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Impact of Capital Market Performance on Economic Growth in Developing Nations: A Qualitative Approach

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Abstract

The recapitalisation of Nigerian banks improved capital market performance and economic growth. However, economic recessions led to a decline in capital market activities and economic growth. Therefore, this study assessed the influence of capital market performance on economic growth in developing countries for the period 2012 to 2022 using empirical evidence. The specific objective of the study was to examine the impact of market capitalisation on the real gross domestic product (GDP) in developing nations. Related and relevant literature was reviewed for the conceptual, theoretical, and empirical framework for the study. The study employed a qualitative approach using descriptive synthesis to evaluate the results of the impact of capital market performance on economic growth in developing countries using empirical evidence from 2012 to 2022. The analysis revealed that 30% of empirical results from the capital market and economic growth studies in developing nations are not consistent with the apriori expectation. The study concludes that using different variables and approaches for time series analysis produces inconsistent results in developing countries. The study recommended encouraging the financing of companies through domestic capital formation in both capital and money markets. There is also a need for harmonising the approach for consistency of findings in capital market research.

Keywords

Capital Market Performance, Market Capitalisation, Economic Growth, Real GDP

1. Introduction

The Capital market is a place where equity capital and long-term development capital for infrastructure such as roads, utilities, housing, energy & telecommunication, are being provided for economic benefits; these projects are financed through Bonds and asset-backed securities for long-term sustainable growth and development (Onuoha et al., 2021). The capital market has a positive influence on economic and financial systems development providing many advantages; hence, the development of the capital market remains a priority to a country's economy and financial system (Sprčić & Wilson, 2007; Imade, 2021).

The successful recapitalisation of Nigerian Banks in 2005 by the Central Bank of Nigeria is an event regarded by many investors to have improved the performance of the Nigerian Stock Exchange due to high listings, transactions, and influx of foreign investments that have increased economic growth (Onuoha et al., 2021). The 2008 global financial crisis emanated from the United States, and it had an impact on different capital markets globally; the performance of the Nigerian capital market was affected due to the crash that led to a loss of capital assets and investments due to the global meltdown (Njiforti, 2015). The recent financial crisis caused an impact on the financial system and the need to investigate the trend (Arumona et al., 2020). Many studies conducted in developing countries, concerning finance, and growth had shown inconsistent results due to unresolved issues within this area of interest (Abubakar & Kassim, 2021).

The main objective of the study was to investigate the impact of capital market performance on economic growth from previous studies and empirical findings from the years 2012 to 2022. The specific objective was to examine the impact of market capitalisation on the real gross domestic product (GDP). Consequently, based on the proxies selected the research question to what extent does market capitalisation influence real GDP in developing economies? The rest of the study is arranged using the following structure; the literature review concerned with the review of the independent and dependent variable, the methodological approach selected for the study, results, and discussion of findings, conclusion, and recommendations.

2. Literature Review

Capital market performance is the assessment of a market that has been efficient through primary features like constant liquidity or a simple process for going into and leaving the exchange by investors (Onuoha et al., 2021). The basic tools that are used to explain capital market performance are market capitalisation, the volume of transactions, market size, liquidity, total value traded ratio, turnover ratio, and all share index (Onuoha et al., 2021). Market capitalisation is the entire worth of all stocks registered on the stock exchange, and arrived at by multiplication of company shares by the current market price of each share. It therefore, shows the market value and eventually market size (CBN, 2016; Ibrahim & Mohammed, 2020).

Economic growth deals with economic expansion within an economic cycle and is usually characterised by an increase in the manufacture of commodities and services for the nation therefore it is measured with the gross domestic product (GDP) i.e. Nominal GDP or Real GDP. Nominal GDP is the normal unadjusted or current prices GDP while real GDP has been adjusted for inflation (CBN, 2016; Bello et al., 2019). Economic growth is a measured improvement in real Gross Domestic Product (GDP) and many factors that can affect economic growth are investment ratio, human capital, research, and development (Reza et al., 2018).

GDP denotes the cumulative worth of commodities and services created within a time frame and is a determinant for the size of an economy, as mentioned earlier it can be shown as nominal GDP or real GDP i.e. constant price or inflation corrected (CBN, 2016; Grbić, 2020). The recent trends in globalisation have led to issues concerning economic sustainability rather than production and wealth distribution (Van Niekerk, 2020). Many developing economies have made reforms to expand their markets because economic sustainability is linked to investments that exist in capital markets; hence, any sustainable economy that shows economic growth requires a functional capital market (Levine & Zervos, 1998). The conceptualisation of these variables is presented in **Figure 1**.

The capital market is a financial marketplace that is very specialised and is an important means for economic growth due to its ability to facilitate and provide or raise savings and investments from economic agents for sustainable economic growth (Vincent et al., 2021). The capital market as a means of financial development usually makes an enormous contribution to economic growth. This economic sustainability is maintained by Securities and Exchange Commission (SEC) in Nigeria which was established in 1978 and has created many initiatives to advance the capital market for long term financing for the promotion of economic growth. This implies that capital market performance is serious for economic advancement in developing countries at the domestic and international levels.

