

Quality of Governance and Stock Market Performance: The Nigerian Experience

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1.0 Introduction

The stock market performance is an important barometer by which the financial health of a country is gauged. The centrality of the market as well as its functionality has been accentuated by the recent global financial crises occasioned by the sub-prime mortgage lending originated in the US housing market. The contagious impacts of the resulting crises had unavoidably inflicted unquantifiable collateral damages to all and sundry. The extent of the cost of damage experienced however depends, to a greater extent, on the level of integration of a country's financial market with the international capital market.

The inevitable outburst of the crises has consequently forced many economies of the world to embark on bailing out schemes in their various domains in order to save some of the ailing sectors and companies who may not ordinarily have survived such calamity-imposing phenomenon from causing total irreparable damages. Evidences have however shown that governance and stock market performance are somewhat inseparable; thus suggesting they both go parri passu. This is underscored by the fact that a precondition for financial market development is the improvement of the institutions which govern the process of exchange. Aggarwal et al. (2002) noted that fund managers invest less in countries with poor legal environments and low corporate governance standards. Thus, better governance environments can increase returns to shareholders by reducing both transaction costs and agency costs (Hooper et al, 2009).

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Further, a well governed country or firm as the case may be, tends to score highly in stock market ratings than a poorly governed one. More importantly, the post-financial crises' reports of countries poor and volatile stock market prices have lent credence to the fact that the enormity of firm-specific corporate governance abuses thrives under the ambience of poor country-level governance environments of the country concerned.

Observably, the Africa's continent is notorious for her poor governance records and this has been found to constituting stumbling blocks on her growth trajectory for decades. Unarguably, Africa have had chequered past in terms of good governance records as compared to the advanced industrialized countries. The history of poor and bad governance is particularly appalling for sub-Saharan Africa where dictatorial tendencies and sit-tightism syndrome seem more prevalent than any other continents in the world. Nigeria, just like other countries within the sub-region had witnessed series of regime shifts from the extreme decree-based to constitutionally-inclined system of governance. Amid these developments, several cases of mis-governance remain the common feature of Nigeria's socio-economic and political landscape. Thus, effective functioning of any investment activity hinges on good corporate governance mechanisms which in turn depend on the quality of governance framework of a country. This is because firms do not operate in a vacuum as they are affected by the governance systems in which they operate.²

Specifically, the issue bordering on corporate governance problem has been found to be more prevalent in the financial segment of the economy. This in effect, implies that the quality of a country's governance is known to have rippling effects on the operation of financial and capital markets through its influence on the availability of external financing, cost of funding, market valuations, and quality of investments (see, Hail and Leuz, 2006; Hooper et al., 2009; Chen et al., 2009; Giannetti and Koskinen, 2010; Chiou et al., 2010; among others for detailed exposition). The situation has so degenerated to the extent that there are reported cases of flagrant abuses of corporate governance codes and guidelines among the management and other top decision making units of organizations. This is rampart among the financial institutions in the economy.

²The important interaction between governance mechanism at firm level and country-level governance framework is illustrated in a number of cross-country studies for examples, Klapper and Love (2004), Durnev and Kim (2005), Chen et al., 2009, Bruno and Claessens (2009), among others.

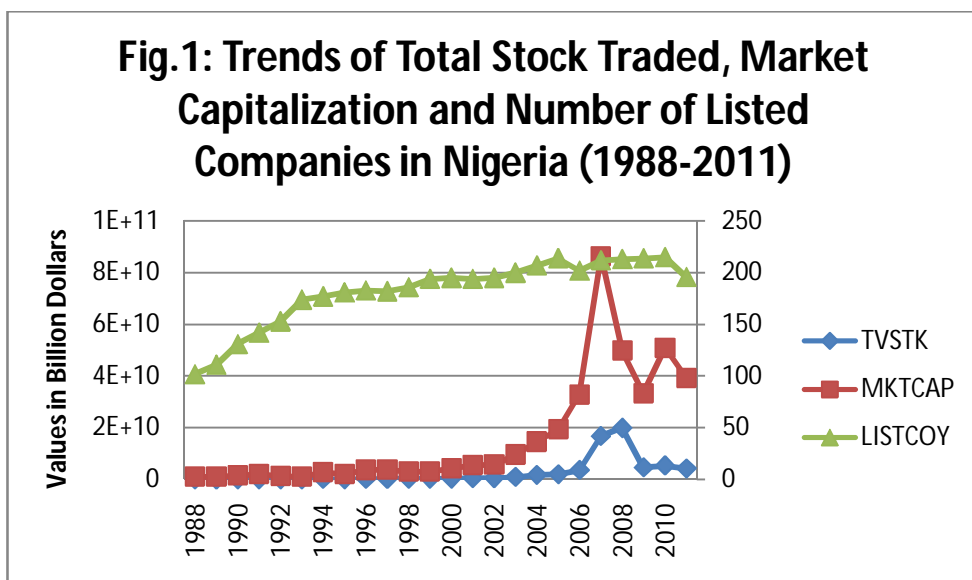
For instance, government at different points in time has had to interfere with running and workings of the Nigerian financial sector owing largely to corporate governance abuses by the financial and other fund managers alike. As a corollary, some experts and stock analysts have attributed post-global financial crises crash of the Nigerian Stock Exchange market, in part to governance abuses among the financial managers as well as captains of the industry. In view of the various misgovernance and extreme intervention through battery of reforms by the government towards maintaining sound financial architecture, the pertinent question remains: to what extent does governance influence stock market performance in Nigeria

