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The Economic Growth Imperative of Foreign Portfolio Investment for Nigeria

Acha, Ikechukwu A.[*a], **Essien, Joseph M.**[b]

[*a]Department of Banking/Finance, University of Uyo, Akwa Ibom State, Nigeria
[b]Ken Saro Wiwa Polytechnic, Bori, Rivers State, Nigeria

Abstract: This study examined the effect of Foreign Portfolio Investment (FPI) on economic growth in Nigeria. The research design adopted was a combination of exploratory and ex post facto research designs. Secondary data were sourced from the Central Bank of Nigeria (CBN) statistical Bulletin for the period 2005 to 2014. Gross Domestic Product was used as dependent variable while Foreign Portfolio Investment, Market Capitalization as well as exchange rate for the period were the independent variables. Ordinary Least Square (OLS) multiple regression was used to analyze the data. The result indicated that Foreign Portfolio Investment (FPI) and market capitalization have positive effect on Real Gross Domestic Product (RGDP) while exchange rate had an inverse relationship with RGDP. Durbin-Watson Coefficient Test shows that there is absence of auto-correlation. Based on this result, the hull hypothesis is rejected implying that there is a positive relationship between FPI and RGDP. The result agrees with the finding made by Baghebo and Apere (2014). It was therefore recommended that since economic performance is critical to attracting Foreign Portfolio Investment into any country, the Federal Government of Nigeria should create enabling environment that will stimulate the economy and strengthen its fundamentals. The government should also work towards the stabilization of the capital and money markets by putting in place appropriate investor friendly policies to sustain their internationalization and attractiveness to investors.

Keywords: Foreign Portfolio Investment, Economic Growth, Capital Market, Money Market, Nigeria.

1. Introduction

Private capital flows to countries within the developed and developing categories has been considered as critical factor in the economic development efforts of these countries. According to Yuguda (2015) capital flows is the movement of capital either in (in flow) or out (outflow) of an economy. Capital inflows occur when domestic assets are being purchased with foreign assets (Rummel, 2010). Private capital flows are indeed major sources of capital which comes in the form of foreign direct investments and foreign portfolio investments. Foreign Direct Investment (FDI) is the category of international investment in which foreigners purchase sufficient stocks in a firm or in an enterprise resident in another country in order to secure profit and obtain significant management control or a lasting interest in that country. This is different from foreign portfolio investment (FPI) which is an investment in which a foreigner invest in a particular country by purchase of stocks and bonds to obtain a return, profits or benefits on the funds invested. By this investment, the foreigner seeks primarily capital gains and do not necessarily reflect a significant and lasting interest in the enterprise of the country. The outflow of such investments could have detrimental consequences on an economy (Acha *et al.*, 2013).

According to IMF (2001), portfolio investments include investments made in bonds, notes, money market instrument financial derivatives outside those included under direct investment, or simply put, investments which are below the 10% rule as portfolio investor is generally restricted to small percentage of the equity thereby not getting involved in the firm's management. In line with IMF definition, foreign portfolio investment can also take any of the following forms: Investment in country fund which is an international mutual fund as a portfolio that could consists of securities, generally stocks of companies located in a particular country. It may also take the form of global funds consisting of securities in all parts of the world, including the country in which the investor resides. Global funds are chosen primarily

by investors who wish to diversify against country – specific risk without excluding their own country. Lastly, investments in international funds, consisting of securities from all countries except the investor's home country, by this fund, investors focus on investment diversification. The major attraction of FPI is the ability to trade in the internationalized financial markets having ease of investment, divestment as well as absence of any form of hindrances to the functionality of the market.

The main reason for investing in the corporate entities in other countries is to seek out opportunities in an economy in which assets can be used productively to create wealth, while the recipient country will take advantage of the investments to expand its productivity. Ngowi (2001) posits that African countries and other developing countries need substantial inflow of foreign capital to fill the saving and foreign exchange gaps due to a rapid rate of capital accumulation and growth needed to overcome the widespread poverty in these countries.

