Portfolio Investment and Banking Sector Growth in Nigeria

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ABSTRACT

Over the years, attempts to explore the effect of foreign portfolio investments have always been correlated with aggregate economy, whereas, foreign portfolio investments go into different sectors that make up the aggregate economy. Hence, this study departed from the norms and examined how foreign portfolio investment and growth of the banking sector are related in Nigeria from 2010 to 2019. The growth in the banking sector was proxy with the total assets of the sector and expressed as a linear function of equity foreign portfolio investment, foreign portfolio investment in debt instruments and exchange rate. Quantitative data used in this study were sourced from the Statistical Bulletin of various editions, issued by the Central Bank of Nigeria while analysis of the data was done with ordinary least square multiple regression technique. Findings from this study revealed that equity foreign portfolio investment was negatively and insignificantly associated with growth in the banking sub- sector. Furthermore, it was revealed that debt portfolio investment and official exchange rate were positive and significant determinants of growth of the banking sector, such that debt foreign portfolio investment positively predicted growth of the banking sector by 6% for every 1% change in its value while exchange rate facilitated growth of the banking sector by 50% for every 1% change in its value. Based on these results, it was concluded that foreign portfolio investment was positive determinants of growth of the banking sector; hence, it was recommended that Nigerian government should, through macro-economic policy reform, create enabling environment strategically for the attraction of foreign portfolio investment; this may include liberalization of the procedures and formalities for the transfer of capital across Nigeria's border.

Keywords: Equity portfolio investment, Debt portfolio investment, Exchange rate, Growth of the banking sector

JEL Classification: E20, E31, F31, O11

1.   Introduction

Securities and other fiscal resources held inactively by foreign investors from other countries make up a foreign portfolio investment. Investing by means of foreign portfolio disallows investors from having ownership of financial assets directly and, as a result, no control over the company is gained by the foreign portfolio investors. This type of investment is very liquid, and depends on the volatility of the market in which it is invested in, and is typically utilized by investors that are not interested in active management of a company in another country. Foreign portfolio investment (FPI) is a major source from which capital flows into a country's economy. After evaluating the potential risk, FPI investors typically make short-

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term investments in another country's domestic security with the goal of receiving a return. Nigeria has been seeking for portfolio investment from other countries in recent years, believing that this will help the country's economy expand and flourish, eventually leading to industrialization (Adeleke, 2004).

Apparently, this possibly led to why Majeed, *et al.* (2021) posit that investment directly from abroad is conceived as a requirement for attaining and sustaining industrial competitiveness; hence the outlook of association between portfolio investment from abroad and extent to which the banking sector is growing has implications for the economy in respect of which such association is investigated. According to Nwanji, *et al.* (2020), this is due to the fact that FDI is primarily the source from which technology, financial and labour force development are transferred for the progress of the developing countries.

However, the recent challenges bedeviling the country may cast some doubts on the potential of Nigeria to become attractive destination for foreign investment. Firstly, the power sector seems to be moribund and lack the necessary capacity to create the enabling environment required for business to thrive. This has made the cost of doing business in Nigeria expensive and unbearable for the survival of any business venture domicile in Nigeria. Secondly, the security challenges, such as kidnappings, banditry, terrorism and many more are now common in Nigeria and this has the propensity to drive away investors and discourage investors abroad from picking investment interest in Nigeria as their choice of investment destination. Despite all these challenges however, Nigeria has always been a choice destination of the foreign direct investment being the acclaimed giant of Africa. This is because as at 2019, about N98.6bn was received in Nigeria as foreign direct investment (CBN, 2019); in addition, as at 2020, Nigeria received a sum of $1.03bn in foreign direct investments, although this declined by $331.2m to about $698.78m in 2021 (Popoola, 2022). This means, Nigerian economy is still a beneficiary if foreign direct investment despite the aforementioned challenges.

Certainly, many scholars have taken an empirical look at influence which foreign portfolio investment has on the economy in Nigeria; however, different but conflicting results have been reported in the literature. Also, the focus of the existing work is unjustifiably and excessively skewed towards the effect of portfolio investment from foreigners on aggregate economy. For instance, Baghebo and Apere (2014), Majeed, Jiang, *et al.* (2021), Mohammed, *et al.* (2020), Adewunmi (2017), Akinbobola, *et al.* (2017), Onyeisi *et al.* (2016) and Ezeanyeji and Ifeako (2019) all investigated the effect of portfolio investment from abroad on the aggregate of Nigerian economy, thereby signifying a clear revelation that little or no attention has been given to how portfolio investment from abroad affects the disaggregated economy like the banking sub-sector. Due to the foregoing, this study strives to assess the relationship that exists between portfolio investment from abroad and the growth of the banking sector in Nigeria for period spanning 2010 to 2019.