The theoretical framework underpinning the study is the endogenous growth theory, a model advanced by Romer (1986) and Rebelo (1991), the theory stipulates that continuous growth can be achieved endogenously (Ibrahim & Mohammed, 2020). The theory came into being due to the critique of neoclassical growth theories like the lack of consideration for technology in the growth
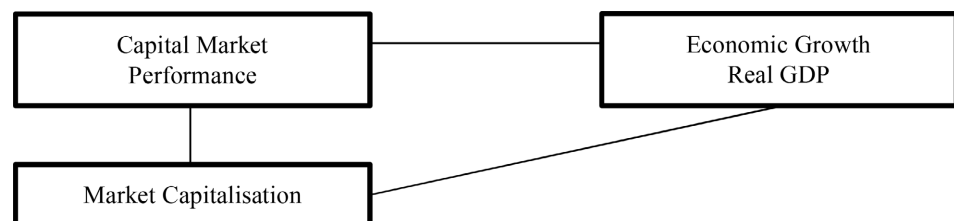
Source: Authors compilation (2022).

Figure 1. Conceptual framework is showing variables.

model (McCallum, 1996). Endogenous growth theory considers the roles played by the government and financial system with factors of production like capital, labour and entrepreneurs (Ibrahim & Mohammed, 2020). The model also considers the performance of economic growth concerning the circulation of income, investments, and technology (Odo et al., 2017). The key assumption of the theory is the concept of continuous growth without diminishing return on factors of production (Sredojević et al., 2016). A critique of this model is its dependence on assumptions that may not be suitable for developing countries (Onyimadu, 2015). The endogenous growth model was used in the studies of Lenee and Oki (2017), Odo et al. (2017), and Ibrahim and Mohammed (2020). This theory was selected to underpin this study because investment activities e.g. capital market investments should promote economic growth.

Algaeed (2021) focused on analysing and testing the effects of capital market development on per capita GDP growth in the Saudi Arabian economy using time series data on a twelve-monthly basis from 1985 to 2018. Economic development was represented by Per capita GDP however, the capital market was measured with the share price index, capitalisation, liquidity, number of share transactions and number of shares; the variables were analysed using Autoregressive Distributed Lag (ARDL), FMOLS and Johansen tests. Results showed market capitalisation and liquidity were negative; however, the share price index, the total number of shares traded, and volume of transactions had positive signs as expected apriori. The study used yearly time series collated data for quantitative analysis and real GDP was not used to measure economic growth.

Imade (2021) in his study titled "capital market performance and economic growth in Nigeria and the United States of America" from 1990 to 2017; investigated the link between the two variables using the cointegration econometric method and the error correction model for data analysis. Results revealed that only gross fixed capital formation had a considerable impact on economic progress in Nigeria in both the short-run and long run. It was recommended that government should regulate the activities of the capital market and its operators. This study used time series data collected annually for quantitative analysis and did not have the minimum of 30 observations required for time series analysis.

Tan and Shafi (2021) in another study explored the effects of the capital market on economic growth in Malaysia using quarterly data from quarter one of 1998 to quarter four of 2018. Economic growth was measured with per capita real GDP while the independent variable was measured with the following proxies of Sukuk conventional bonds, Stock market capitalisation, Total stock market turnover, real savings and growth rate of employment. The Autoregressive distributed lag cointegration bounds test was used for analysis and the results revealed the prevalence of a long-run equilibrium relationship between capital market variables and economic growth. The approach for the study was quantitative using quarterly time-series data.

The studies reviewed have shown that similar studies have been carried out in

different locations concerning capital market performance on economic growth, but different time range, time series data, and methods of analysis were used. Therefore, it becomes necessary to conduct further analysis on recently published articles from 2012-2022 to assess if the trend is consistent. The selected time frame will contain the most recent studies (i.e. three years) in the area of interest.

3. Methodology

The research methodology adopted for this study was the qualitative approach, recently published and high-quality journal articles from reputable databases were preferred for the study. An open search was conducted using the Google Scholar database which met a selection criterion of the population of capital market studies from developing countries, the concepts of capital market performance and economic growth within the context of economic development or sustainability from a public sector perspective. The advanced search of google scholar with keywords "capital market performance and economic growth" plus "market capitalization and real GDP" were used for anywhere in the article or in title of article search criteria with dates from 2012 to 2022. Then thirty relevant articles from developing countries were purposefully selected for the analysis.

A thematic analysis of empirical pieces of evidence was used to extract empirical results from previous studies. Findings were from a descriptive synthesis of heterogenous results from previous studies concerning the area of interest. Trustworthiness and rigour were maintained during the study by using verification strategies that led to generalisations made in the study. Finally, the findings were related to existing theories; hence, the theoretical significance of the study.

