

## The Crash of Nigerian Capital Market: Explanations Beyond the Global Meltdown

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**Abstract:** The global economic meltdown which started like a child's play late 2007 has done no small damage to the economies of the world. Worst hit in Nigeria are government revenue profile, the financial sector, manufacturing sector and the capital market. The Nigerian capital market lost nothing <60% of its capitalisation. The major stakeholders on the market have hewed all blames on the global financial crises. Whereas, there were inherent problems ravaging the market behind the curtain which would have busted sooner or latter, the global financial crisis only acted as catalyst. The main thrust of this study is to find explanations for the crash outside the global crisis. It is discovered that there was inherent risk in the market induced by lack of discipline, unethical practices, lopsidedness in capitalisation and weak supervisory role. The study did a comparison of the fluctuations in capitalisation and all shares index of the Johannesburg stock exchange and Nigeria stock exchange over 2001-2009 and discovered that is higher level of risk on the Nigerian capital market. Recommendations aimed at curtailing future plunge in the market include discipline, enforcement of ethical practices and diversification to the alternative market.

**Key words:** Capitalisation, all shares index, unethical behaviour, capital market, fluctuations, global meltdown, risk

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### INTRODUCTION

The importance of the capital market to any economy (developed or emerging) cannot be overemphasised. It has been discovered that there is a direct linkage between the capital market of a nation and its economic growth (Olowookere and Osunubi, 2007; Kalu, 2009; Nwachukwu, 2009).

Among other linkages discovered are Foreign Direct Investment (FDI) generation, stability of capital market indicates stability in the economy, sources of finance for economic development (public and private), investment avenue for surplus fund and so forth.

In Nigeria, the capital market, before the recent crash happened to be one of the most profitable investment havens in the economy (George, 2008).

It accumulated about ₦12.6 trillion (about \$84 billion) around first quarter of 2008. Public and private sectors trooped to the market to raise fund. The global economic meltdown and other peculiarities have seen the capitalisation eroded to about ₦5.4 trillion (\$36 billion) in the fourth quarter of 2009 (Ahuko, 2008). The crash saw the all share index cascading from 31,450.78-23,206.23 points for the same period.

This crash has led to the opening of can of worms and black boxes. Eight banks chief executive officers and their executive directors lost their jobs. Margin loans of over ₦1 trillion in Nigeria banks have been

discovered. Banks have been making dumb-founding provisions for non-performing loans of over 2.1 billion (Omoh and Egwuatu, 2009; Imoyo, 2009). The negative complexion of the global economic downturn and other intrinsic factors on the capital market and the attendant effect on banks and other market players were minimizable if there had been discipline, ethical practices and diversification of the market.

### MATERIALS AND METHODS

**The Nigerian Stock Exchange (NSE): A synopsis:** The Nigeria Stock Exchange came into existence in 1960 under the nomenclature of Lagos Stock Exchange and came to be known as the Nigerian Stock Exchange (NSE) in December, 1977. It began operations in 1961 with 19 securities listed for trading (George, 2008). The NSE has the following braches in major cities of the country Kaduna, Port Harcourt, Kano, Onitsha, Ibadan, Abuja and Yola opened in 1978, 1980, 1989, 1990, 1990, 1999 and 2002, respectively.

It has 280 securities made up of 33 government stocks, 5 state government bonds 33 industrial loans (debenture/preference) stocks and 209 equities of companies. The exchange has 23 mutual funds on its memorandum quotation; about 3 million individual investors, hundreds of corporate investors, 20 dealing members and 27 registrars (George, 2008; Mbedi, 2008).

**Questionable growth and inundating crash in capitalisation and all share index of the Nigeria stock exchange:**

The type of growth that the Nigerian capital market has undergone between 2003 and late 2007 has called for so many questions which are not yet answered by concerned authorities. The capitalisation growth has been christened questionable, artificial, cosmetic, unrealistic, unsustainable and the like (Onuoha, 2009; Uwah, 2009; George, 2008). On the other hand, as was the growth was the crash. Quite a free fall indeed. To be able to analyse and question the level of fluctuations in the capitalisation and all shares index, let us consider along the changes in the Johannesburg Stock Exchange (JSE) within the same period. JSE is the largest and oldest stock exchange on the continent and ranks among the top twenty in the world.

Looking at the fluctuations in the market indicators of NSE between 2001 and 2009 as shown in Table 1, the capitalisation grew by 230% and all share Index by 75% between 2006 and 2007. Between 2007 and 2008, there were 36 and 46% crashes in capitalisation and all shares Index, respectively (Fig. 1). Whereas between 2008 and October 2009, the market fell by 21 and 28% in capitalisation and all share Index respectively. Meaning, a cumulative crash of 57% (36+21) in capitalisation and 74% (46+28) fall in all shares Index in <2 years.