Most empirical studies that had been conducted in the past focus mainly on firm-specific corporate governance as it affects stock market returns or prices as the case may be. This study charts a different path as it beams a searchlight on the country-level governance environment under which firm-specific corporate governance is implemented. The underlying assumption is that if a sound country-level governance structure exists, then all things being equal, all other sub-governance structures will be bettered. Governance factor apart, literature is also replete on other factors as playing contributory roles on stock market performance. These include but not limited to country ratings (Erb et al, 1995, 1996b; Bekaert et al, 1997; Bekaert and Harvey, 2000a, Cantor and Packer, 1996a), valuation ratios (Campbell and Shiller, 1998; Fama and French, 1992; Maroney et al, 2004; Ciaessens et al, 1998; Groot and Verschoor, 2002), inflation rates (Erb et al, 1995; Hooker, 2004), population demographics (Bakshi and Chen, 1994; Bekaert et al, 1998), exchange rates (Bailey and Chung, 1995; Harvey, 1995), and sovereign spreads (Gendreau and Heckman, 2003). The novelty of this study over the previous related studies stems from the following grounds: First, we are not aware of any country-specific studies on governance-stock market performance for Nigeria thus signifying that our represents the first empirical attempts at investigating such relationship for the country. Second, literature on the subject is scanty but where exists they are usually conducted at the cross-country or sectional levels. As a consequence, this study adds new empirical evidence to the existing stock of knowledge. Third, an advanced econometric technique of Bound testing approach of ARDL is employed. Lastly, a high frequency dataset is used thus guaranteeing credit estimates as well as ensuring a more robust policy recommendations are made.

While section one gives the introductory part, section two presents the stylized facts about governance and stock market performance in Nigeria. Section three reviews the literature on governance-stock market performance nexus with a view to situating the issue in the proper perspective and also the layout of the theoretical framework on which the study is anchored as well as the methodological tools to be adopted is properly outlined in section four. Section five presents the empirical analysis of the findings while section six concludes and gives policy recommendations for policy applications.

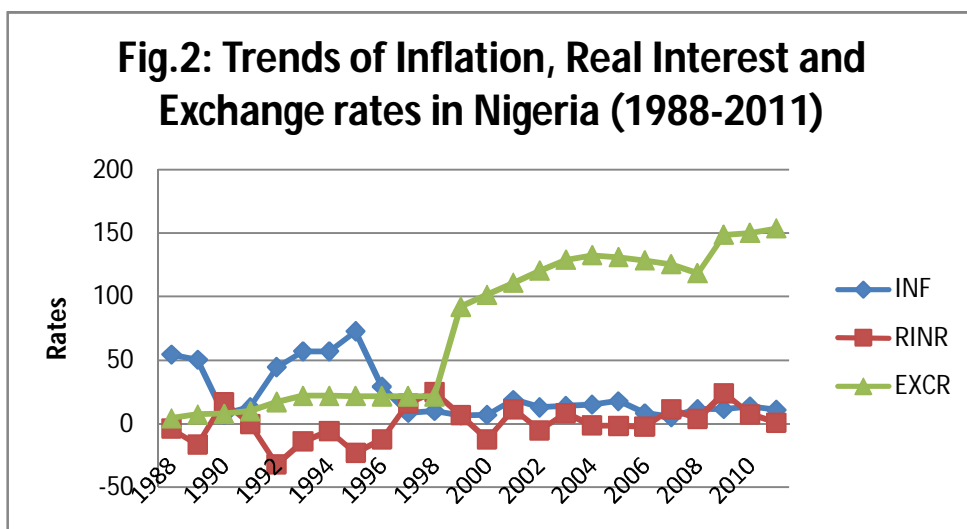
2.0 Stylized Facts about Governance and Stock Market Performance in Nigeria

This section presents some stylized information about the trends of key variables like value of total stock traded, market capitalization, all share price index, number of listed companies, inflation, real interest and exchange rates as well as the components of governance index for Nigeria. It can be observed from the Fig.1 that there have been sustained growths both in the values of total value of stock traded and market capitalization. The latter witnessed unprecedented jumps in growth beginning from 2002 up till 2007 before nosedived sharply and this can be attributed mainly to global financial crises occasioned by sub-prime mortgage lending originated in the US housing bubble in the late 2007. Similar pattern of movements are also observed in the case of the former.



