASI does not Granger Cause LNTMC	30	0.76812	0.4745
LNTMC does not Granger Cause LNASI		0.39344	0.6788
LNSMV does not Granger Cause LNTMC	30	4.52136	0.0211
LNTMC does not Granger Cause LNSMV		1.96893	0.1607
LNSMV does not Granger Cause LNASI	30	3.47111	0.0412
LNASI does not Granger Cause LNSMV		5.09719	0.0112

Source: Author's Computation e-view 10

From the result presented above, from the first coach of the table, bidirectional causality is found between Foreign Direct investment and Stock Market Value in Nigeria. This bidirectional causality emanates from LNFDI to LNSMV with a feedback. This is evidenced given that the first couch is significant $0.0467 < 0.05$ while the second is also significant $0.0139 < 0.05$. Hence, there is a cause and that cause results to an effect which has a feedback thereby showing that Foreign Direct investment has a causal relationship with Stock Market Performance in Nigeria. The causal relationship has a feedback Mechanism

V Conclusion

This study investigated the Impact of foreign Direct Investment on Stock Market performance of Nigeria between the periods 1986 to 2016. The economic motivation of the study is anchored on the desire to find out the extent to which Impact of foreign Direct Investment affected Capital Market performance of Nigeria between the periods 1981 to 2016. A review

of empirical and theoretical basis for the work was done. The research methodology concentrated on the use of the Granger Causality method. The analysis of the test reveals that Foreign Direct investment causes Stock Market Value in Nigeria with a feedback.

Based on findings, the study concludes that foreign Direct Investment and Stock Market performance of Nigeria between the periods 1981 to 2016 have a bi directional relationship. It should be noted that this study can be employed for the purposes of generalization and can be expanded to capture other economic sphere with distinctive peculiarities.

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