In 2006-2007, there were 17 and 16% growth in capitalisation and all share Index of JSE, respectively. Between 2007 and 2008, JSE recorded 29 and 26% falls in capitalisation and all share Index, respectively. Between 2008 and October 2009, the JSE capitalisation grows by 17% and all share Index by 16%.

There have been questions agitating minds about the sudden turn of events in both positive and negative sides on the NSE. Why is the growth drastic and revolutionary and not evolutionary or gradual? Why is the crash so sharp and has become difficult for the market to rebound along with other market around the world? Figure 1 shows the fear that the pattern of fluctuations in capitalisation of the NSE is not predictable in both the long and short runs.

The answers to the questions earlier posed could be viewed from two perspectives namely: the insiders (which tries to be protective and biased) and the outsiders explanation (which tends to be objective and constructive).

**The insiders:** The insiders include the stock brokers, registrars and the stock exchange management. In the recent past they have provided the following defence for

Table 1: Capitalisation and all share Index of the Nigeria Stock Exchange (NSE) and the Johannesburg Stock Exchange (JSE) for 2001-2009

Years	Capitalisation		All share index (point)	
	NSE (₦)	JSE (Rand)	NSE	JSE
2001	648 billion	1.8 trillion	10,963	-
2002	748 billion	1.6 trillion	12,137	9,465
2003	1.3 trillion	1.8 trillion	20,128	10,387
2004	1.9 trillion	2.6 trillion	23,844	12,675
2005	2.5 trillion	3.6 trillion	23,921	18,312
2006	3.2 trillion	3.5 trillion	33,189	24,915
2007	10.3 trillion	4.1 trillion	57,990	28,958
2008	6.65 trillion	2.9 trillion	31,450	21,509
2009	5.3 trillion	3.4 trillion	22,589	24,910

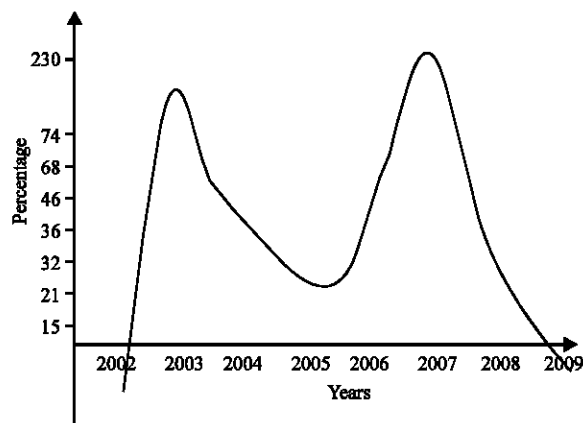


Fig. 1: Capitalisation fluctuation of the NSE between 2002 and 2009

the market growth especially for the 230 and 75% outburst in capitalisation and all shares Index, respectively between 2006 and 2007 (George, 2008; Afrinvest, 2008):

- The Federal Government economic reforms started in 2003, which resulted in 18 billion dollar debt written off and earning Nigeria a BB minus credit rating. This led to a free flow of foreign direct investment into the country
- Pension reform programme of 2004 which saw the pension scheme shifted from the defined to the fully funded contributory pension. This alone, they argued, injected ₦43.87 and 110.7 billion in the capital market for 2006 and 2007, respectively. As at 2008, the total contribution stands at about ₦1 trillion
- Reforms in the banking and insurance sectors. These exercises took place between 2004 and 2007. The reforms brought the number of insurance companies from 103 in 2005 to 48 in 2007. A total of about ₦80 billion additional capitals was raised by the insurance sector. The sector has only 2% of the capital market share

The reform in the banking sector jacked up bank's capital base to ₦25 billion and reduced the number of commercial banks to 25 from 89 in 2004. The consolidated banks raised over ₦1.1 trillion naira in 2007 only and currently has about 60% of the capital market share. The banking sector has a total of ₦600 billion capital base as at 2008.

- Impressive finance performance posted by company listed on the stock exchange which led to appreciation in share price
- All the insiders have been unanimous in blaming the crash of the market on the global economic meltdown. They have not seen anything wrong with the practices of the insiders that would have fuelled the effect of global economic downturn on the market

**The outsiders:** This category includes the stock market analysts, academics, financial journalists, economists and the like. They assess the market from the objective and constructive criticism parlance. The under listed factors have been their explanations for the questionable growth of the market and why the global meltdown has affected the market to this large extent. While other stock markets are getting out of the wound, it has become difficult for NSE to rebound significantly.