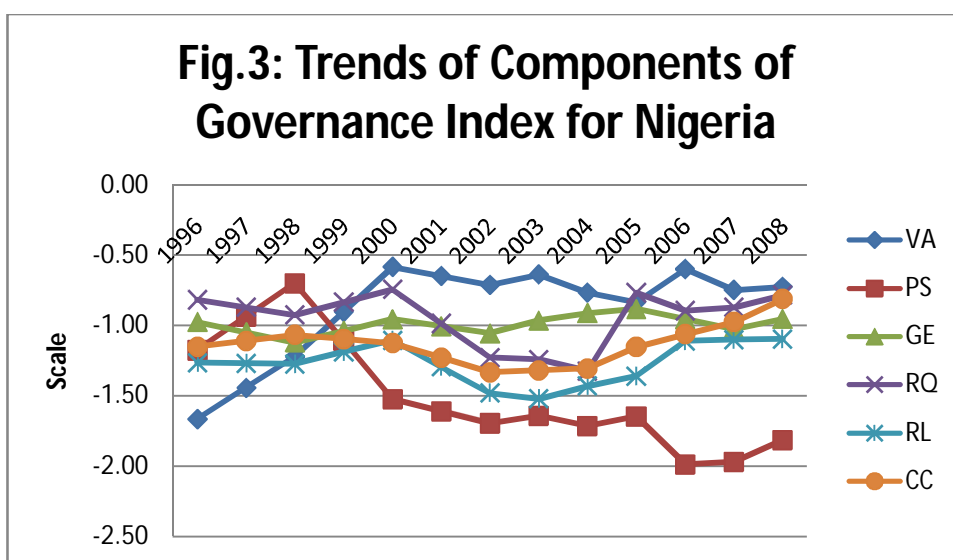
We also equally observed consistent upward trend of movements in the number of listed companies in Nigeria but slight downward trends became noticeable between 2006 and 2011 respectively. The fall in the number of companies can be said to be due to spate of liquidations experienced by the listed companies for the reasons that has to do with corporate governance problems like insider dealings, irrecoverable debts, falsification of accounting records etc

The macroeconomic environment can also be explained within the context of macroeconomic instability as captured by the inflationary trend, real interest rates and exchange rate respectively. Double digits inflation rates largely characterized the Nigerian experience and this became heightened in 1995 when the rate was well over 70 percent. Beginning from 1996 till 2011, there were remarkable declines from the rates owing largely to policy targets aiming at maintaining price stability usually at single digits. For the real interest rates, the values were in large part negatives for the most part of the period of consideration. With double digit inflation rates and negative values of real interest rates, the performance of stock are adversely affected. Further, the value of naira to dollar kept depreciating for the large part of the period as can be observed from Fig.2



The components of governance index like voice and accountability, political instability, government effectiveness, regulatory quality, rule of law and control of corruption are in negative values beginning from 1996 up till 2011 thus portending bad and worsening condition of governance in the country.

Of the components, political instability drifts away from the baseline as compared to other as can be observed from the diagram. Same goes for rule of law and control of corruption lines.



3.0 A Concise Literature Review on Governance-Stock Market Performance Nexus

Extensive literature has documented the importance of stock market development to stimulating economic growth³ to date. The strand of literature that dwells on the relationship between governance and stock market performance is still emerging and scanty. The seminal work of Jensen and Meckling (1976) provided the early literature on governance but focused on firm-level agency costs⁴ arising from the ownership and control delineation structure of firms.

³ For example, Demircuc-Kunt and Levine (1996a), Singh (1997), and Levine and Zervos (1998) find that stock market development plays an important role in predicting future economic growth. *The World Bank Economic Review* issue of May 1996 is dedicated exclusively to the role of the stock markets in economic growth.

⁴ Love (2010) provides a good review on corporate governance and performance around the world.

The more recent literature (see, e.g., La Porta et al., 1997, 1998, 2000; Ball et al., 2000; Gul and Qui, 2002; Shleifer and Wolfenson, 2002) shifted the focus from firm-specific corporate governance to country-level governance environments.

Garcia and Liu (1999) empirically explored the determinants of stock market development, particularly market capitalization.

They also examined the association between financial intermediary development and stock market development using a sample of fifteen industrial and developing countries from 1980 to 1995. They concluded that real income level, saving rate, financial intermediary development, and stock market liquidity are important predictors of market capitalization, while macroeconomic stability does not have any explaining power. They confirmed that stock market development and financial intermediary development are complement instead of substitutes.

Lombardo and Pagano (2000) estimate the correlation between the quality of the institutional environment and the return on equity for a cross-section of national stock market indices from both developed and emerging markets. They use several measures of the return on equity, such as the total return on national equity markets (controlling for risk premia), accounting-based measures of return including dividend yields and earning-price ratios (controlling for international differences in growth and inflation), and the degree of initial public offering (IPO) underpricing. They find that all estimates reveal a positive correlation between the risk adjusted return on equity and measures of the quality of legal institutions. These measures include the origins of the judicial system, respect for the law, lack of corruption among government officials, quality of accounting standards and the risk of contract repudiation. The same results were found when they use accounting measures of the rate of return on equity: both the dividend yield and the earnings-price ratio were found to be positively correlated with measures of the quality of legal institutions

Naceur et al (2007) investigated the determinants of stock market development in 12 Middle-Eastern and North-African region countries, employing fixed and random estimation technique. Their results showed that saving rate, financial intermediary, stock market liquidity and stabilization variable appeared as important determinants of stock market development.

