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The Impact of Access to Financial Markets and Efficiency of Financial Institutions on Domestic Investments in Nigeria

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Abstract

This study examined the influence of access to financial markets as well as efficiency of financial institutions on domestic investment in Nigeria. Data used in the study were obtained from the International Monetary Fund (IMF), the Central Bank of Nigeria Statistical Bulletin and World Bank World Development Indicators for the period 1981-2021. The findings show that there is a unidirectional causality from access to financial market to domestic investment in Nigeria. Therefore, the study recommends that the Federal Government of Nigeria to regulate the insider dealings in the stock exchange market, as it will promote access to financial market, which will in turn positively influence domestic investment in Nigeria. It further recommends that monetary authorities, particularly the Central Bank of Nigeria, put policies in place that will prevent commercial banks from making frequent charges on customers, as it will improve bank deposits and domestic investment in Nigeria.

Keywords: Access, Efficiency, Financial Markets, Financial Institutions, Domestic Investment, Nigeria.

Introduction

Countries around the globe depends largely on financial markets and financial institutions to enhance investment. A person or an organization may have an investment plans that requires funding beyond their savings. Bonds and stock markets, which are financial

markets, can be of immense help to the successful establishment of businesses because they provide funds to investors who do not have adequate fund to finance investment plans. Similarly, banks and insurance companies, which are financial institutions, provide funds to investors to finance investment plans. Given the important role of financial markets and financial institutions in an economy, it is essential to investigate whether domestic investors in Nigeria have access to financial markets. It is also important to have knowledge of the degree of efficiency of financial institutions in Nigeria. According to Cihak, Asli, Erik, and Ross (2012), access and efficiency are the most important features of financial system, and if a large proportion of members of the public who have investment plans cannot access loans, then financial systems are of limited use. Katsiaryna (2016) noted that "financial markets have developed in ways that allow individuals and firms to diversify their savings, and firms can now raise money through stocks, bonds, and wholesale money markets, by-passing traditional bank lending." He added that "the constellation of such financial institutions and markets facilitate the provision of financial services". In line with this insight, Akintola, Oji-Okoro and Itodo (2020) noted that "the financial sector is no doubt the engine oil of any economy as it makes resources available for investment, which in turn lead to economic growth". They added that "credit availability has assisted in the expansion of small businesses, leading to increase in income and employment generation. The opinions of the preceding authors are based on general expectations of the positive influence of financial development, of which access to financial market and the efficiency of financial institutions are components, on domestic investment which in turn lead to economic growth.

Contrary to the opinions discussed in the preceding paragraph, Okeke and Chinanuife (2022) emphasized on the poor features of some economic variables that third world countries have. According to them, in many developing countries, the resources to finance the different business ideas are in short supply. Third world countries, including Nigeria, are characterized by low income, inadequate financial systems, low domestic savings, vicious level of poverty, low tax revenue, macroeconomic instability, political instability, unstable exchange rate, limited exchange earnings among others. Given these features of developing countries, it is essential to, on the basis of data, know how some of the variables of interest in this study behave in recent time.

The figure below shows the annual sectorial distribution of commercial banks' loans to domestic trade and manufacturing sectors in Nigeria for the period 2015-2021.

