FOREIGN PORTFOLIO INVESTMENT AND STOCK MARKET PERFORMANCE IN NIGERIA

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Abstract

The study investigated the effect of foreign portfolio investment on the performance of the stock market in Nigeria. The study made use of annual data spanning a period of 1986 and 2016.The data were analysed using multiple regression analysis, augmented dickey fuller of unit root test, Cointegration test and error correction model. The study revealed that foreign portfolio investment has a negative but insignificant effect on the performance of the stock market. It was recommended that government should put facilities in place to lure more foreign portfolio investors, since it is very glaring that it boosts the economy and makes stock market more robust.

Keywords: Foreign portfolio investment, all share indexes, foreign direct investment.

Introduction

Capital inflow is the movement of capital resources in to a country for the purpose of investment, trade or business production. Global flows to Africa have increased rapidly since 1990s for all types of private investment and capital. Financial liberalization whose key factor is free movement of capital has been experienced in the last decade. In following years there has been a growing interest among researchers in the examination of effect of foreign investor transactions on emerging stock markets. Reason behind that interest could be the view which associates foreign investor transactions and financial crises for emerging markets. According to proponents of this view, foreign investor transactions lead emerging markets to become destabilized and expose them to financial crises.

Thus, many African countries are trying to attract private capital flows. With regards to the economic weight of African countries, net private capital flows remain high. Contrary to popular beliefs, bilateral donors and international institutions are no longer the main source of funding

(capitals flows and transfer included) of investment and growth (Sayeh, 2011). With the increase of private investment on equity returns and economic growth in African countries hosting major stock markets?

Foreign investment flows are important to nations that are recipients of these flows as they have an opportunity to benefit from less expensive modes of financing. Nevertheless, they intensify a country's susceptibility to global economic meltdown which occurs during spontaneous reversals in foreign investment flows. The economic crisis of the 1980s, Latin American and the association of Southeast Asian Nations in the 1990s and Argentina in 2001-02, are examples of the adverse effects resulting from uncertainties in foreign portfolio flows (Chen and Quang, 2012). Although the economic turmoil in the united states of America (U.S.A) and some parts of the group of European nations in 2008-2009 may have been agitated on many issues such as bank failures, property bubbles and government fiscal deficit, the crises were transmitted to other nations through financial intermediaries. The meltdown in these advanced economies that were believed to be resilent exposed the vulnerability of developing countries that depended on foreign inflows and the global financial system as a whole.

Foreign capital brings credit, knowledge, and discipline to the host countries, which are thought to be essential for economic growth. In addition, access to foreign funds can enhance capital allocation efficiency and productivity, and thus growth in recipient countries (Ahmed and Zlate, 2014). Yet, a number of recent studies argue against such and the other positive benefits of capital inflows. For example, capital inflows can cause a transfer of economic resources from tradable to non tradable sectors, which are often subject to slow productivity growth (Benigno and Fornaro, 2014; Reis2013). In addition, episodes of large capital inflows increase the possibility of a sudden stop which hurt economic performance (Calvo and Reinhart, 2000) and

may trigger a shift of capital and labour out of the manufacturing sector to non manufacturing sectors (Beningo converse and Fornaro, (2015). All in all, the jury is still out on whether capital inflows are associated with better economic growth performance.

A close survey of the Nigeria economy indicates that Nigeria has recorded the trade imbalances in most fiscal years, indicating that total payments surpassed total receipts in relation to total imports and total exports. Overall balance of payments became worse in 1999, 2002 and 2008 mostly because of increased outflow from capital accounts (CBN, 2009). Most of the capital outflow must be attributed to increased importation, declining exports mainly non-oil subsector and particular due to external debt servicing required in meeting up with resource gaps. Essien and Onvioduokit (1999) and Ariyo (1999) described debt servicing and reserave creation as fluctuating variables that create dependence on foreign capital the flows into Nigeria through foreign investors' transactions. Investment inflows are a broad term which foreign direct investment (FDI) and foreign portfolio investment (FPI).