4. Results and Discussions

This section presents an empirical appraisal of articles that studied the influence of capital market performance on economic growth. The empirical pieces of evidence were explained using groupings based on the findings of the various studies. The groups are based on studies that confirm a positive relationship, negative relationship, and a mixed relationship between the variables using proxies of market capitalisation and real GDP for the independent and dependent variables. Tables 1-3 present the results of studies with a positive, negative and mixed relationship.

Tables 1-3 have shown how the same studies using the same variables of study could generate inconsistent results due to variation in analytical methods, and time-series data collection especially in the case of Malaysia and Nigeria where studies conducted within the same period have conflicting results of both positive and negative relationship.

The previous and current practice of having many studies using different independent, control, dependent variables, and various approaches for time series data collection and analysis that utilises varying time frames produces inconsistent

Table 1. Studies with a positive relationship.

S/N	Location	Variables	Positive
1	20 Developing countries	Market capitalisation on real GDP	Abubakar and Kassim (2021)
2	Nigeria	Market capitalisation on real GDP	Akintola and Cole (2020), Arumona et al. (2020), Efanga et al. (2020), Ibrahim and Mohammed (2020), Idris (2020), Owen (2020), Ubesie et al. (2020), Erasmus et al. (2021), Imade (2021), Okafor et al. (2021), Mamudu & Gayovwi (2020), Ananwude and Osakwe (2017), Taiwo et al. (2016), Nwaolisa et al. (2013)
3	Zimbabwe	Market capitalisation on GDP	Mawanza et al. (2020)
4	Serbia	Market capitalisation on real GDP	Grbić (2020)
5	Malaysia	Market capitalisation on real GDP	Tan and Shafi (2021)
6	Pakistan	Market capitalisation on real GDP	Sharif and Afsan (2016)
7	Nepal	Market capitalisation on real GDP	Bist (2017)
8	Kenya	Market capitalisation on real GDP	Nzomoi and Ikikii (2013)

Source: Authors compilation (2022).

Table 2. Studies with a negative relationship.

S/N	Location	Variables	Negative
1	India	Market capitalisation on real GDP	Lakshmanasamy (2021)
2	Saudi Arabia	Market capitalisation on real GDP	Algaeed (2021)
3	Kuwait	Market capitalisation on real GDP	Al-Kandari et al. (2020)
4	Malaysia	Market capitalisation on real GDP	Derk (2020)
5	Nigeria	Market capitalisation on real GDP	Adesina-Uthman (2020), Agu Bertram (2018), Alajekwu and Achugbu (2012)

Source: Authors compilation (2022).

Table 3. Studies with a mixed relationship.

S/N	Location	Variables	Mixed
1	Ghana	Market capitalisation on real GDP	Ogbuji et al. (2020)
2	Sudan	Market capitalisation on real GDP	Elhassan and Braima (2020)

Source: Authors compilation (2022).

results. Consequently, 30% of empirical evidence on the role of market capitalization and its impact on real GDP is inconclusive. These findings are in line with the gaps identified by Abubakar and Kassim (2021), especially in developing countries. Therefore, there is a need for harmonisation of variables, methodology, methods, data collection techniques and analysis to produce consistent results. The results are generalisable due to the number of articles selected, verification strategies adopted and the endogenous growth theory used to underpin the study with apriori expectation that market capitalisation should improve real

GDP in developing economies.

5. Conclusion

The major aim of this analysis is to study the influence of capital market performance on economic development from previous studies using empirical pieces of evidence from the year 2012 to 2022. The specific objective is to what extent market capitalisation influences real GDP in developing economies. The descriptive synthesis of empirical pieces of evidence shows the current practice of having many studies using different variables and approach for time series analysis produces inconsistent results of up to 30% in developing countries.

The limitation of this study was the inability to consider empirical evidence from research carried out in the past decade since more recent studies are showing heterogeneous results. Another limitation is the inadequacy of high-quality research articles from the area of interest which led to the use of available articles on the topic. However, this provides an avenue for making wider dissemination of findings from this study. It also provides an opportunity for future studies that should compare findings from developing and developed nations for more insights.

Developing nations are struggling to achieve rapid economic growth and development but the continuous boom and burst in the economic cycle of developing countries are making this target difficult to attain. Therefore, there is a need for continuous monitoring and the evaluation of financial system activities in developing countries, specifically capital market performance.

The study recommends that capital market research on how it influences economic growth should adopt a methodology where the same variables are used consistently to promote the availability of homogenous results for better analysis, forecasts, and policies. The implementation of this can be achieved by allowing researchers to adopt and adapt data from previous studies, but data should be updated without altering the variables, methodology, or type of time series data collected (i.e. daily, monthly, quarterly, or annually). However, the methods of analysis should also be maintained for consistency. Therefore, future studies can follow these steps for conducting research as this will enable comparison of findings across geographic locations, while trends and patterns can now be observed.

The capital market should provide complementary services to the money market for financing activities in developing countries, financial institutions should not compete with the capital market to achieve the needed accelerated economic growth and improvement in developing nations. This can be implemented by ensuring the capital and money market segments of the economy are developed together.

Conflicts of Interest

The authors declare no conflicts of interest regarding the publication of this paper.

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