Foreign portfolio investment benefits the investors with the acquisition of dividends, capital gains and interest, while interest rates, speculation, expectation of profits, economic conditions, political stability and taxation policies are some of the factors that can affect its movement (Nwokoma, 2003). While the recipient countries will benefit as portfolio asset purchases from residents increase bank liquidity and encourage a credit boom. In addition to the liquidity of domestic capital market it favours the country's capital market development. It also leads to the financial sector development thus strengthening the financial infrastructure and deepening the process of financial intermediation. (Dauda, 2007) notes that foreign capital investment like portfolio investment increases the gross domestic product (GDP) and generates a stream of real incomes. It was observed that foreign portfolio investment into a country will lead to more foreign exchange and could help to reduce pressure on exchange rate (Nwosa and Amassoma, 2014). It has been observed that essential characteristic of instruments classified as portfolio instruments is that they are traded or tradable.

According to UNCTAD (2005), foreign investment in Africa has advanced much further and faster than integration especially in the area of structural, institutional and policy trends, and in some cases at its expense.

Ekeocha *et al*. (2012) asserted that though, foreign Portfolio investment is generally considered more passive or speculative in nature than direct investment and can be withdrawn from the market at short notice. To be able to attract investors to invest in foreign portfolio investments in developing countries, investors look out for some determinants which involve the interactions of factors related to policy, market development environment, liquidity and profitability opportunities of firms, political, security and other economic determinants which are not directly linked to policies aimed at attracting foreign portfolio flows. They are a reflection of the general health of the economy, the potential for firms operating in such a business environment to earn profits and to obtain a satisfactory return. The investor will also look out for high economic growth opportunity, friendly policy and regulatory frameworks. These are the factors over which domestic government has a direct influence, and these are ease of repatriation of dividend/capital, domestic capital gain tax, stocks and bond market regulation, quality of domestic according and disclosure standards, speed and reliability of the settlement system as well as degree of investor's rights protection. Accordingly, a conductive business environment and strong legal system have been identified as a major attraction of foreign investments (Acha and Akpanuko, 2011).

Ololade and Ekperiware (2015) stated that it was after the abrogation of the Exchange Control Act 1962 in Nigeria which constrained foreign participation in the Nigerian capital market that foreign investors were allowed to invest and participate in the Nigerian capital market both as operators and investors. It was the internationalization of the Nigerian stock exchange, in the mid-2000 by the Federal Government of Nigeria that led to an increased inflow of foreign portfolio investments into the Nigeria economy through the robust capital market. Government of Nigeria had viewed foreign investment as a vehicle for political and economic domination of Nigeria and hence the stipulation of government indigenization policy through the Nigeria Enterprise Promotion Decree (NEPD) in 1972 regulating foreign investments, with a maximum of 40% foreign participation allowed. Sequel to this policy, there was a decline in both foreign private investment and it slowed down growth in all sectors of the economy including the capital and money market (Baghebo and Apere, 2014). It has been observed that the value of foreign portfolio investments invested in Nigeria domestic economy grew from ₦896.1b in 2005 to ₦10, 088.3b in 2014, despite the growth more foreign portfolio investments were in equity of quoted companies in Nigeria and Federal Government of Nigeria bonds and notes amounting to ₦ 9,011.5b (89.3%) while investment in money market was ₦1, 076.8 representing 10.7% (CBN, 2015). Statistically, foreign investment or capital flows into the Nigerian economy has not really been as much as flows of similar nature into other developing economics. It is worth noting that majority of foreign investment

/capital flow or capital importation into the country by equity and debts were mainly in financing, telecommunications, banking, manufacturing, service and trading sub-sectors.

Central Bank of Nigeria in 2014 annual report observed that total portfolio investment made by Nigerians abroad stood at US$23,332.99 against total FPI received into Nigeria of US$59, 4555. (Rummel, 2010) highlights a number of benefits that could be attributed to capital flows especially to the recipient country such as foreign savings, lower cost of capital for borrowings, smoothen consumption, help develop financial markets and institutions as well as facilitate transfer of technology and management expertise.

Nigeria has seen numerous and increased flow of foreign portfolio investment into the country, which has provided more capital for the companies operating in the country. By the foreign portfolio investments, the company's outputs are expected to increase, leading to increase employment opportunities, capacity utilization and economic growth, but this is not the case as more companies are operating below capacity, high exchange rate movements and high unemployment rates are evident.

It is based on the above observation that this study would analyze the contribution of foreign portfolio investment to the economic growth and development in Nigeria. Specifically this study intend to determine the causal relationship between Foreign Portfolio investment and Economic growth in Nigeria, determine the effect of some macroeconomic variables like Exchange Rate, and Market Capitalization on Nigerian economic growth and to examine avenues of attracting and benefiting from the investment in Nigeria. To this end, the study hypothesized that foreign portfolio investment has not contributed to economic growth in Nigeria.