Portfolio investment is a recent phenomenon in Nigeria. Up to the mid-1980s, Nigeria did not record any figure on portfolio investment (inflow or outflow) in her balance of payment account. The nil return on the inflow column the account is attributable to absence of foreign portfolio investors in the Nigerian economy. This is largely because of non-internalization of the country's money and capital market as well as nondisclosure of information on the portfolio investments in foreign capital /money markets. Following a careful review of consequences of the Exchange Control Act of 1962 on the economy, after some 33years of its operation, Nigerian authorities came to the conclusion that the Act had not brought the economy any substantial benefits. The Act was judged inimical to a market driven economy. While equity trickled into Nigeria as a result of the Exchange Control Act of 1962, portfolio investments dried up, because portfolio

investment required an investment climate, which guarantees speedy free entry and free exit of investment funds into and out of the country in a flash. The investment climate in Nigeria engineered by the Exchange control Act of 1962 did not guarantee the speedy mobility of funds across borders. It took the authorities more than three decades to realize that protection of the economy in a world striving to dismantle economic frontiers had not paid off., and that the capital market being the major player in the mobilization of funds for investment has to be liberalized and modernized to enable it capture enough resources for the economy from within and from outside. The Exchange control Act of 1962 was identified as a major constraint on the growth of the Nigeria capital market. Accordingly, the Act was blown away with gale force in 1995,by the strong wind of deregulation which swept across the Nigerian macro-economic arena from the beginning of the last quarter of 1986 (Onoh, 2002). The deregulations of the securities pricing by SEC in 1993, the abolition in 1995 and the reorganization of the Nigerian stock Exchange to make more dynamic and mobile in the provision of adequate liquidity of investment bring up the operation of the Exchange to international standard and attract foreign portfolio investors. Accordingly, FGN in March 1996 set up a panel on the Nigeria stock Exchange and the panels term of reference include the reorganization of the Nigerian stock Exchange to make it more dynamic.; to recommend ways for modernizing the Exchange to bring it to international standard and to make other recommendations, which in the view of the panel, would strengthen the operation of the Exchange, and position it to deal with the domestic and international capital market challenges to the coming millennium(Onoh,2002).

Every investor wants to get better returns from investment .there are many investment opportunities around the globe, investment in stock market is one of them. The return on investment in stock market depends on various factors, the precise number of those factors is not

known yet. All share index is mostly used to determine the growth of the market as it captures the overall performance of the market. NSE all share index captures all the other performance measures such as market capitalisation, liquidity and turn over ratios. It the major determinants of market size of any stock exchange. The size of the all share index and its growth rate pose a major influence on the growth and Development of the economy.

Conceptual Framework and Theoretical Framework

Foreign portfolio investments consist of securities and other fiscal resources inactively held by alien investors. Foreign portfolio investment does not provide the investor with direct ownership of financial assets, and thus no direct management of a company. This kind of investment is relatively liquid, depending on the volatility of the market invested in as is usually used by investors who do not want to manage a firm abroad. Foreign portfolio investment (FPI) is an important source of investment in flows to an economy. FPI investors usually make short term investment in domestic security of foreign country with expectation of earning return on it after weighing the expected risk. Nigeria in the last few years had clamored for foreign portfolio investment to the country as this is believed to be a facilitator of economic growth and development, which could lead to industrialization of the economy in the long run (Adeleke et al, 2004).

Foreign private investment is an investment made by a private individual or a private entity in a foreign country. This type of investment differs from other investments made by a foreign public or governmental entity in another country for the fact that it is made by an individual or a private entity. It can either be direct or indirect in nature, that is, foreign direct investment and foreign portfolio investment. Foreign direct investment (FDI) is a direct investment into production or

business in a country by an individual or company by another country, either by buying a company in the target country or by expanding operations of an existing business in that country. Foreign direct investment is in contrast with portfolio investment which is a passive investment in the securities of another country such as stocks and bonds (Adeleke, Olowe, and Fasesin, 2014).

The stock market is common feature of a modern economy and it is reputed to perform functions that promote the growth and development of the economy. It is an institution that promotes efficiency in capital formation and allocation.

The capital market has been identified as an institution that contributes to the economic growth and development of emerging and developed economies. The stock market, through the provision of long term funds, enhances capital accumulation that is seen as significant tool in the process of economic growth and development. The stock market has basically been viewed as a predictor of the direction of national economy. It is a fact that if significant occurs in the share (stock) price, they are reflective of an impending recession while if significant increase occurs in the share (stock) price they are suggestive of a future economic boom (Uremadu, 2008).