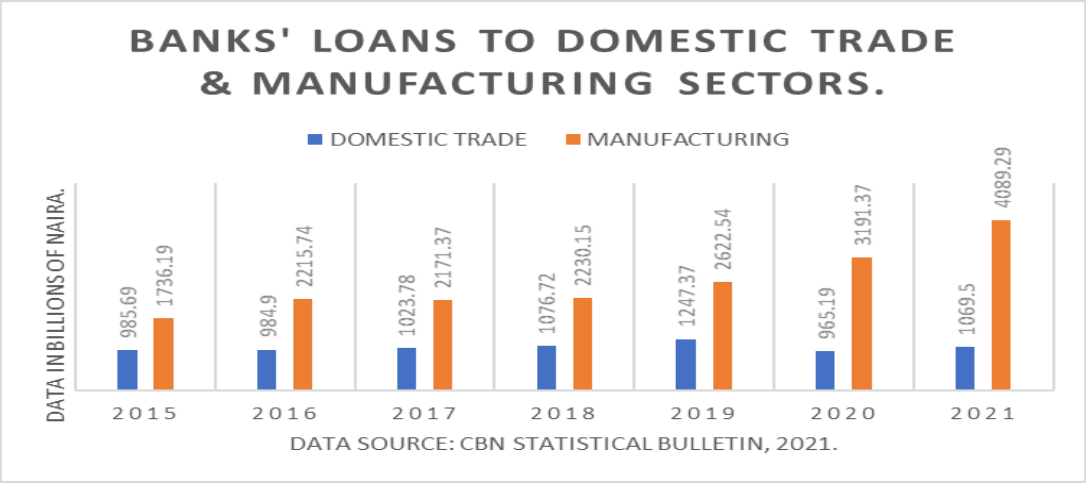
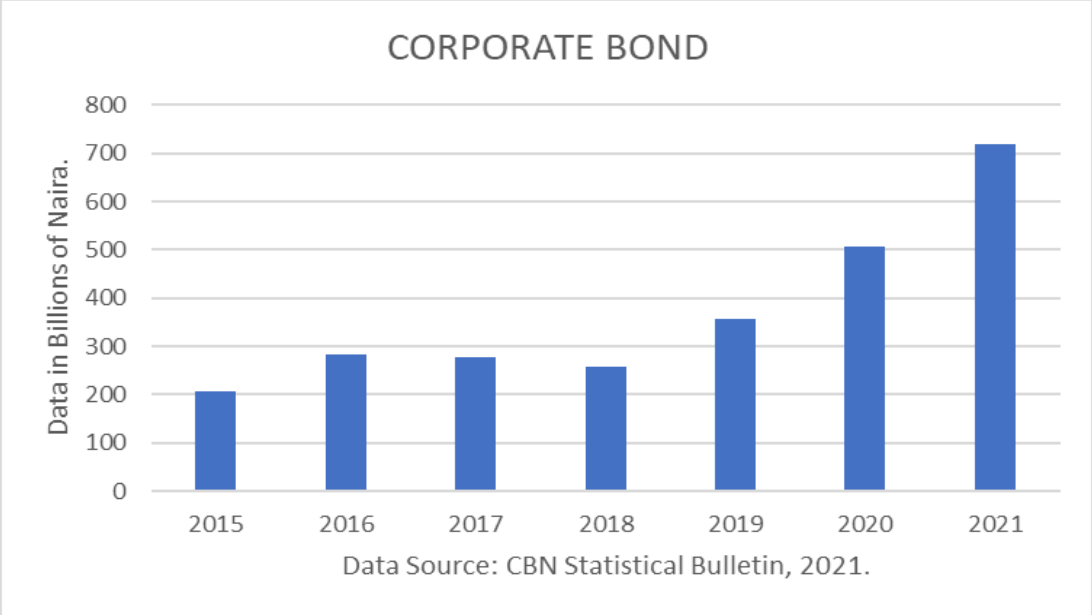


Figure 1: Banks' Loans to Domestic Trade and Manufacturing Sectors in Nigeria

The horizontal axis of the figure above shows the years that were under consideration. The vertical axis shows the scale of the data, which are measured in billions of naira. The graph shows that commercial banks loan to the manufacturing sector increased at an increasing rate in the last couple of years. However, same cannot be said for loans to domestic traders for the years under review. For example, the graph shows that the loans to traders in 2019 is higher than the loans in 2020. Similarly, commercial banks' loans to domestic traders in 2015 is slightly greater than the loans in 2016.Even though there seems to be improvement in the distribution of loans by commercial banks, the graph suggests that commercial banks loans to the sectors of interest are not proportional.

Credit risk could be one of the reasons commercial banks' loans to domestic traders is not as smooth as that of manufacturers. Perhaps, manufacturers are credit worthy because they have assets that could be used as collateral so that in the event of default on settlement of debt, their assets would be used to repay loans. Another reason could be that a manufacturing firm can be easily tracked because it operates in a particular location. There are so many other reasons why it may be convenient for commercial banks to give more loans to the manufacturing sector. It should be noted that domestic investment comprises investments in various sectors of an economy.