In addition, it is found that financial intermediaries and stock markets are complements rather than substitutes in the growth process.

Hooper et al (2009) used international asset pricing models to investigate the link between the quality of government institutions and the performance of global stock markets. The results demonstrate a significant positive association between stock market performance measures and the quality of the institutional environment.

Performance measures examined for the cross-section of countries were the average monthly stock index excess returns and the Sharpe ratio. All measures of performance were adjusted for global and local risk factors known to explain their international variation. The quality of governance is also found to be negatively associated with stock market total risk and idiosyncratic risk, consistent with the notion that stable institutions are linked to reduced variations in equity returns. These findings suggest countries with better developed governance systems have stock markets with higher returns on equity and lower levels of risk.

Low et al (undated) examined the link between country-level governance and global stock market returns. They found a negative relation between governance quality and equity return. Countries with low governance scores, on average, have higher equity returns than those with high governance scores after controlling for global risk factors known to influence international equity returns. By implication, that investors associate low governance quality with increased risk and thus demand higher risk premium. They also confirmed from their result that the quality of governance as measured by political stability and absence of violence is key governance dimension affecting international equity returns, suggesting that heightened investor concerns over political risks have profound impact on equity markets. Interestingly, they found no evidence that variation in equity returns is affected by the governance indicator representing voice and accountability.

The foregoing provides the basis for the void the study intends to plug which distinguishes it from previous studies at least in a major respect. To the best of our knowledge, our represent one of the pioneering studies that has examined the possible impacts of governance on stock market performance for the sub-Saharan region at a country-specific level.

4.0 Empirical Specifications, Data and Estimation Techniques

This section presents a framework to model the impact of governance on the stock market performance and the objective is to identify the simple relationship between stock market performance, components of governance index and some selected key forcing macroeconomic variables. In line with the previous empirical studies, the causal relations among the variables is thus specify as follows:

$$STKPERF = f(GOVERNANCE_FACTORS, CONTROL_VAR) \text{-----(1)}$$

Where STKPERF represents stock market performances, GOVERNANCE_FACTORS as components of governance index and CONTROL_VAR stands for other control variables. Also GOVERNANCE_FACTORS can be decomposed as:

$$GOVERNANCE_FACTORS = f(CC, GE, PS, RL, RQ, VA) \text{-----(2)}$$

Governance comprises of six governance measures (World Governance Indicators-WGI) provided by the World Bank as proxies of countries' governance quality (Kaufmann et al., 2006). The indicators are constructed using an unobserved components methodology (Kaufmann et al., 2010). *Control of Corruption* (CC) captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests. *Political Stability and Absence of Violence* (PS) measures the perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including domestic violence and terrorism. *Government Effectiveness* (GE) captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. *Regulatory Quality* (RQ) captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. *Rule of Law* (RL) captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.

Voice and Accountability (VA) captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media. Given the brief expositions on governance indicators, we then specify the empirical model as:

$$STKPERF_i = f(CC, GE, PS, RL, RQ, VA, INF, RINR, EXCR) \text{ -----(3)}$$

$STKPERF_i$ stands for stock market performance and where subscript i represents the three measures used to proxy for stock market performance like all-share price index, market capitalization and value of total stock traded.

A positive relationship is hypothesized between any of the stock market performance measures and governance indicators. That, an improvement or increase in any of the governance indicators is expected to increase the value of stock market performance. Hence CC, GE, PS, RL, RQ and VA in relation to stock performance measures should be greater than zero and the converse holds in case of the diminution in governance indicators. Inflation reduces the value of stock market performance thus suggesting that it has negative effects on stock market activities and vice versa. A higher interest rate has a tendency of stimulating stock market activity and conversely a lower rate of interest discourages investment activities. In this case a negative relationship is hypothesized. Finally, an inverse relationship is posited between exchange rates and stock market performance. Symbolically, it can be stated as: $CC, GE, PS, RL, RQ, VA > 0$ while $INF, RINR, EXCR < 0$

4.1 Methodology

The methodology of this study is designed to assess the impact of the governance on real estate markets performance in Nigeria. In this study, we utilize the Autoregressive Distributed Lag (ARDL) approach to cointegration as outlined by (Pesaran and Pesaran, 1997) and (Pesaran and Shin, 1998). The ARDL model has been chosen here because it has numerous advantages. Firstly, it can be applied irrespective of whether the individual regressors are integrated of the order $I(0)$ or $I(1)$, regardless of stationarity. Secondly, the ARDL model takes sufficient number of lags to capture the data generating process from a general to specific modeling framework (Laurenceson and Chai, 2003). Thirdly, the ARDL approach yields superior estimates of long-run coefficient, and, the diagnostic tests of the estimated equation are more reliable (Gerrard and Godfrey, 1998, p 235) and (Laurenceson and Chai 1998, p 405).