Capital market is defined as the market where medium and long term finance can be raised (Akugbohungbe, 1996). It offers a variety of financial instruments that enable economics agents to pool liquidity and risk characteristics, as well as encourage savings in financial form. According to Al-Faki (2006), the capital market is a network of financial institutions, series of mechanisms, process and infrastructure, that in various ways facilitate the bringing together of suppliers and users of medium to long term capital for investment in economic development projects.

The Markowitz Efficient Frontier Model: Markowitz (1952, 1958) conveyed two significant insights with regard to modern portfolio theory. Firstly, he realized that the mathematics could not out a single optimal portfolio but rather could only identify a set of efficient portfolios. Secondly, he recognized that the appropriate risk facing an investor was portfolio risk which led to a fundamental point that the riskiness of a stock should not be measured just by the variance of the stock but also by their covariance. Markowitz discovered that it was the covariance that determines the risk of a portfolio and not the variance of individual assets in the portfolio. The best portfolio would consist of assets which are perfectly negatively (inversely) correlated. However, according to Markowitz, the benefits of diversification need not only exist if the assets are perfectively negatively correlated. In fact, as long as the correlation coefficient between two assets was less than 1.0, there will be a reduction in risk by combing both assets in portfolio. Markowitz proposed that investors should instead consider variances of return along expected returns, and choose portfolio that offered the highest expected return for a given level of variance he called this rule the E-V maxim (Markowitz, 1959). In Modern portfolio theory, the Markowitz stock portfolio model is optimizing by minimizing the risk of the portfolio as measure by the variance of stock prices, subject to a given portfolio return. In reality, modern portfolio theory is a way to determine just how many eggs to put in each of several specified baskets.

Markowitz also demonstrated that for given level of risk, an investor can identify particular combinations of securities that maximize expected return. Markowitz referred to a continuum of such portfolio in dimensions of expected return and standard deviation as the ‘efficient frontier’. According to Markowitz’s E-V maxim, investors should restrict their choice of portfolio to those that are located along the efficient frontier. The efficient frontier considers a universe of risky investments. The notion of ‘optimal’ portfolio can be defined in one of two ways: for instance,

for any level of risk (standard deviation), consider all the portfolios which have the level of risk. From among them all, select the one which has the highest expected return; and also for any expected return, consider all the portfolios which have that expected return. From among them all , select the one which has the lowest risk (standard deviation). Markowitz opined that the first definition produces an optimal portfolio for each possible level of risk while the second definition produces an optimal portfolio for each expected return. However the two definitions are equivalent as the set of optimal portfolio obtained using one definition is exactly the same set which is obtained from the other. The efficient frontier comprises a series of points each of which represents a particular allocation of assets across the clusters. Each allocation produces a specific return at a specific level of risks. In 1956, Henry Markowitz published the critical line algorithm for tracing out the efficient frontier given estimates of expected reruns, variances and covariance for any number of securities subject to various kinds of constraints. There are two restrictions in solving the efficient frontier. Firstly, the sum of the proportions of each assets represented in the portfolio must equal one, and secondly all assets must have positive or zero representation in the portfolio. Returns are varied between the minimum risk portfolio and the maximum risk portfolio.

Empirical Review

Ajayi, Adejayan and Obalade (2017) examined the impact of foreign private investment on the Nigerian capital market using time series data from 1986 to 2014. ADF unit root test, Johansen co-integration test and error correction mechanism were used for the purpose of analyses. Capital market development is proxies by market capitalization while foreign private investment is stationary at first difference and that there is a long run co-integration among market capitalization, foreign direct and portfolio investment. ECM results showed that, both types of

private investment have positive impact on market capitalization but only the foreign direct investment is significant (0.0015<0.05) in determining market capitalization. The study concluded that foreign private investment has positive and significant impact on the development of capital market.