Corporate Bonds in Nigeria for the Period 2015-2021



The horizontal axis of the figure above shows the years considered, whereas the vertical axis shows the scale of the data used to plot the graph, which is in billions of naira. The graph clearly shows that corporate bonds increased in 2016 but decline slightly in 2017 and 2018. However, it increased at a high rate in 2019 and has continue to increase since then. Corporate bonds markets are markets where financial instruments are bought and sold. Issuers of bonds

are lenders, whereas buyers of bonds are borrowers. It should be noted that both buyers and sellers of bonds are investors. It should further be noted that increase in the volume of trade in bonds market is a reflection of access to financial markets. There are so many financial instruments that are traded in the financial markets. For example, treasury bills are short term financial instruments issued by the government. When issued buyers hold it for three or more months as the case may be, and thereafter they get back their capital, that is, the money they used to buy the security and also get interest payment on the security. There are so many plausible reasons why government issue treasury bills. But the point to note is that such financial instruments are traded in the financial market.

Literature Review

This study is centered on three concepts: The efficiency of financial institutions, access to financial market and domestic investment.

The Efficiency of Financial Institutions

According to Cihak, Asli, Erik and Ross (20120, "the efficiency of financial institutions is the ability of financial institutions to provide financial services at low cost and with sustainable revenues". Jiang and Mahmood (2019) define the efficiency of financial institutions as "an aspect of the financial system that works efficiently with regards to resource allocation and information provision, as well as operating as a cost-reduction mechanism". Note that the efficiency of financial institutions is one of the indices of financial development. It is measured in form of data by the International Monetary Fund (IMF) for so many countries including Nigeria.

Access to Financial Market

Katsiaryna (2016) define access to financial market "as the ability of individuals and companies to access financial services in bond and equity markets". According to Mollah, Muhammad, Jozsef, Wlodzimierz and Judith (2020), "access to financial market refers to increase in the provision of financial products as well as services by functional financial markets to members of the public, enterprises and foreign investors in a country". Again, access to financial market is one of the indices of financial development, which is measured in its own right in form of data by the International Monetary Fund (IMF) for so many countries including Nigeria.

Domestic Investment

Okeke and Chinanuife (2022) define investment as "deferred consumption which involves purchasing an asset, giving a loan or keeping funds in a bank account with the aim of generating future returns". According to them, "investment means real gross private domestic capital formation, as it is the measure of physical investment used in the computation of gross domestic product, which is the measure of a country's economic activities". Ewubare and

Worlu (2020) defines investment as "the commitment of resources made with the hope of realizing benefits which are expected to occur over a reasonable period of time; an economic activity where an individual, group or government buys assets with the hope of receiving adequate risk premium or returns overtime.' According to Oyedokun and Ajose (2018), 'domestic investment is an expenditure made to increase the total capital stock in an economy.' They added that domestic investment is undertaken 'by acquiring more capital-producing assets and other assets that generate income within the domestic economy' stressing that 'physical assets particularly add to the total capital stock.

Model Specification for Objective One

To examine the impact of the efficiency of financial institutions on domestic investment in Nigeria, the study follows Akintola et al (2020) in assuming a linear functional relationship between the regressand and the regressors. In addition to the efficiency of financial institutions, which is the core explanatory variable, other variables, that is, control variables, were included based on related established studies in the literature such as Atuma, Odo and Nweze (2017)

$$DMI_t = f(EFI_t EXR_t INFR_t GDPR_t) \quad (1)$$

$$DMI_t = \beta_0 + \beta_1 EFI_t + \beta_2 EXR_t + \beta_3 INFR_t + \beta_4 GDPR_t + \mu_t \quad (2)$$

Equation (1) is the functional form of the relationship among the variables and equation (2) is the econometrics form.

Where:

DMI = Domestic Investment proxy by Gross Fixed Capital Formation, which is measured in billions of naira. It is the dependent variable.