Fourthly, from the ARDL model, one can derive a dynamic error correction model (ECM) through a simple linear transformation (Banarjee et al, 1994, pp 50-52). The ECM also helps us to measure the short-run relationship among the model's variables. Finally, the ARDL model is a more appropriate measure in the case of a smaller sample. Since the sample size of our study is limited to 60 observations, it provides more motivation for the study to apply the ARDL approach for analysis.

$$\begin{aligned} \Delta STKPERF_t = & \xi_0 + \sum_{i=1}^p \xi_1 \Delta STKPERF_{t-i} + \sum_{i=1}^p \xi_2 \Delta INF_{t-i} + \sum_{i=1}^p \xi_3 \Delta RINR_{t-i} + \sum_{i=1}^p \xi_4 \Delta EXCR_{t-i} + \sum_{i=1}^p \xi_5 \Delta CC_{t-i} + \\ & \sum_{i=1}^p \xi_6 \Delta GE_{t-i} + \sum_{i=1}^p \xi_7 \Delta PS_{t-i} + \sum_{i=1}^p \xi_8 \Delta RL_{t-i} + \sum_{i=1}^p \xi_9 \Delta RQ_{t-i} + \sum_{i=1}^p \xi_{10} \Delta VA_{t-i} + \Xi_1 STKPERF_{t-i} + \\ & \Xi_2 INF_{t-1} + \Xi_3 RINR_{t-1} + \Xi_4 EXCR_{t-1} + \Xi_5 CC_{t-1} + \Xi_6 GE_{t-i} + \Xi_7 PS_{t-i} + \Xi_8 RL_{t-i} + \Xi_9 RQ_{t-i} + \\ & \Xi_{10} VA_{t-i} + \sigma_t \end{aligned} \quad \text{-----(4)}$$

where Δ = 1st difference of a variable,

L indicates that the data set are expressed in natural logarithms,

ξ_0 is a constant,

ρ is a maximum lag order,

ξ_1 ----- ξ_{10} represent the short-run coefficients (error correction dynamic),

Ξ_1 ----- Ξ_{10} correspond to the long-run relationship,

i time trend, and, σ_i is the white noise error.

The implementation of the ARDL approach involves two stages. First, the existence of the long-run nexus (cointegration) between variables under investigation is tested by computing the F-statistics for analyzing the significance of the lagged levels of the variables. (Pesaran, Shin, and Smith, 1999) and (Narayan, 2004) have provided two sets of appropriate critical values for different numbers of regressors (variables). This model contains an intercept or trend or both. One set assumes that all the variables in the ARDL model are of I(0), and another assumes that all the variables are I(1). If the F-statistic lies above the upper-bound critical value for a given significance level, the conclusion is that there is a non-spurious long-run level relationship with the dependent variable.

If the F-statistic lies below the lower bound critical value, the conclusion is that there is no long-run level relationship with the dependent variable. If it lies between the lower and the upper limits, the result is inconclusive. The general form of the null and alternative hypotheses for the F-statistic test is as follows:

$$\begin{aligned}
 H_0 : \Xi_1 = \Xi_2 = \Xi_3 = \Xi_4 = \Xi_5 = \Xi_6 = \Xi_7 = \Xi_8 = \Xi_9 = \Xi_{10} = 0 \\
 H_0 : \Xi_1 \neq \Xi_2 \neq \Xi_3 \neq \Xi_4 \neq \Xi_5 \neq \Xi_6 \neq \Xi_7 \neq \Xi_8 \neq \Xi_9 \neq \Xi_{10} \neq 0 \text{-----(5)}
 \end{aligned}$$

Secondly, if the cointegration between variables is identified, then one can undertake further analysis of long-run and short-run (error correction) relationship between the variables. The error correction representation of the series can be specified as follows:

$$\begin{aligned}
 \Delta STKPERF_t = \xi_0 + \sum_{i=0}^p \xi_1 \Delta STKPERF_{t-i} + \sum_{i=0}^p \xi_2 \Delta INF_{t-i} + \sum_{i=0}^p \xi_3 \Delta RINR_{t-i} + \sum_{i=0}^p \xi_4 \Delta EXCR_{t-i} + \sum_{i=0}^p \xi_5 \Delta ACC_{t-i} + \\
 \sum_{i=0}^p \xi_6 \Delta GE_{t-i} + \sum_{i=0}^p \xi_7 \Delta PS_{t-i} + \sum_{i=0}^p \xi_8 \Delta RL_{t-i} + \sum_{i=0}^p \xi_9 \Delta RQ_{t-i} + \sum_{i=0}^p \xi_{10} \Delta VA_{t-i} + \psi ECT_{t-1} + \varepsilon_t \\
 \text{--(6)}
 \end{aligned}$$

Where ψ is the speed of adjustment parameter and ECM is the residuals obtained from equation 1 (i.e. the error correction term). The coefficient of the lagged error correction term (ψ) is expected to be negative and statistically significant to further confirm the existence of a cointegrating relationship.

Data Source

The data were sourced from Central Bank of Nigeria (CBN) Statistical Bulletin, various issues, stock market fact book, World Development Indicators (WDI), 2012, World Governance Indicators (WGI) by Kaufmann et al, 2012.

5.0 Analysis of Empirical Results

As is the convention in contemporary time series investigations, to side step spuriousness in the regression estimates. The results of Ng and Perron (2001) unit root tests are reported in Table 1. Ng–Perron test is preferred as the results are more reliable and consistent compared to the traditional ADF and P–P tests.