Koskei (2017) studied the effect of foreign portfolio equity outflow on stock returns of listed financial institutions in Kenya, the study of population was 21 financial institutions listed on the Nairobi securities exchange. The study adopted panel data regression using the ordinary list square (OLS) method where the data included time series and cross sectional. A unit root test was carried out to examine stationary of variables, because it used panel data which combines both cross sectional and time series information. Panel estimation result indicated that foreign portfolio equity outflow have no effect on stock returns of listed institutions kenya.

Ibrahim and Akinbola (2017) examined the relationship between foreign portfolio investment, democracy and economic growth in Nigeria. This was with a view to explore the nexus between foreign portfolio investment, democracy and economic growth in Nigeria. Secondary data were used in this study. Annual time-series data for the period 1986 to 2013 on foreign portfolio investment and maximum lending rate. Data collected were analyzed with both descriptive statistics and econometric techniques. Time series properties of the variables were examined using both Augmented Diskey Fuller and Phillip Peron tests. Co integration properties of the variables were also examined. Vector auto-regressive technique supported by variance decomposition and impulse response analysis were employed to empirically determine the relationship between foreign portfolio investment and economic growth in Nigeria. The results showed that foreign portfolio investment inflow was more stable in democratic periods between 1999 and 2013 than the military periods between 1986 and 1998 and that the correlation between

economic growth and foreign portfolio investment is positive and very significant. The result showed that in the long run foreign portfolio investment had positive and significant effect on the economic growth in Nigeria ($t=3.7$, $p<0.05$). it also showed that democracy had a positive and significant effect on economic growth ($t=2.7$, $p<0.05$), while it has positive but not significant effect on the relationship between foreign portfolio investment and economic growth($t=1.92$, $p<0.05$). this study therefore concluded; the impact of foreign portfolio investment on economic growth significantly and positively but democratic government had no significant effect on the relationship between foreign portfolio and economic growth.

Onyeisi, Odo and Anoke (2016) studied the impact of foreign portfolio investment inflows on stock market growth in Nigeria from 1986 to 2014. The study used co-integration, vector error correction model and granger causality econometric tools. The results obtained includes the following; the trace statistics indicates one co-integrating equation at 5% level of significance, the vector error correction model indicates long run significant impact of foreign portfolio investment on stock market growth in Nigeria and the granger causality shows there is no causality between foreign portfolio investment and stock market growth in Nigerian economy.

Okafor, Ezeaku and Eje (2015) examined the effect of foreign investments (disaggregated into foreign direct investment and foreign portfolio investment) inflows on economic growth in Nigeria with a view of ascertaining the better contributor, using time series data from 1987-2012. The OLS and the granger causality procedures were employed in analyzing the data. The result displays that both foreign direct investment and foreign portfolio investment have positive and significant effect on economic growth though the partial correlation coefficient show that foreign portfolio investment is the better contributor.

Okpoto (2015) analyzed the impact of foreign private investment on the Nigerians economic growth from 1980-2013 using Augmented Dickey Fuller (ADF) and ECM to analyze the long run relationship between real GDP and other variables in the model. In order to actualize this, the relationship between real GDP and foreign private investment, inflation, exchange rate and interest rate were considered. The findings revealed that the activities in Nigeria within the period of study.

Baghebo and Apere (2014) in an attempt to ascertain the impact of foreign portfolio investment (FPI) On Economic growth as well as the long run determinant of FPI in Nigeria, it was discovered that foreign portfolio investment, market capitalization and trade openness has a positive long run relationship with real gross domestic product in Nigeria using Augmented Dickey Fuller unit root test. The variables considered were foreign portfolio investment, inflation rate, market capitalization, trade openness.

Ozurumba (2012) investigated the impact of stock market returns on foreign portfolio investment in Nigeria. Data were collected from central bank of Nigeria (CBN) statistical bulletin. The data were consequently analyzed using E-views statistical package. The methodology used was multiple linear regression analysis to capture the impact of foreign portfolio investment and inflation rate on stock market returns as well as granger causality tests to determine the direction of causality between the variables. The results showed that foreign portfolio investment has a positive and significant impact on stock market returns while inflation rate has positive but insignificant impact on stock market returns. In the case of causality test, evidence of the result showed that there is a unidirectional causality running from stock market returns to foreign portfolio investment in the economy, while in turn will foster stock market returns in Nigeria.