EFI=Efficiency of Financial Institutions, which is an index measured by the International Monetary Fund (IMF). It is the core explanatory variable.

EXR= Exchange Rate (nominal), which is measured as the rate at which the Nigeria naira exchanges for United States of America's dollar. It is a control variable.

INFR = Inflation Rate, which is measured in percentage. It is a control variable.

GDPR= Gross Domestic Product growth rate, which is measured in percentage. It is a control variable.

$\mathbf{B_0}, \boldsymbol{\beta_1}, \boldsymbol{\beta_2}, \boldsymbol{\beta_3}$ and $\boldsymbol{\beta_4}$ are parameters of the model, t represents the time index and $\boldsymbol{\mu_t}$ is the error term, which is assumed to be well behaved.

Gujarati and Porter (2009) stated that "research studies based on time series data assumes that the underlying time series is stationary." However, experience has shown that time series data often have stochastic trend. In view of this possibility, the variables in equation two may be integrated of different orders. However, if co-integration exists among the variables, that is, if equilibrium or long run relationship exist among the variables, then the autoregressive and

distributed lag model in its unrestricted error correction form can be employed to investigate the relationship among the variables in equation two. Moreover, ARDL model addresses the possible problems of serial correlation and endogeneity that may arise if equation two is estimated. Thus, equation (3) is specified as an autoregressive and distributed lag model in its unrestricted error correction form as follows:

$$\Delta DMI_t = \beta_0 + \beta_1 DMI_{t-1} + \beta_2 EFI_{t-1} + \beta_3 EXR_{t-1} + \beta_4 IFR_{t-1} + \beta_5 GDPR_{t-1} + \sum_{i=1}^{p} £_i \Delta DMI_{t-i} + \sum_{i=0}^{q} \alpha_i \Delta EFI_{t-i} + \sum_{i=0}^{q} \lambda_i \Delta EXR_{t-i} + \sum_{i=0}^{q} \delta_i \Delta INFR_{t-i} + \sum_{i=0}^{q} \phi_i \Delta GDPR_{t-i} + \varepsilon_t \quad (3)$$

All variables remain as previously defined. The β's in equation (3) are long run parameters, whereas £, α, λ, δ, ϕ, are short run parameters, Δ is difference symbol, p and q are lag length symbols. Notice that the dependent variable *DMI*, appear as an explanatory variable in equation (3). This explains why the model is autoregressive. If co-integration exists among the variables, we would want to know the speed at which short run effects adjust to full effect in the long run. It is given by equation (4) as follows.

$$\Delta DMI_t = \beta_0 + \pi ECM_{t-1} + \sum_{i=1}^{p} £_i \Delta DMI_{t-i} + \sum_{i=0}^{q} \alpha_i \Delta EFI_{t-i} + \sum_{i=0}^{q} \lambda_i \Delta EXR_{t-i} + \sum_{i=0}^{q} \delta_i \Delta INFR_{t-i} + \sum_{i=0}^{q} \phi_i \Delta GDPR_{t-i} + \varepsilon_t \quad (4)$$

All variables and parameters remain as previously defined except ECM and π, which are error correction mechanism and parameter respectively. The parameter, π, show the speed at which short run effects of the explanatory variables on the dependent variable is adjusted towards long run full effect.

Model Specification for Objective Two

Objective one differs from objective two in that the former aims to find out the effects of the impact of the efficiency of financial institutions on domestic investment in Nigeria, whereas the purpose of the latter is to find out the impact of access to financial markets on domestic investment in Nigeria. All variables and parameters in the preceding equations remain the same. The wisdom behind the adoption of ARDL model is still valid. The only change is "access to financial market" that is used in lieu of "the efficiency of financial institutions" as the core explanatory variable. All the control variables are still serving the same purpose as in the preceding equations.