This study would contribute to existing literature by attempting to examine the role of foreign portfolio investment Nigeria as it affects economic growth for the period 2005 to 2014. Accordingly, the study will offer policy recommendation to increase the flow of foreign portfolio investment in Nigeria. The rest of the work is organized as follows: section 2 contains literature review, Section 3 methodology, section 4 data presentation and analysis of results, sections 5 will conclude and offer appropriate recommendation.

2. Literature Review

2.1. Theoretical Review

New economic growth theory (endogenous theory) studies economic growth called "New" because unlike previous attempt to model the phenomenon, the new theories treat knowledge as at least partly endogenous. Research and development is one path. Endogenous growth theory holds that investment in human capital innovation and knowledge are significant contributors to economic growth. The theory focuses on positive externalities (external impact) and spillover effects of a knowledge based economy which will lead to economic development. The theory also holds that policy measures can have an impact on the long-run growth rate of an economy. It is an economic theory which argues that economic growth is generated from within a system as a direct result of internal processes. It notes that the enhancement of a nation's human capital will lead to economic growth by means of the development of new forms of technology efficient and effective means of production. By this, production will be profitable and investment in this economy will be better utilized and could generate profit, given the abundance technology and knowledge.

It can therefore be stressed that investment on the nations human capital and knowledge will lead to economic growth by means of the creation or development of new forms of technology, efficient and effective means of production, which will ultimately enhance the economic growth of the nation, Capital flow by way of foreign portfolio investment into a country which is allowable due to the policies that embrace openness, competition, change and innovation can facilitate and lead to effective production.

Truly, the endogenous growth models emphasize technical progress resulting from the rate of investment, the size of the capital stock, and the stock of human capital (Jhingan, 2013).

2.2. Empirical Review

Ogujiuba and E. (2012) studied the relationship between foreign private capital components and foreign portfolio investment, economic growth and some macroeconomic indicators; interest rate and inflation rate as well as policy implications there from, using time series data from 1986-2008. They adopted a non-restrictive vector Autoregressive (VAR) model for the study. By their analysis, it was observed that the response of the GDP to shocks from foreign portfolio investment was not contemporaneous and this was applicable to other variables. It was somewhat sluggish but remains faster

to equilibrium compared to the response from Net Portfolio investment (NNPI). Also, the interest rate (INTR) was shown to impact on the NNPI in the short-run. Consequently, the study recommended that government should not discourage the flow of foreign private capitals, but be more vigilant about the nature and sources of the flow as this will forestall the potential adverse impact on key macroeconomic variables as well as stimulate economic growth.

Duasa and Kassim (2009) investigated the relationship between foreign portfolio investment (FPI) and Malaysia's economic performance by analyzing the relationship between foreign portfolio investment (FPI) and real Gross Domestic Product (GDP), using the widely adopted Granger causality test and the more recent non-causality test to establish the direction of causation between the two variables as well as the relationship between volatility of FPI and real GDP. Using quarterly time series 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. The findings noted that economic performance is the major pull factor in attracting FPI into the country. The study recommended a healthy economy for sustainable growth so as to build investor's confidence in the economy.

Osinubi and A. (2010) conducted a study on the foreign private investment (FPI) and economic growth in Nigeria. The study therefore analyzed the direction and significance of the effect of foreign portfolio investment on the economic growth in Nigeria for the period 1990-2005. It was revealed that foreign portfolio investment, domestic investment growth and net export growth impacted positively and significance on economic growth in Nigeria. The study also noted that despite the increased flow of foreign portfolio investment to developing countries in especially Sub-Sahara African countries including Nigeria, low levels of per capital income, high unemployment rate, low and falling GDP are still prevalent. The study noted that in recent times, Nigeria government has initiated policies to attract foreign portfolio investment but this has not impacted positively on the growth rate of GDP. Ahmad *et al.* (2015) examined the causality relationship between foreign portfolio inflows and economic growth. They used Granger causality test for both China and India time series data ranging from 2001 to 2013 and the result agreed with the findings of Durham (2003) and Duasa and Kassim (2009) that there was no direct causality between Foreign Portfolio Inflows and Economic Growth.