DeJong et al (1992) and Harris and Sollis (2003) argued that due to their poor size and power properties, these tests are not reliable for small sample size. These tests will over-reject the null hypotheses when it is true and accept H_0 when it is false. Ng–Perron test can solve the problem of over-rejection of null hypothesis and can be applied on small sample size. Table 1 shows that some variables are $I(0)$ while some are $I(1)$ thus provide justification for the use of ARDL of bound tests.

Table.1: Results of the Ng-Perron Unit Root Test

Variables	MZa	MZt	MSB	MPT
Level				
ALLSHR	-12.63241**	-3.7617	0.1176	27.8918
MKTCAP	-17.9712**	-4.6175	0.1852	19.1981
TVSTK	-5.7432	-1.8767	0.2343	29.4524
CC	-4.9871	-0.9871	0.5464	21.2341
GE	-5.1551	-1.1232	0.4231	17.9021
PS	-7.9770	-1.4526	0.3081	19.0341
RL	-4.0918	-1.4352	0.2322	20.1020
RQ	-5.9776	-0.9898	0.3397	18.7681
VA	-4.4616	-0.7876	0.2871	19.7657
First Difference				
ALLSHR	-34.9812***	-3.1341	0.1157	3.6424
MKTCAP	-52.9081***	-2.9087	0.1091	4.4526
TVSTK	-29.9342***	-5.0917	0.1324	5.2561
CC	-18.9816**	-2.9871	0.1171	6.6123
GE	-19.8614**	-3.3141	0.1615	6.2871
PS	-22.9123***	-4.0041	0.1342	4.2561
RL	-28.9181***	-3.1173	0.1228	3.8791
RQ	-20.0198**	-2.8979	0.1671	3.9082
VA	-19.0445***	-4.7521	0.1342	5.0245

Note: ***(**)* indicate the significance at the 1%,5% and 10% respectively

Given a relatively small sample size, a lag length of 2 is used in the bounds test. The results of the bound test are given in table 2. The critical values used in this paper are extracted from Narayan (2004)⁵.

⁵ Narayan (2004) has provided critical values that are considered to be more appropriate for ARDL modeling using small samples as compared to Pesaran and Pesaran (1997) and Pesaran et al (2001). These critical values are based on small sample size between 30 and 80 observations, unlike Pesaran and Pesaran (1997) and Pesaran et al (2001) which are based on 500 and 1000 observations and suitable for large sample size.

The F-statistic for the models are 6.5866, 9.8981 and 10.9538 which are greater than the upper critical bounds both at the 1 and 5 percent significance levels. This suggests that there is a long-run relationship among stock market performance (e.g all-share price index, market capitalization and value of total stock traded) and inflation, real interest rate, exchange rates, components of governance index like control from corruption, government effectiveness, political instability, rule of law, regulatory quality and voice and accountability respectively.

Table.2: Estimated ARDL Models and Bounds F-test for Co integration

Models for estimation	Lag Length	F-Statistic	Critical value at 1%	Critical value at 5%
$(ALLSHR / INF, RINR, EXCR, CC, GE, PS, RL, RQ, VA)$	2	6.5866	3.674-5.019	2.694-3.829
$(MKTCAP / INF, RINR, EXCR, CC, GE, PS, RL, RQ, VA)$	2	9.8981	3.674-5.019	2.694-3.829
$(TVSTK / INF, RINR, EXCR, CC, GE, PS, RL, RQ, VA)$	2	10.9538	3.674-5.019	2.694-3.829

Source: Computed

Notes: The critical values (CV) for the lower I(0) and upper I(1) bounds are taken from Narayan (2005, Appendix: Case II).

Table.3 presents long run static results of an ARDL model. From table.3 below, Inflation rate was found to conform with a priori expectation of model 1 with and without control for autocorrelation problems. In 1(a) a one percent increase in inflation rate will lead to -1.44 percent decrease in all-share price index and this is statistically significant at 1 % level. This seems logical as increasing rate of inflation has a depressing impact on share prices as suggested by the result. The real rate of interest also does not repudiate theoretical expectation. This is particularly true since an increase in the real interest rate tends to drive up the demand for shares and which consequently stimulates increase in the prices of shares. This is statistically significant at a conventional level of 1% in both 1a and 1b respectively. The depreciating value of naira vis-à-vis dollar measured by exchange rate appeared insignificant in 1(a) but statistically significant in 1(b) and this can be said to be due to costly nature of the rate of exchange of naira to dollar mostly by foreigners when purchasing shares in Nigeria.

This apart, of the components of governance index, three out of six comply with theoretical predictions. These include control from corruption (CC), government effectiveness (GE) and regulatory quality (RQ) respectively. Variations however exist in terms of variables significance in both 1(a) and 1(b). Five components appeared as significant in the former whereas three were significant in the case of the latter. A marginal increase in the unit of corruption control will make share prices to command much higher prices than the case when corruption was made to thrive. A unit increase on the coefficient of control of corruption (CC) will make all share price index to rise by 37 % and 48% respectively. So also, the level of government effectiveness will likely increase share prices by 1.43 and 1.10 percent respectively.

