IOSR Journal of Economics and Finance (IOSR-JEF)
e-ISSN: 2321-5933, p-ISSN: 2321-5925.Volume 8, Issue 5 Ver. I (Sep.- Oct .2017), PP 08-12
www.iosrjournals.org

Equity Financing and Economic Growth Nexus in Nigeria.

*Dr. Eze, Onyekachi R., Dr. Onwe, Basil U. and Nwanne, Ndubuisi C.
Department Of Accountancy/ Banking & Finance, Ebonyi State University, P.M.B 053 Abakaliki-Nigeria.
Corresponding Author: Dr. Eze, O. R. ezerich2014@gmail.com

Abstract: *The aim of the study is to examine the reverse causation between equity financing and economic growth in Nigeria. In achieving the objectives of the study, the study made use of secondary data and granger causality test. The study found among other things that economic growth determines two measures of equity financing (ASI and MCAP) while one of the measures of equity financing (MCAP) determine economic growth. The evidence in support of supply-leading hypothesis is weak compared to the demand-following hypothesis. The policy implication of this study is that there is bi-directional causality between equity financing and economic growth in Nigeria. The study recommends among other things that government need to strengthen the supervision of equity financing to ensure economic stability over time as we found reverse causality.*

Keywords*: Economic Stability, Causality, ASI, MCAP, Growth, Equity Financing.*

Date of Submission: 17-08-2017 Date of acceptance: 05-09-2017

I. Introduction

The relationship between equity financing and economic growth has received a great deal of attention throughout the modern history of finance. The earlier work of Schumpeter (1911) argued thatequity financing promote economic growth.

Equity financing is the method of raising capital by selling company stock to investors. In return for the investment, the shareholders receive ownership interests in the company. Equity financing often means issuing additional shares of common stock to an investor (Murtala, Surya and Zunaidah, 2015).

The relationship between equity financing and economic growth has emerged as a significant source of long term investment funds in Nigeria. Steady economic growth means a pace of growth which a country can maintain without creating other substantial economic problems, especially for future generations (Soludo, 2007). There is evidently a switch between speedy economic growth today, and growth in the future through equity financing (CBN, 2015). The economic growth goes to suggest that as the Nigerin economy develops, the higher the likelihood of growth causing equity financing.

In the face of this, the possibility of economic growth promoting equity financing has not be found in any empirical study and the efficacy of equity financing to raise and allocate long term capital required for investment and growth through economic growth has became questionable. Some authors (James and Anthony, 2014; Daibi and Walter, 2009; Akinde 2015; Murtala, Suraya and Zunaidah, 2015 and Osual, Okereke and Nwanbi, 2013) have argued that rapid expansion in the market through equity financing did not reflect economic fundamentals. The conflicting evidence on the casual link between equity financing and economic growth in Nigeria creates the need for further research. For a developing country, the existence of supply-leading hypothesis is compared to demand-following hypothesis. This is because financial intermediaries are required to always act as growth catalysts in developing economies. In Nigeria, it is assumed that economic growth is dependent on the development of equity financing. However, there is also the possibility of development of equity financing to occur only when economic growth is achieved based on growth-led finance theory. This paper therefore seeks to re-examine the reverse causality between equities financing and economic growth nexus in Nigeria.

The issue of reverse causality between equity financing and economic growth in both developed and developing countries like Nigeria have not been deliberated empirically. However, the reverse causality between equity financing (internal and external equity financing) and economic growth is not without inharmonious results in the empirical literature. The principal view between scholars as well as public policy makers, however, is that government can play a very vital role in increasing the level of economic growth through equity financing as an essential instrument because it enables the government to intervene in realising full employment and other macro-economic goals. However, we are looking at how economic growth can promote equity financing in this study which is a research gap. This is because there has been controversies of finance and growth nexus in Nigeria.