$$\Delta DMI_t = \beta_0 + \beta_1 DMI_{t-1} + \beta_2 AFM_{t-1} + \beta_3 EXR_{t-1} + \beta_4 IFR_{t-1} + \beta_5 GDPR_{t-1} + \sum_{i=1}^{p} £_i \Delta DMI_{t-i} + \sum_{i=0}^{q} \alpha_i \Delta AFM_{t-i} + \sum_{i=0}^{q} \lambda_i \Delta EXR_{t-i} + \sum_{i=0}^{q} \delta_i \Delta INFR_{t-i} + \sum_{i=0}^{q} \phi_i \Delta GDPR_{t-i} + \varepsilon_t \quad (5)$$

All variables and parameters remain as previously defined except *AFM*, which is access to financial markets. Again, to know the speed of adjustment from short run effects toward long run, the following model is employed.

$$\Delta DMI_t = \beta_0 + \pi ECM_{t-1} + \sum_{i=1}^{p} £_i \Delta DMI_{t-i} + \sum_{i=0}^{q} \alpha_i \Delta AFM_{t-i} + \sum_{i=0}^{q} \lambda_i \Delta EXR_{t-i} + \sum_{i=0}^{q} \delta_i \Delta INFR_{t-i} + \sum_{i=0}^{q} \phi_i \Delta GDPR_{t-i} + \varepsilon_t \quad (6)$$

All variables and parameters remain as previously defined. Note that the only change between objective one and two is the use of access to financial market (*AFM*) instead of the efficiency of financial institutions (*EFI*) as core explanatory variable.

Model Specification for Objective Three

The models in the following equations will be employed to trace the direction of causality between the efficiency of financial institutions and domestic investment in Nigeria.

$$DMI_t = \sum_{i-1}^{n} \alpha_i EFI_{t-i} + \sum_{j-1}^{n} \beta_j DMI_{t-j} + \mu_{1t} \quad (7)$$

$$EFI_t = \sum_{i-1}^{n} \lambda_i EFI_{t-i} + \sum_{j-1}^{n} \Omega_j DMI_{t-j} + \mu_{2t} \quad .$$

Data Type and Sources

Data used in this study were obtained from three published sources. First, data on "the efficiency of financial institutions" as well as "access to financial markets" were obtained from the International Monetary Fund (IMF). Second, data on domestic investment, which is proxy by gross fixed capital formation, gross domestic product's growth rate and inflation rate were obtained from the Central Bank of Nigeria Statistical Bulletin. Finally, data on exchange rate were obtained from World Bank World Development Indicators (WDI). Excel and E-views statistical packages (software) were used to run analysis.

Descriptive Statistics of Variables Used to Achieve the Objectives of the Study.

	DMI	AFM	GDPR	EXR	EFI	INFR
Mean	8638.592	0.341463	2.985332	108.0575	0.609756	19.08636
Median	8246.21	0	3.2001	111.2313	1	12.8765
Maximum	15789.67	1	15.3292	399.96	1	72.8355
Minimum	5668.87	0	-13.1278	0.6177	0	5.388
Std. Dev.	1978.563	0.480091	5.390958	109.8907	0.493865	16.63377
Skewness	1.26722	0.668648	-0.785839	0.975986	-0.45	1.838702
Kurtosis	5.60346	1.44709	4.568141	3.178567	1.2025	5.277032
Jarque-Bera	22.55237	7.174811	8.420783	6.563557	6.903386	31.95981
Probability	0.000013	0.02767	0.014841	0.037561	0.031692	0
Sum	354182.3	14	122.3986	4430.359	25	782.5407
Sum Sq. Dev.	1.57E+08	9.219512	1162.497	483038.5	9.756098	11067.29
Observations	41	41	41	41	41	41

This table shows that the number of observations for the variables of interest is 41, which is quite large. It also shows variations in the mean values of the variables.

ADF Unit Root Test Results

Variable	ADF Test Statistic	5% Critical Value	Order of Integration	P-Value	Decision
AFM	-7.197222	-2.938987	I(1)	0.0001	Stationary After First Difference.
DMI	-7.749602	-3.533083	I(0)	0.0001	Stationary at Levels.
EFI	-3.162278	-2.936942	I(0)	0.0299	Stationary at Levels
EXR	-4.773232	-3.529758	I(1)	0.0023	Stationary After First Difference.
GDPR	-3.860497	-2.941145	I(0)	0.0053	Stationary at Levels.
INFR	-3.642822	-2.938987	I(0)	0.0092	Stationary at Levels

This table shows that access to financial market and exchange rate are stationary after first difference, whereas other variables are stationary at levels. The econometric features of the variables of interest are consistent with the assumptions of the autoregressive and distributed lag models.