Olotu and Jegbefume (2011) in their study of the place of foreign capital flows in the Nigerian economic growth equation with a bias in the foreign portfolio investment, the result indicates that domestic investment is not statistically different from zero, openness has a negative value. They also found a close relationship between FDI and the real nonoil GDP.

Duasa and Kassim (2009) in their study examined the relationship between foreign portfolio investment (FPI) and Malaysias economic performance. In particular, the study analyses the relationship between FDI and real GDP using the widely adopted granger causality test and the more recent Toda and Yamamotos (1995) non-causality test to establish the direction of causation between the two variables. Similar method is also applied on the relationship between volatility of FPI and the real GDP. Additionally, the study used an innovation accounting by simulating variance decompositions and impulse response functions for further inferences. Using quarterly data covering the period from 1991 to 2006 the study found evidence that economic growth causes changes in the FPI and its volatility and not vice versa. Also, Ekeocha (2008) submitted that the volatility nature of foreign portfolio investment does not affect its role as an important source of fund to support investment in any economy that has a wide saving-investment gap like Nigeria.

In a study by Prasad, Raghuran and Subramanian (2007) on foreign capital and economic growth, they highlighted that among developing countries, there exists positive correlation between current account balances (surpluses, not deficit) and growth. The correlation is quite strong because it is present in cross-sectional as well as in panel data; it is not very sensitive to the choice of period or countries examined. It cannot be attributed simply to aid flows and it survives some other robustness tests. The went further to reveal that among industrial countries, those that rely more on foreign finance seem to grow faster. So it is probable that when facing improved

domestic investment opportunities and related higher incomes, poor countries do not have financial systems are particularly unlikely to utilize foreign capital to finance growth.

Sethi and Patnaik (2005) researched on the impact of international capital flows on Indians financial market and economic growth. By using monthly data, they find that FDI positively affects the economic growth, while the effect of foreign portfolio investment is negative. This result is in line with the study of Durham (2003) on the effects of foreign portfolio investment and other foreign investment on economic growth using cross-country data observes that FPI has no effect on economic growth and does not correlate positively with macroeconomic vitality. Knill (2003) studies the impact of the FPI on small firms and finds that it helps to bridge the gap between the amount of financing small firms need and that which they can access through the capital markets. Particularly, he finds that FPI is linked with an increased capacity to issue publicly traded securities for small firms in all nations.

Model Specification:

Multiple Regression Model

Functionally, ASI=f(FDI,FPI,EXR),

Mathematically, $ASI=B_0+B_1FDI+B_2FPI+B_3EXR+e$

Converting the above equation into log-linear form, we have:

$LogASI=B_0+B_1logFDI_t+B_2logFPI_t+B_3logEXR_t+e_t$

The a-priori expectation of the slope coefficient is:

$B_o>0$; $B_1>0$; $B_2>0$ and $B_3>0$.

Error Correction Model

$dASI=B_0+B_1dFDI_{t-1}+B_2\ dFPI_{t-1}+B_3\ dEXR_{t-1}+ECM+e_t$

Augmented Dickey Fuller Model

$dY_t=a_0+a_1Y_{t-1}+\ b_1dY_{t-1}+e_t$

where,

ASI=All-share index proxy for stock exchange performance

FDI=foreign direct investment

EXR=exchange rate

B_i=coefficient parameters of the variable or a_i

e=stochastic error term

d=change

ECM=error correction model

In order to have a first insight into the nature and trend of the individual variables , descriptive analysis was conducted for this study and the result presented below:

Table 1: Descriptive statistic result

Variables	observations	Mean	Maximum	Minimum
ASI	31	15623.95	57990.2	163.8000
FDI	31	404861.4	1360308	735.8000
EFI	31	299735.8	2687233	151.6000
EXR	31	90.31806	305.0000	1.75OO

Source: E View Version 8

In order to have an first insight into the order of integration of the individual variables ,Augumented Dickey Fuller unit root test was conducted for this study and the result presented below:

Table 2: Unit Root Test

VARIABLE	ADF at level	ADF at first difference	Order of integration
ASI	-2,631672	-3.803834***	1(1)
FDI	-2.385838	-8.802471***	1(1)
FPI	0.050594	-6.026549***	1(1)
EXR	-2.518820	-5.527176***	1(1)

Source: E View Version 8

Note: Test critical value at i% =-3.67, 5%=-2.96, and at 10%=-2.62.