The coefficient on political instability variable conveys a contrary a priori signs thus confirming the declining impacts of the variable on the share prices. This is plausible as no individual or country would want to invest in a country that is confronted by political turmoil as witnessed by the country. In fact, the level of significance occurs at a 1% in model 1 both with and without autocorrelation problems. Further, the deficient in the freedom of voice and accountability and rule of law also exert negative impacts on the share prices whereas regulatory impinges positive effects as can be observed on the table. Unlike 1(a), none of the component variables appear significant statistically in 1(b).

For model 2, the resulting outcomes are almost similar to model1 except for the variable of voice and accountability component that has negative association with market capitalization at the highest level of statistical significance of 1 % most especially after controlling for problems of autocorrelation that invalidated model 2(a). Noticeably, the impact of corruption control seems to exert greater influence on market capitalization at least at a 1% level as indicated on the table.

Model 3 also share similar traits with the two models 1 and 2 in many respects. The slight difference however seems to occur in 3(b) when the impact of regulatory quality imposes significant negative impacts on the total value of stock traded on the floor of the stock exchange market. The possible explanation can be likened to the fact that firms or companies will only be allowed to trade in their stocks provided all the laid down rules guiding the conduct of the trading processes are duly complied with.

More importantly, the basic statistics measured by R-squared show that all the models' dependent variables are explained by the explanatory variables to the tune of over 90% while the Durbin-watson statistics fall within the acceptable region for model 1b, 2b and 3c that have been controlled for autocorrelation problems. In addition, all the models (those controlled for autocorrelation) passed all the diagnostic tests relating to residual normality, white heteroskedasticity autoregressive conditional heteroskedasticity, model specification and serial correlation

Table.3: Long Run Estimates of an ARDL Model

	Model 1		Model 2		Model 3	
	Dependent variable: All Share Price Index (ALLSHR)		Dependent variable: Market Capitalization (MKTCAP)		Dependent variable: Value of Total Stock Traded (TVSTK)	
	Without control for Autocorrelation (1a)	Control for Autocorrelation (1b)	Without control for Autocorrelation (2a)	Control for Autocorrelation (2b)	Without control for Autocorrelation (3a)	Control for Autocorrelation (3b)
Intercept	3.5757 (14.3953)***	4.8481 (3.3958)***	9.2514 (32.9616)***	10.4438 (9.7502)***	9.5388 (22.8671)***	11.8101 (6.3107)***
INF	-0.0144 (-4.4447)***	-0.0060 (-2.4505)**	-0.0192 (-5.2289)***	-0.0095 (-3.4873)***	-0.0188 (-3.4492)***	-0.0096 (-2.2630)**
RINR	0.0092 (4.9883)***	0.0066 (4.8788)***	0.0109 (5.2132)***	0.0079 (5.2764)***	0.0153 (4.9225)***	0.0111 (4.7690)***
EXCR	-0.0003 (-0.2692)	-0.0034 (-3.2698)***	0.0019 (1.3721)	-0.0021 (-1.8255)*	0.0029 (1.4608)	-0.0021 (-1.1640)
CC	0.3796 (1.7926)*	0.4759 (2.1198)**	1.4135 (5.9072)***	0.6018 (2.3958)**	3.4169 (9.6081)***	1.9109 (4.9082)***
GE	1.4309 (7.3791)***	1.1012 (5.1663)***	1.2863 (5.8708)***	0.8980 (3.7678)***	1.8450 (5.6660)***	1.7138 (4.6353)***
PS	-1.0328 (-9.8977)***	-0.6195 (-5.5134)***	-1.3479 (-11.4320)***	-0.9684 (-7.7013)***	-1.5293 (-8.7268)***	-0.8669 (-4.4441)***
RL	-0.5689 (-2.1620)**	-0.0209 (-0.0923)	-0.7783 (-2.6179)**	-0.2194 (-0.8679)	-1.5516 (-3.5115)***	-0.5090 (-1.3018)
RQ	0.0607 (0.4542)	0.0222 (0.2216)	0.0974 (0.6446)	0.0109 (0.0974)	-0.3460 (-1.5416)	-0.5082 (-2.9286)**
VA	-0.4480 (-4.1084)***	-0.1714 (-1.4161)	-0.8088 (-6.5646)***	-0.5030 (-3.7141)***	-0.4249 (-2.3202)**	-0.2560 (-1.2230)
AR(1)	-	0.9845 (37.5734)***	-	0.9800 (36.0174)***		0.9807 (39.7411)***
Basic Statistic						
R ²	0.928	0.977	0.963	0.988	0.964	0.987
D.W	0.6240	2.1129	0.6065	2.1162	0.6448	2.1662
Diagnostic Tests						
χ^2_{NORMAL}	4.9248 (0.0852)	211.003 (0.8212)	5.1188 (0.0774)	187.783 (0.4211)	5.6677 (0.0588)	438.790 (0.2862)
χ^2_{WHITE}	2.07E+24 (0.0000)	0.6931 (0.7780)	1.68E+24 (0.0000)	0.6814 (0.7890)	9.80E+23 (0.0000)	0.7856 (0.6864)
χ^2_{ARCH}	157.57 (0.0000)	0.5075 (0.4790)	116.134 (0.0000)	0.5354 (0.4672)	1.88.195 (0.0000)	0.2506 (0.6185)
χ^2_{RESET}	85.946 (0.0000)	8.1990 (0.0061)	73.376 (0.0000)	6.8289 (0.0118)	11.5095 (0.0013)	4.5025 (0.0387)
χ^2_{SERIAL}	24.486 (0.0000)	0.1978 (0.8212)	25.974 (0.0000)	0.2142 (0.8079)	23.049 (0.0000)	0.4500 (0.6402)