The role of economic growth on equity financing in Nigeria is worth studying because Nigerian stock exchange market was the most sophisticated and strongest in the entire African continent. Therefore investigating the contribution of economic growth to its advancement is very essential as no much studies conducted about this nexus despite the fact that Nigerian economy is among the most promising in the emerging market economies. This study examined the equity financing (All Share Index (ASI) and Market Capitalization (MACP)) and economic growth nexus in Nigeria because it is believe that as the Nigerian economy develops, the higher likelihood of growth causing equity financing.

II. Review Of Related Literature

Concept of Equity Financing

Equity finance refers to the sale of an ownership interest to raise funds for business purposes. In order to grow, any company will face the need for additional capital, which it may try to obtain through debt or equity. If the company opts for equity, the owner sells a stake to others (John, Wekesa and Peter, 2015). During early growth stages of a company, especially when the company does not have sufficient fund, equity financing can provide capital from investors who are willing to take risks along with the entrepreneur (Berger and Udell, 1998). Similarly, when a company has prospects of explosive growth, it can raise substantial capital through equity financing.

Various types of equity financing which has effect on the growth of the economy are available. Equity investors may combine equity with convertible debt or straight debt. This is done either as a form of extended due diligence, or to meet cash flow requirements while limiting dilution of the principal owner's shareholding.

Equity financing is the process of raising capital through the sale of shares in an enterprise. Equity financing essentially refers to the sale of an ownership interest to raise funds for business purposes. Equity financing spans a wide range of activities in scale and scope, from a few thousand naira raised by an entrepreneur from friends and family, to giant initial public offerings (IPOs) running into the billions by household names. While the term is generally associated with financings by public companies listed on an exchange, it includes financings by private companies as well. Equity financing is distinct from debt financing, which refers to funds borrowed by a business (Osuala, Okereke and Nwanbi, 2013).

Equity financing is the method of raising capital by selling company stock to investors which in turn help to improve the level of economic growth in any nation. In return for the investment, the shareholders receive ownership interests in the company. A method of financing in which a company issues shares of its stock and receives money in return. Depending on how you raise equity capital, you may relinquish anywhere from 25 to 75 percent of the business (Akinde, 2015).

Theoretical Framework

Based on the nature of this study, the study applied theories and past studies that are related to the present study. The study made use of Supply-leading hypothesis and demand-following hypothesis.

The Supply-leading hypothesis

The Supply-leading hypothesis was developed by Mckinnon (1973) and Shaw (1973). Mckinnon (1973) and Shaw (1973) argue that a well-developed financial sector minimizes transaction and monitoring costs and asymmetric information; thus there is improvement in financial intermediation. The existence of well-developed financial sector enhances the creation of financial services as well as accessibility to them in anticipation to their demand by participants in the real sector of the economy. That equity financing is a determining cause of economic growth. It posits that optimal allocation of resources is an outcome of financial sector development (Hurlin and Venet, 2008). The supply-leading hypothesis suggests that causality flows from finance to economic growth with no feedback response from economic growth. The theory also state that a well-developed financial sector is a pre-condition for economic growth. The supply-leading hypothesis presumes that the economy responds to growth in the real sector facilitated by financial development.

The Demand-following Hypothesis

Demand-following hypothesis was developed by Schumpeter (1934). Robinson (1952) theory disagree with the supply-leading hypothesis and stated that equity financing is dependent on growth that occurs in the economy. This stance is embedded in the demand-following or growth-led finance hypothesis. It suggests that causality is from economic growth to equity financing. Calderón and Liu, (2002) opined that increasing demand for financial services deepens the financial sector as the economy progresses. Singh (1999) opines that when an economy expands, there is a rise in macroeconomic activities which resultantly develops the financial sector. It posits that the causal link between equity financing and economic growth alternates as the economy develops. Based on the nature of this study, we anchor this study on demand-following hypothesis because supply-leading hypothesis holds in an economy in the early developmental stage, and as the economy grows, it fades away and the demand-following hypothesis prevails.

Empirical Review

There are several studies that have articulated theoretically and empirically on equity financing and economic growth nexus but very few studies are on reverse causality between equity financing and economic growth in both developed and developing countries. Results about the reverse causality between equity financing and economic growth differ by country, analytical methods employed and categorization of equity financing and it reverse causality effect on economic growth in Nigeria. None has produce the evidence showing how economic growth promote equity financing.