This is due to a large extent on the fact that the unprecedented growth was not absolutely genuine. Objectively, the outsiders agreed to the fact that the government economic reforms derive of 2003 that culminated in the debt written-off, financial sector and pension reforms of 2003 and 2004 affected stock market growth positively. Almost all the banks and insurance companies raised additional capital from the market and pension fund custodians invested a chunk in the capital market.

The financial performances reported by Nigerian banks are questionable performances. Not until recently when the new helmsman of the Central Bank of Nigeria came into office (Lamido Sanusi) did we know that larger percentage Nigerian banks have long sacrificed corporate governance.

And that the banks have been given deceptive financial reporting without full disclosure (Ekeoba, 2009; Abubakar, 2009; Omoh and Egwuatu, 2009). Due to this, about 10 bank chief executives along their executive directors serially lost their jobs. The current year financial reporting of Nigeria banks revealed large provisions for margin loans. This affected reported profits, little or no dividends and crash in share prices. Objectively speaking the bank's share prices are just coming down to their real

values. George (2008) shares this same opinion of mine. It is just a blessing in disguise for Nigeria investors. They have been long deceived that the NSE is a fortune market.

In the last six months, particularly the last 3 months, have witnessed a drastic revaluation of stock prices. While some of the stocks were actually over-valued and needed price adjustment to fall-in-line with their fundamentals.

Lopsidedness in market capitalisation: This is a hydra-headed case on the NSE. On one side, the market capitalisation is not evenly spread, among market instruments which include equities, bonds, debts, options, derivatives mutual funds. Equities alone dominates the NSE to the tune of 94%, whilst debt is just 6%. It is the federal Government and few state governments that have rejuvenated the structure for the issuance of bond between 2003 and 2007 raising about ₦750 billion.

Corporate bonds are only on the primary market. Secondly, most of the investors in equities are more of individual investors inform of money bag individuals, who had either made it their private businesses or from the political front. Mutual fund investments on the market between 1991 and 2009 are <30. The burden of the market failure or crash is been borne by individuals and they find it hard to recover from the stock. Thirdly, out of the equity capitalisation on the NSE, banks only has over 60% quota (Abubakar, 2009).

The banks also control above 60% of the mutual funds operating in Nigeria NSE therefore operates on a one-legged footing. Anything that affects Nigeria banks will affect the capital market to the tune of 60% at least. This accounts for the reason why it has been difficult for the market to rebound, because the banks are still not strong enough to recover from the effect of toxic asset and margin loans.

Take it as a prophecy, immediately the banks quit provision for toxic assets and margin loans and begin to declare fat returns to shareholders, the market will automatically respond in the same direction.

Fourthly, the driving force of the Nigeria economy after government spending is the contribution of the financial sector which is monopolised by the banking sector to the tune of 90% (Nwachukwu, 2009). The bane of the protracted crash will remain until the banks get out of their current wounds. Market indiscipline has contributed largely to fluctuations in market capitalisation and unethical behaviour involving share price manipulation and weak disciplinary procedure have become pandemic in the market (Geoge, 2008; Elomba, 2009; Uwah, 2009; Onuoha, 2009).

Recently, the wealth intoxication feud between Otedola, Femi and Aliko Dangote (both billionaire businessmen in Nigeria) led to share price manipulation of African petroleum. The company shareholder's lost about ₦240 billion in that saga (Elomba, 2009). The Security and Exchange Commission (SEC) disciplinary process exonerated the big fish, Aliko Dangote.

The accomplished Nova Registrar through which the dirty deal was executed was only suspended and fined for a paltry ₦1,000,000 by the SEC disciplinary committee. The same Aliko Dangote became the NSE council president. The regulatory authority, the Security and Exchange Commission did nothing substantial about that.

When the price of shares were skyrocketing the unsustainable and unjustifiable manner on NSE beyond what the performances of the company could explain, there was nothing the NSE council and SEC did to investigate. These acts of negligence of discipline and ethical behaviour have caused untold hardship on the capital market investors. The global financial downturn has come to stir the hornet's net.

**RESULTS AND DISCUSSION**

An attempt must be made from statistical point of analysis to explain that the fluctuations in the capitalisation and all shares index of the NSE is beyond the justification provided by the insiders explanation but that there is inherent risk involved in investing on the Nigeria Stock Exchange. The risk can be understood from the view point the constructive bashing provided by the outsiders explanation viewing the market in the areas of indiscipline, unethical behaviour and lopsidedness in market capitalisation (Table 2).

Table 2 shows that the highest capitalisation fluctuation is 230% (in 8 years) and 75% growth for the same period in the all share index. The average for capitalisation fluctuation is 58% in 8 years. Investment value can does fluctuate to the tune of 58% per annum.