Source: Computed

The results of the short-run dynamics associated with the ARDL are reported in table 4. The coefficient of ECT (-1) shows speed of adjustment from short-run to long-run and for all the models, they are statistically significant with negative signs. The coefficient of the lagged error correction term for model 1 (-0.4821) is negative and statistically significant. The magnitude of the coefficient implies that 48 percent of the disequilibrium caused by previous quarter's shocks converges back to the long-run equilibrium in the current quarter.. Bannered etal.(1998) noted that significant lagged error term with negative sign is a way to prove that the established long-run relationship is stable. The deviation of all share price index from short-run to the long-run is corrected by 48.2 % each quarter. Just like in the long run, inflation and exchange rates reduce all share price index by meager of 0.006 and 0.0034 percent respectively. The real rate of interest exerts a positive impact on share prices as indicated by t-value of 3.2117. Of the components of governance index, the impacts of control of corruption, government effectiveness and political instability stand out prominently as they are statistically significant at both 1 and 5% levels but with alternating signs. While that of corruption and political instability carry negative signs on the one hand and the coefficient on government effectiveness bears a positive sign on the other hand. Other components remain insignificant with alternating signs.

In the same vein, error correction models for both model 2 and 3 confirm the existence of a stable long-run relationship and cointegration relationship among variables. Table.4 shows that the coefficients on the error correction term ECM (-1) are statistically significant with the negative expected signs. This confirms the existence of a stable long-run relationship among the variables. The coefficients on ECM (-1) for models 2 and 3 are (-0.403) and (-40.8) per cent, which suggests fast adjustment processes. Nearly 40 and 41 per cent of the disequilibrium of the previous quarter's shock adjusts back to the long run equilibrium in the current quarter. All other forcing variables remain as they are in the long run static results.

Table.4: Estimates of Short Run Dynamics of an ARDL Model

	Model 1	Model 2	Model 3
	Dependent variable: All Share Price Index (ALLSHR)	Dependent variable: Market Capitalization (MKTCAP)	Dependent variable: Value of Total Stock Traded (TVSTK)
Intercept	0.0126(1.7273)*	0.0143(1.7291)*	0.0258(2.0545)**
Δ INF	-0.0060(-2.3981)**	-0.0095(-3.4198)***	-0.0096(-2.2222)**
Δ RINR	0.0066(4.7991)***	0.0080(5.2017)***	0.0112(4.7116)***
Δ EXCR	-0.0034(-3.2117)***	-0.0021(-1.7955)*	-0.0021(-1.1566)
Δ CC	0.4787(2.0891)**	0.5992(2.3395)**	1.9032(4.7981)***
Δ GE	1.1085(5.0847)***	0.9074(3.7247)***	1.7321(4.5911)***
Δ PS	-0.6148(-5.0847)***	-0.9617(-7.4865)***	-0.8550(-4.2990)***
Δ RL	-0.0190(-0.0826)	-0.2187(-0.8499)	-0.5057(-1.2701)
Δ RQ	0.0175(0.1712)	0.0046(0.0404)	-0.5195(-2.9373)**
Δ VA	-0.1648(-1.3550)	-0.4919(-3.6271)***	-0.2391(-1.1373)
ECT(-1)	-0.4821(-2.3611)**	-0.4034(-2.2032)**	-0.4080(-2.4012)**
AR(1)	0.0078(0.0058)	-0.0244(0.0244)	0.0011(0.0010)
Basic Statistics			
R ²	0.538	0.635	0.66
D.W	1.999	1.996	2.000

Source: Computed

6.0 Conclusion and Policy Recommendations

The paper examines the impact of governance on stock market performance using quarterly data series spanning 1996Q1 to 2010Q4. An ARDL bound testing methodology was employed to explore such causal relationship. The important role of the forcing variables like inflation, real interest rate and exchange rate were clearly brought to fore as influencing the performance of stock measured through all share price index, market capitalization and the value of total stock traded. Of interest however are the key roles of the components of governance index on the performance of the performance measures. Notably, control of corruption and government effectiveness exert positive impacts while political instability had a dampening impact on such measures of stock performance. More importantly, a long run stable relationship were established through the error correction terms of each of the measures used to the tune of -0.4821, -0.4034 and -0.4080 for all share price index, market capitalization and the value of total stock traded respectively.

Emanating from this, are a few policy messages which includes: stability should be constantly maintained and promoted as it constitutes drag on the stock performance; any acts of corruption should be eschewed as it scares away potential investors into the country and the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies should be enhanced altogether.

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