Daibi and Walter (2009) in a study of the effect of venture capital financing on economic value added profile of Nigeria small and medium enterprises. The study adopted questionnaire as source of data and regression analysis as the methodology. It was found that venture capital through equity financing clearly outperformed non-venture capital finance of small and medium enterprises. This means that there is positive effect of venture capital financing on economic value added profile of Nigerian small and medium enterprises.

Osuala, Okereke and Nwanbi (2013) used granger causality test to investigate the effect of stock market financing on promoting economic growth in Nigeria. It was found that there is long-run co-integration between economic growth and stock market performance. Meanwhile, the impact of the stock market on economic growth was found to be negative and non-significant at 5% level. This is quite understandable because of the unethical practices and the subsequent crash in the stock market have undermined the potentials of the market in enhancing economic growth in Nigeria.

James and Anthony (2014) studied the relationship between private equity and economic growth in Kenya using theoretical approach. It was discovered that private equity tends to increase when there is economic growth in an economy. This was as a result that economic growth model contend that for economic growth to be sustainable, there should be continuous advancement in technical knowledge main in the form of new product.

Akinde (2015) investigated the dynamic of stock market performance fundamentals and economic growth in Nigeria. The study made use of causality test and error correction model. The study identify significant relationship between stock market performance fundamentals and economic growth in Nigeria.

Murtala, Suraya and Zunaidah (2015) examined the relationship between equity financing and economic growth in Nigeria. Ordinary least square model was used as methodology. It was discovered that there is long-run relationship between equity financing and economic growth in Nigeria..

Gap in Reviewed Literature

Available literature tends to focus on the impact of private equity, venture capital financing, stock market performance, stock market financing, equity financing, etc on economic growth of both developed and developing countries. In this study, we focused on the reversed causality relationship between equity financing and economic growth nexus in Nigeria using ordinary least square analysis and causality test. Equity financing was decomposed into two variables namely: All Share Index and Market Capitalization

III. Methology

This study made use of the *Ex-post facto* research design. The data already exist as no attempt would be made to control or manipulate relevant independent variable. Annual secondary data of the variables were used and they include equity financing variables (All Share Index (ASI) and Market Capitalization (MACP)) and economic growth variables (gross domestic product (GDP)). All these variables were collected from the Central Bank of Nigeria Statistical Bulletin from 1985-2015. The study made use of annual data on selected variables from 1985 to 2015. The study adopted economic growth proxy as gross domestic product (GDP) as its dependent variables. The chosen independent variables are the variables of equity financing which includes: all share index and market capitalization.

Gross Domestic Product (GDP) is an economic indicator which measures the welfare and economic performance of a country and serves as the measure of real economic activity. Market Capitalization (MACP) is the total market value of the equities in publicly traded corporate entities. It also refers to the value of all listed securities based on their market prices and it serves as an indicator in assessing the size of capital market in an economy.

All Share Index (ALSI) is a measure of magnitude and direction of general price movement.

Model Specification

Since the aim of this study is to examine the reverse causation between equity financing and economic growth in Nigeria, we used econometric model (granger causality test).

This model is thus specified as:

$$\mathbf{Y_t = \alpha_0 + \alpha_1 x_1 + \mu_t \ldots (1)}$$

Where:

$\mathbf{Y_t}$ is the dependent variable,

$\boldsymbol{\alpha_0}$ is the intercept term,
$\boldsymbol{\alpha}$ is the regression coefficient,
$\mathbf{X_t}$ is a set of explanatory variables.
$\boldsymbol{\mu_t}$ is the error term.

The above model is relevant in determining the reverse causality between equity financing and economic growth. We therefore re-specify the model above to capture the objective of our study.

ASI = F(GDP) … 2
MACP = F(GDP) … 3
Where: GDP= Gross Domestic Product, MACP= Market Capitalization and AlSI=All Share Index.

IV. Result And Discussion Of Findings

Granger Causality Results.