Ololade and Ekperiware (2015) studied the contribution of foreign portfolio investment (FPI) towards financing Nigeria infrastructural deficits and determined the factors that attract FPI into the Nigerian bond market. It also examined the relationship between FPI and bond yield in Nigeria. The study used both primary and secondary data. Data collected were analyzed using multiple regression analysis and the results showed that there was no Federal Government Investment in the bond market until 2003 when the federal government through the Debt Management Office issued the first FGN bond series. The study concluded that factors attracting foreign investors into the bond market in Nigeria were critical and if well managed by policy makers could enhance the attraction of FPI needed for financing infrastructural projects through the Nigeria bond market.

Baghebo and Apere (2014) examined the impact of foreign portfolio investment (FPI) on economic growth as well as the long run determinants of FPI on economic growth in Nigeria over the period 1986-2011. A three stage methodological process of Augmented Dickey Fuller Unit Root test, Johnson co-integration test, and parsimonious error correction result was adopted. The variables considered were foreign portfolio investment, market capitalization and trade openness and it was discovered that all the variables have a positive long-run relationship with real gross domestic product in Nigeria. It recommended that capital market be strengthened against fraudulence to ensure free flow of foreign capital into the economy and ensure inflation is actively controlled in the economy

Dua and Garg (2013) conducted a study on the determinants of portfolio flows to India for the period of October 1995 to 2011. The determinants of disaggregated component of portfolio flows (FPI), foreign institutional investment flows (FIIS) and investment flows received through American/ Global depository receipts (ADR/GDRs) were also examined. The determinants were based partially on the portfolio balance model in which capital flows in an emerging economy and determined through an arbitrage condition. These included domestic stock market performance, exchange rate, reserves to import-ratio, interest rate differential, volatility in exchange rate, domestic output growth, foreign output growth and emerging market equity performance the results indicated that domestic stock market performance, exchange rate and domestic output growth were the most important determinants of both FII and ADR/GDP flows. Emerging market equity performance, interest rate differential and volatility in exchange rate influence FII flows but not the investment flows received through ADR/GDRs. Moreover, ADR/GDR flows were influenced by foreign output growth, but this was not so for the FII flows. Since FIIs have been the most dominant component of aggregate portfolio flows, therefore as expected the results for aggregate portfolio flows were similar to FII flows.

Durham (2003) examined the effect of foreign portfolio investment (FPI) and other foreign investment (OFI) on economic growth using data on 88 countries from 1977 through 2000. Most measures suggested that foreign portfolio investment has no effect and some results indicated that OFI has a negative impact on growth that is somewhat mitigated by initial financial and/ or legal development. However, these results were questionable due to possible simultaneity bias. The empirical analyses also examined whether non- FDI foreign investment affects growth indirectly. FPI does not correlate positively with macroeconomic volatility, but the results indicated that the negative indirect effect of other foreign investment through macroeconomic volatility comprises a substantial portion of the gross negative effect of OFI on growth.

Bada (2016) examined the effect of foreign portfolio investment (FPI) on Nigerian economic growth using time series data sourced from CBN for the period 1991 to 2014. OLS estimation was adopted for the analysis and major finding was that there were increase in the FPI for a given period as well as decline caused by global recession. He recommended improvement in regulation and capital market infrastructure.

3. Methodology

A quasi experimental research rooted on ex post facto research design is adopted to investigate the cause and effect relationship among the variable in the model. This approach combines theoretical consideration (apriori criterion) with empirical observations.

3.1. Data Sources

The method of data collection adopted in this study is the secondary method of data collection and it is sourced from the Central Bank of Nigeria (CBN) Annual statistical Bulletin and CBN Annual Report for the period 2005 to 2014.