Asterisks *,**,and *** represents 10%,5%, and 1%.

The ADF unit root test result above showed that all the variables were not stationary at level as their values in absolute terms are less than their critical value at 5% level of significance. However, all the variables became stationary after the first difference.

The result of the dependent variable ASI indicates that its mean value during the period under study is 15623.95, maximum value 57990.20 and minimum 163.800. On the other hand, FPI shows an average of 299735.8 during the period under study with the maximum and minimum of 2687233 and 151.600 respectively.

Table 5: Parsimonious Result for the study

Dependent variable: D(LogASI)

Method: Least squares

Date:10/11/2018< Time:9:30amSample(adjusted): 1987-2016

Included observations: 30 after adjustments

Variable	Coefficient	Standard error	t-statistic	Prob.
C	1.376784	0.407807	3.376066	0.0024
LOGFDI(-1)	-0.145135	0.069501	-2.088236	0.0471
LOGFPI(-1)	-0.037256	0.027100	-1.374368	0.1814
LOGEXR(-1)	0.222378	0.104130	2.135585	0.0427
ECM(-1)	-0.355236	0.117651	-3.019413	0.0058
R squared		0.464488	Mean dependent variable	0.170010
Adjusted R squared		0.378806	S.D. dependent Variable	0.309931
S.E. of Regression		0.244275	Akaike Information criterion	0.169967
Sum squared residual		1.491757	Schwarz criterion	0.403500
Log Likelihood		2.450489	Hannan-Quinn criterion	0.244677
T-statistic		5.42068	Durbin-watson criterion	1.707625
Prob.(t-statistic)		0.002770		

Source: E View Version 8

$ASI=B_0+B_1FDI+ B_2FPI+B_3EXR+e$

ASI=1.38-0.15FDI -0.04FPI+ 0.22EXR+e

The above table showed that there exists a negative but insignificant relationship between one-year lagged FPI and stock market performance, proxies in ASI in Nigeria. This means that 1% increase in FPI leads to $% decrease in in stock market performance. The probability value of FPI (0.180) is greater than the test significant level (0.05).With this, we conclude that FPI has significant effect on stock market performance in Nigeria in the short run. This collaborates with the study of Koskei (2017), who found out that FPI has no effect on stock returns of listed institutions in Kenya.

Furthermore, an important feature to notice is the coefficient of error correction term. This carries the correct sign and it is statistically significant at 5% level with the speed of adjustment to equilibrium of 36%. This implies that in the short run, the economy adjusts by 36%of the past years deviation from equilibrium. This indicates that the speed of adjustment to equilibrium is relatively low. This is essential for maintaining long run equilibrium to reduce the existing disequilibrium over time. This result justifies the use of an ECM specification of the model in the study.

The coefficient of determination measured by adjusted $R^{2,}$ showed that 46% of the variations in stock market performance, proxies by LogASI are explained by changes in independent variables (FPI,EXR). Hence, the remaining 54% of the variations are due to other factors(which may be qualitative), not included in the model.

Finally, the Durbin-Watson statistic (1.70) which is approximately 2, showed that there is no presence of autocorrelation being that 2<=DW>=4. Most interestingly, the Durbin Watson statistic exceedsthe R-squared value ($DW>R^2$) which indicates that the regression result is not spurious.

Conclusion and Recommendation

The study found out that foreign portfolio investment has a negative and insignificant effect on stock market performance in Nigeria. The study investigated the effect of foreign private investment inflows on the stock market performance in Nigeria. Foreign direct investment and foreign portfolio investment were chosen as proxies for foreign private investment inflows. Exchange rate was introduced as an explanatory variable while all share index of the Nigeria stock exchange served as the proxy for stock market performance. The study made use of annual

data spanning 1986 to 2016. Findings showed that foreign direct investment has a negative and significant effect on stock market performance. In conclusion, the study argued that foreign investment inflows have significant effect on stock market performance in Nigeria. The study recommends that inflow of foreign portfolio investment should be encouraged, even though it has negative and insignificant effect on the stock performance in Nigeria.

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