The Granger causality test is a statistical hypothesis test for determining whether one time series is useful in forecasting another. In conducting an econometric study, the direction of causal relationship among variables is determined according to the information obtained from the theory. In this study, Granger Causality test was used in order to test the hypotheses regarding the presence and the direction of the causality between equity financing and economic growth. For the purpose of this, the direction of causality determines the direction of the relationship among variables.

Table 1: Granger Causality Test Result on ASI = f(GDP)

Pairwise Granger Causality Tests
Sample: 1985 2015
Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
GDP does not Granger Cause ASI	29	0.75806	0.5040
ASI does not Granger Cause GDP		2.05681	0.2014

Source: E-View Econometrics 7.0

Considering the output of Granger Causality and using 2 degree of freedom and 29 observations, the F-tabulated value is 0.75806 and 2.05681 at 29 observations. It is observed from the pair-wise relationship between GDP and ASI that the T-statistics is 0.75806 and probability value of 0.5040 while the value for ASI and GDP is 2.05681 with p-value of 0.2014. The test is based on the objective one for testing the causality between economic growth and equity financing (ASI) in Nigeria. The result in table 1 above shows that there is no causality exists between GDP and ASI and from ASI and GDP. This implies that they are interdependently related. It also indicates that both variables do not granger cause each other in the present study. The finding did not support any of the study reviewed. Therefore, we are of the opinion that the use of All Share Index as variable of equity financing in this study had yield a different result.

Table 2: Granger Causality Test Result on MACP = f(GDP)

Pairwise Granger Causality Tests
Sample: 1985 2015
Lags: 2

Null Hypothesis:	Obs	F-Statistic	Prob.
GDP does not Granger Cause MACP	29	12.6564	0.0001
MACP does not Granger Cause GDP		2.45372	0.1255

Source: E-View Econometrics 7.0

Table 2 above reveals that causality flows from GDP to MACP only; thus suggesting that MCAP does not granger cause GDP. In summary, GDP predicts MCAP. This implies that economic growth has greater predictive power on equity financing than equity financing has on economic growth. This is observed as the f-statistic of GDP and MACP is 12.6564 with p-value of 0.0001 while the f-statistic of MACP is 2.45372 with p-value of 0.1255 which is more that 0.05 level of significance. The result however did not agree with any of the study reviewed as they did not focus on the reverse causality between equity financing and economic growth. However, the finding support supply-leading theory.

V. Conclusion

This study examines the reverse causality between equity financing and economic growth in Nigeria. The study was undertaken with the use of granger causality test. The study observed that economic growth has positive and significant effect on equity financing in Nigeria. The result is in support of supply-leading hypothesis is weak compared to the demand-following hypothesis. This implies that though supply-leading hypothesis is confirmed in Nigeria but demand-following hypothesis is dominant. This study concludes that there is bi-directional causality existing between equity financing and economic growth and this supports the assertion that equity financing and economic growth are interdependently related. The policy implication of this is that for economic growth to promote equity financing in higher level in Nigeria, there must be a shift in government policies and implementation to favour industrial production.

VI. Recommendations

Based on the findings of this study, it is recommended that, for a more economy-friendly through equity financing in Nigeria, the following measures should be adopted:

1. The government need to strengthen the supervision of equity financing to ensure economic stability over time.
2. The regulatory authorities need adequate indicators of equity financing to strengthen the stability of Nigerian economic growth. This is because there is bi-directional relationship between the two variables.
3. Based on our findings, there should be policies that can improve the level of effect of economic growth on equity financing in Nigeria.

References

[1] Akinde, M. A. (2015). The Dynamic of Stock Market Performance Fundamentals and Economic Growth in Nigeria: A Causality Investigation. Research Journal of Finance and Accounting, 6(3): 13-21

[2] Calderón, C. and Liu, L. (2002). Financial Services Deepens Economic Progresses. Journal of Economic and Monetary Finance, 2(5): 1-10

[3] Central Bank of Nigeria Statistical Bulletin, various issues

[4] Daibi, W. D. and Walter, G. O. (2009). The Effect of Venture Capital Financing on the Economic Value Added Profile of the Nigerian Small and Medium Enterprises. African Journal of Accounting, Economics, Finance and Banking Research, 5(5): 37-51.