It is necessary for us to determine the risk associated with fluctuations in capitalisation of the NSE by applying standard deviation as the absolute five measure of risk (Gupta and Gupta, 2004; Drury, 1985). The notation for standard deviation is given as:

$$Q^2 = \sqrt{\frac{\sum_{i=1}^n (X - \bar{X})^2}{n}}$$

Where:

- Q<sup>2</sup> = Standard deviation
- X = Annual capitalisation growth
- $\bar{X}$  = Mean capitalisation growth  $\Sigma X/n$
- n = No. of years (8)

X	(X - $\bar{X}$ )	(X - $\bar{X}$ ) <sup>2</sup>
15	- 50.25	2,525
74	8.75	77
46	-19.25	371
32	-33.25	1,106
68	2.75	8
230	164.75	27,143
36	-29.25	856
21	-44.25	1,958

$\Sigma X$  522, 34,044; Q<sup>2</sup> =  $\sqrt{34044/8}$  = 65%

The risk associated with investing in NSE within that period is 65%.

Within the same period the average fluctuation for JSE is 21.25% resulting in the risk of 13% is calculated as:

**JSE SD:**

X	(X - $\bar{X}$ )	(X - $\bar{X}$ ) <sup>2</sup>
II	-10.25	105
II	-10.25	105
44	22.75	518
38	16.75	281
3	-18.25	333
17	-4.25	18
29	7.75	60
17	-4.25	18

$\Sigma = 170, 1,438; \bar{x} = 170/8 = 21.25; Q^2 = \sqrt{1438/8} = 13\%$

Table 2: Percentage fluctuation in capitalisation and all share Index of NSE and JSE between 2002 and 2009

Years	Capitalisation		Change (%)		All share Index (points)		Change (%)	
	NSE (₦)	JSE (Rand)	NSE	JSE	NSE	JSE	NSE	JSE
2001	648*	1.8*	-	-	10,963	-	-	-
2002	748*	1.6**	15+	11-	12,137	9,465	11+	10+
2003	1.3**	1.8**	74+	11+	20,128	10,387	66+	10-
2004	1.9**	2.6**	46+	44+	23,844	12,675	18+	10+
2005	2.5**	3.6**	23+	38+	23,921	18,312	3+	44+
2006	3.12**	3.5**	68+	3-	33,189	24,915	39+	36+
2007	10.3**	4.1**	230+	17+	57,990	28,957	75+	16+
2008	6.65**	2.9**	36-	29-	31,450	21,509	46-	26-
2009	5.3**	3.4**	21-	17-	22,589	24,910	28-	16+
Average			58	21.5				

\*Billion; \*\*Trillion

The average fluctuation in capitalisation on NSE and JSE is 58 and 21.25%, respectively for the same period of 2002-2009. Apparently suggesting that investment on NSE is 44% better. This is quite literal and by the time the risk involved in the two exchanges are compared, the revelation becomes questionable. It is 65% risky to invest on NSE and 13% risky to invest in JSE. Therefore, it could be inferred that it is 52% safer to invest on JSE.

Furthermore, the highest fall in the all share index for JSE is 26% whereas it is 46% for NSE. There is a 75% maximum and 3% minimum fluctuation in the all share index for NSE creating a range of 72% (75-3%). On the other hand, the range of fluctuation on the all shares index of JSE is 33% (44-10%).

### CONCLUSION

The role of the capital market in the economic development of a nation can not be over emphasised. The global economic meltdown has exposed some inherent weaknesses in Nigerian capital market which fuelled its crash to the magnitude discussed in the research. Yet the hope of revival for the NSE is not lost, though it's going to be gradual.

It also requires dedication and sincerity on the part of the regulator and the participants. One thing must be understood that the security prices may not be able to return to the pre- downturn era in the short-run.

### RECOMMENDATIONS

It is not yet all over for the Nigerian Stock Exchange (NSE). The current experience in the market is an opportunity for new comers into the market and long term investment for capital gains. The short term investors that came on board have learnt their lessons in the hard way. These are the following recommendations:

- It is high time for NSE to diversify into other market instruments like derivatives, bonds, mutual funds and commodity trading to lessen the risk and volatility associated with investment in common stock
- The Nigerian Stock Exchange Council, the dealers on the market and the supervising body (the Security and Exchange Commission) should rise up to the occasion of maintaining sanity in the market. Let no participant be too big to be sanctioned

- There is also the need to list the NSE as a quoted company on the exchange. A commercial Bank needs ₦25 billion to be registered in Nigeria. The Nigerian Stock Exchange has a capitalisation of over ₦5 trillion. The JSE is a limited liability company and the London Stock Exchange is quoted on its own market where its shares are been traded. NSE should be free from the hands of few Oligarchs in Nigeria

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