Co-Integration Test Results When EFI is the Core Explanatory Variable

Dependent Variable	F-Statistic Value	K	Levels of Significance	I(0) Bound	I(1) Bound	Decision
DMI	3.920603	4	10%	2.2	3.09	Co-Integration
	3.920603	4	5%	2.56	3.49	Co-Integration
	3.920603	4	1%	3.29	4.37	No Co-Integration

This table shows that co-integration or long-run relationship exist among domestic investment, financial institutions' efficiency, exchange rate, inflation rate and the growth rate of gross domestic product, as the value of F-statistic in the table above is greater than the values of the lower and upper bound values at the ten and five percent respectively. Therefore, the null hypothesis that long-run relationship does not exist among the variables is rejected. Next in the procedure developed by Pesaran et al (2001) is the estimation of the parameters of the specified model employed to achieve objective one.

Co-Integration Test Results When AFM is theCore Explanatory Variable.

Dependent Variable	F-Statistic Value	K	Levels of Significance	I(0) Bound	I(1) Bound	Decision
DMI	9.115531	4	10%	2.2	3.09	Co-Integration
	9.115531	4	5%	2.56	3.49	Co-Integration
	9.115531	4	1%	3.29	4.37	Co-Integration

Based on the F-statistic value (9.115531) in table 8, which is greater than the I(1) bound values at the 10%, 5% and 1% level of significance respectively, co-integration or long-run relationship exist among the variables of interest when access to financial market is the core explanatory variable.

Summary of the Findings

This study investigated the influence of access to financial markets as well as the efficiency of financial institutions on domestic investments in Nigeria. The findings of the study show that the influence of the efficiency of financial institutions on domestic investment in Nigeria is not instantaneous, but dynamic. It also shows that the efficiency of financial institution positively and significantly influences domestic investment in Nigeria in the long-run. For the impact of access to financial market on domestic investment in Nigeria, the findings of study indicate that the influence of access to financial market on domestic investment is not instantaneous, but dynamic. However, the long-run impact of access to financial market on domestic investment is negative.

The findings of the study further show that the direction of causality between domestic investment and access to financial market in Nigeria is unidirectional from access to financial market to domestic investment. Overall, the study establishes that both access to financial markets and efficiency of financial institutions have dynamic effect on domestic investment in Nigeria. But the long-run effect of the former is negative, whereas the long-run effect of the latter is positive.

Conclusions

Access to financial markets and efficiency of financial institutions are components of the financial development index measured by the International Monetary Fund (IMF) and other

established published sources. So many studies reviewed in this study investigated the influence of financial development on economic growth, domestic investment, foreign direct investment etc. Some of the studies used credit to private sector as proxy for financial development, others used IMF index. These measures are considered too narrow and broad in this study. Hence, the choice of access to financial market and efficiency of financial institutions in this study, which are considered not too broad or narrow.

Recommendations

First, Federal Government of Nigeria should regulate the activities in the financial markets, especially the stock exchange market in which insider dealings, that is, the practice of trading on the stock exchange to an investor's own advantage, is common. This regulation by the government will go a long way to make access to financial markets to positively influence domestic investment in Nigeria in the long run. Second, monetary authorities, particularly the Central Bank of Nigeria (CBN), should put a policy in place that will prevent commercial banks from making frequent charges such as debit card maintenance fee, money transfer levy, etc. on customers. This will make customers to deposit more money in commercial banks, which can be loaned to potential investors to finance their investment plans, and therefore improve domestic investment. Finally, government should create an awareness of the economic benefits of investing in securities such as treasury bills, shares, bonds, etc. It will promote access to financial markets, which will in turn promote domestic investment in Nigeria.

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