[5] Eze, O. R. (2015). Finance-Growth Nexus in Nigeria: Fragility and Development effects. European Scientific Journal, 10(6): 281-295

[6] Forget, M. K. (2013). Finance and economic growth nexus: Complementarity and substitutability between the banking sector and financial markets in Africa, using South Africa as a case. Journal of Economics and International Finance, 5(7): 273-286

[7] Granger, C.W.J. (1969). Investigating causal relations by econometric models and cross spectral methods. Econometrica, 37, 424-435.

[8] Hurlin, S. and Venet, H. (2008). Financial Sector Development and Economic Growth in South African. International Journal of Finance and Economics, 5(6):12-25

[9] James, M. G. and Anthony, S. M. (2014). Private Equity and Economic Growth: A critical Review of the Literature. European Journal of Business and Innovation Research, 2(3): 1-10

[10] John, M. R., Wekesa, W. and Peter, W. (2015). Equity Financing Strategy and the Performance of Small and Medium Enterprises in Kenya. International Journal of Business and Management, 10(4): 193-202

[11] McKinnon, R. I. (1973). Money and Capital in Economic Development. Washington,DC: Brookings Institution

[12] McKinnon, R.I., (1973). Money and capital in economic development. Washington DC: Brookings Institution.

[13] Micheal, A. (2013). Finance-Growth Nexus in Africa. A Panel Generalized Method of Moments (GMM) Analysis. Asian economic and Financial Review, 3(10): 1314-1324

[14] Murtala, B. U., Suraya, I. and Zunaidah, S. (2015). Stock Market-Based Financial Development and Economic Growth with Reference to Nigeria: A Review of Literature. International Journal of Academic Research in Economics and Management Sciences, 4(1): 141-159

[15] Osinubi, T. S. (1998). ―Stock Market Development and Long-run Growth in Nigeria. UnpublishedM.Sc. Economics Dissertation, University of Ibadan, Nigeria.

[16] Osinubi, T. S. (2002). ―Does Stock Market Promote Economic Growth in Nigeria? http://sta.uwi.edu/conferences/financeconference/

[17] Osuala, A. E., OKereke, J. E. and Nwansi, G. U. (2013). Does Stock Market Promote Economic Growth in any Emerging Market? A Causality Investigation. Proceedings of 6th International Business and Social Sciences Research Conference, Dubia, Pp. 1-14

[18] Robinson, J. (1952). "The Rate of Interest and Other Essays, Macmillan Press, London.

[19] Robinson, J. (1952). The Generalization of The General Theory, In The Rate of Interest and Other Essays, London Oxford University Press.

[20] Rousseau, P. and Wachtel, P. (2000). "Equity Markets and Growth: Cross Country Evidence on Timing and Outcomes 1980--1995, Journal of Banking and Finance, 24, 1933-1957.

[21] Schumpeter, J. A. (1911). "The Theory of Economic Development, Harvard University Press, Cambridge, MA

[22] Schumpeter, J. A. (1934). The Theory of Economic Development. Translated by Redvers Opie, Cambridge MA: Harvard University Press

[23] Shaw E. (1973) Financial Deepening in Economic Development, New York: Oxford University Press

[24] Shaw, E.S. (1976). Financial Repression and Liberalization, In Meir, G.M. (ed), Leading Issues In Economic Development, New York, Oxford University Press.

[25] Singh, A. (1999). Should Africa promote stock market capitalism? Journal of International Development, 11, 343-365.

[26] Soludo, C.C. (2007). Consolidating The Nigerian Banking Industry to Meet The Development Challenges of The 21st Century: Being An Address Delivered At The Special Meeting of The Bankers' Committee, Abuja, (July).

DR. Eze. " Equity Financing and Economic Growth Nexus in Nigeria." IOSR Journal of Economics and Finance (IOSR-JEF), vol. 10, no. 8, 2017, pp. 08–12.