3.2. Model Specification

It is the new economic growth (endogenous growth) theory that the model is built on the premises that good economic policy measure can promote growth thereby attracting foreign portfolio investments. Conversely, policies which will be intended to protect or favour particular existing industries are likely to slow growth. Accordingly, the endogenous growth theory is augmented with variables such as foreign portfolio investment (FPI), market capitalization (MCAP) and exchange rate (EXR). A multiple regression model of ordinary least square (OLS) is being used to determine the linear estimation of the effect of the independent variables for the growth of the Nigerian's economy. Therefore the model for this study is specified as follows:

RGDP= F (FPI+ MCAP + EXR)

$RGDP = a_0 + a_1 FPI + a_2 MCAP + a_3 EXR + U$

Where:

RGDP = Real Gross Domestic Product
FPI = Foreign Portfolio Investment
MCAP = Market Capitalization
EXR = Exchange rate
a_0 = the intercept of the function
$a_1 – a_3$ = Coefficient of the variables
u = the error term
$a_1 > 0, a_2 > 0, a_3 < 0$

4. Data Presentation and Analysis

Table 1: Real Gross Domestic Product (RGDP), Foreign Portfolio Investment (FPI), Market Capitalization (MCAP) and Exchange Rate (EXR)

Year	RGDP	FPI	MCAP	EXR
2005	561.90	896.10	2900.10	143.78
2006	595.80	1244.60	5120.90	148.33
2007	634.30	1459.10	13181.70	155.75

2008	672.20	1816.50	9563.00	93.64
2009	719.00	2149.30	7030.80	98.77
2010	776.30	2729.50	9918.20	92.31
2011	834.00	3689.20	10225.30	89.80
2012	888.90	6321.60	14800.90	80.61
2013	950.10	8448.10	19077.40	63.60
2014	1018.00	10088.00	16875.10	59.66

Source: CBN Statistical Bulletin 2014.

5. Presentation and Interpretation of Result

The ordinary least square (OLS) regression technique was employed in analyzing the model adopted in this study using its log form and the result obtained is presented below.

Table 2. Regression Results

Variable	**Coefficient**	**Std. Error**	**t-Statistic**	**Prob.**
C	5.353336	0.660551	8.104352	0.0002
LOG(FPI)	0.200305	0.046394	4.317454	0.0050
LOG(MCAP)	0.010417	0.034115	0.304115	0.7704
LOG(EXR)	-0.091750	-0.091750	0.090683	0.3507
R-squared	0.984319	Mean dependent var		6.621509
Adjusted R-squared	0.976479	S.D dependent var		0.202425
S.E.of regression	0.031045	Akaike info criterion		-3.817579
Sum squared resid	0.005783	Schwarz criterion		-3.696545
Log likelihood	23.08790	Hannan-Quinn criter		-3.950353
F-statistic	125.5454	Durbin-Watson stat		1.420526
Prob(F-statistic)	0.000008			

Source: Authors computation.

The result of the R^2 of 0.9764 indicates that the model has a very good fit indicating that, the explanatory variables determine over 97% of the variations in the dependent variable. The result also indicates that FPI and MCAP have positive effect on RGDP while an inverse relationship exists between EXR and RGDP.

Also, from the regression result, only FPI is found to have a significant positive relationship with RGDP at 1% level of significance. Consequently, a unit change in FPI is capable of stimulating RGDP by about 20%. The F-statistic of 125.5454 also reveals that the overall model is statistically, significant at 1% level of significance. The result is in line with a prori expectation and agrees with the findings of Baghebo and Apere (2014). Accordingly and based on this result, the null hypothesis is rejected implying that there is significant positive relationship between foreign portfolio investment and Real Gross Domestic Product in Nigeria.

The Durbin Watson coefficient shows that there is absence of auto correlation in the level series given that the value of 1.4205 lies within the critical region of 0.52534 and 2.01632 for 10 observations and 4 regressors.

6. Conclusion and Recommendation

This study appraises the impact of foreign portfolio investment on the economic growth in Nigeria for the period 2005 to 2014. Secondary data was sourced from the Central Bank of Nigeria statistical Bulletin and analyzed using ordinary least square (OLS) multiple regressions. Based on the result obtained, it is concludes that Foreign Portfolio Investment and market capitalization have positive effect on Real Gross Domestic Product(RGDP) in Nigeria , although only Foreign Portfolio Investment (FPI) have a significant positive relationship with RGDP, while exchange rate has an inverse relationship with RGDP. Consequently, it is recommended that enabling environment that would encourage foreign portfolio investment inflow should be created in order to enhance economic growth. Since economic performance is critical to pulling Foreign Portfolio Investment, the economy should be stimulated to ensure that it possesses strong fundamentals. Government of Nigeria should stabilize capital and money market activities with appropriate policies to sustain internationalization and attractiveness to investors.

Measures should be taken to ensure stability in the exchange rate movement, as high exchange rate can lead to dwindling economic fortune of the country.

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