

Investigating the Nexus between Institutional Quality and Stock Market Development in Nigeria: An Autoregressive Distributed Lag (ARDL) Approach

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Abstract: This study investigates the nexus between institutional quality and stock market development. The Autoregressive Distributed Lag Model (ARDL (1,1)) and ARDL bounds testing procedure (Pesaran et al., 2001) was adopted for the estimation. We used annual time series data that covers the periods 1985 to 2013. Institutional quality is measured with corruption control, democratic accountability and bureaucratic quality, while stock market development is measured with market capitalization ratio. The institutional quality captures the degree of transparency and the level of investors' confidence while market capitalization measures overall performance. In addition, we also accounted for the influence of the banking sector (proxy: ratio of credit to the private sector). We control for the influence of variables such as stock market liquidity and per capita income. The results of the bounds test suggest that institutional quality and market development move together in the long run. Further investigation also shows that corruption control and democratic accountability are key institutional measures that impact significantly on stock market development, suggesting that institutional quality promotes the degree of transparency and investors' confidence. Other variables such as stock market liquidity, bureaucratic quality and per capita income were also found to be important determinants of stock market development in Nigeria. Hence, given the above findings, the relevant authorities should increase their efforts to control the level of corruption through the enhancement of the regulatory framework that could ensure accountability and efficient monitoring of the market actors for the sustainability of investors' confidence and the promotion of stock market development in Nigeria.