Therefore, due to the observed gap in the literature, the following questions are raised:

 i. Does portfolio investment from abroad have any relationship with growth of the banking sector?
 ii. Does equity portfolio investment have any relationship with growth of the banking sector?
iii. Does exchange rate have any relationship with on growth of the banking sector?

Consequent to the above questions, this study is generally aimed at examining how portfolio

investments by the foreigners affect the growth of the Nigerian banking sector; specifically, this study seeks to:

i. assess how equity portfolio investment from abroad affect the growth of the banking sector in Nigeria.
ii. assess how debt portfolio investment from abroad affect growth of the banking sector in Nigeria.
iii. investigate how exchange rate affect growth of the banking sector in Nigeria.

The research hypotheses stated are;

HO_1: Equity portfolio investment from abroad has no significant relationship with the growth of banking sector in Nigeria.

HO_2: Debt foreign portfolio investment from abroad has no significant relationship with the growth of banking sectors in Nigeria.
HO_3: Exchange rate has no significant relationship with the growth of banking sector in Nigeria

2. Literature Review

2.1 Conceptual Review

A portfolio investment refers to a grouping of assets like stocks, bonds, and cash equivalents. Investors hold portfolio investments directly or have them managed by financial specialists. Consequently, portfolio investment from abroad is a way by which funds are introduced into a country whereby foreigners either deposit money in a bank domiciled in a country' or purchase stocks and bonds on the stock markets in such country purposely for speculation (Akanbi, 2013). Foreign portfolio investment is a technique for investors to diversify their portfolio by taking advantage of international opportunities (Appleyard, Dennis, Alfred & Field, 2014). Portfolio Equity refers to a situation where the owner holds less than 10% of a company's shares are classified as portfolio investment. These transactions are known as "portfolio flows," and they are documented in a country's balance of payments financial account (Yartey, 2014). A debt security is an instrument evidencing debt, such as a government-backed corporate bond, a certificate of deposit (CD), a municipal bond, or preferred stock, which are usually purchased and sold between with basic terms such as the notional amount (amount borrowed), the interest rate, the maturity and renewal dates spelled out between two parties involved.

2.2 Indicators for Measuring Banking Growth

In measuring bank's growth, a number of variables come to play. Thus, in his own assessment, Lucco (2020) provides that the metrics for discerning the growth of banks include Ratio of Operating Expenses as a Percentage of Assets, Total Asset under Management, Percentage of total assets under management which above Benchmark, Return on Equity: Return On Assets (ROA), amount of net profit generated by the bank divided by the total assets expressed as a percentage, Return on Equity (ROE), Return on capital Employed (ROCE), which is the percentage of the profit after tax in relation to the total capital employed. However, according to Anyanwu, *et al.* (1997), no precise measures of bank growth exist; however, by looking the changes in the statement of financial position and income statement structure, it can be judged whether the banking system are at upper growth level or not. Consequently, some of the important indicators of growth in the banks,

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which are used in short term and long term, are profit increase, deposit base, total assets, and total liabilities. Long term liabilities are more used once the banks want to expand externally. Moreover, banking sub-sector capitalization in the stock market is another reliable indicator of the growth in the banking sector. In this study however, total assets of the bank is used to measure the growth of the banking sector.

2.2   Theoretical Review

Portfolio Investment Theory

Markowitz (1952, 1958) conveyed two significant insights with regard to Modern Portfolio Theory. To begin, he noticed that the mathematics could only identify a group of portfolios that are efficient rather than a single optimal portfolio. Second, he understood that portfolio risk was the right risk for an investor, which led to the fundamental insight that a stock's riskiness should not be judged alone by its variance, but also by its covariance. The covariance of a portfolio, not the variance of individual assets in the portfolio, was discovered by Markowitz to determine the risk of a portfolio. Assets that are inversely correlated perfectly would make up the best portfolio. The benefits of diversification, according to Markowitz, do not have to exist if the assets are inversely correlated perfectly. Indeed, the combination of two assets in a portfolio will reduce risk if the correlation coefficient between them is less than 1.0. Instead, it was proposed by Markowitz that variances of return should be considered by investors with expected returns, and choose portfolios that offered the highest return that is expected for a given level of variance. He called this rule the E-V maxim (Markowitz, 1959).

The Markowitz stock portfolio model is optimized in Modern Portfolio Theory by minimizing the portfolio's risk, which is measured by stock price variance, while maintaining a certain portfolio return. Modern Portfolio Theory, in reality, is a method for determining how many eggs to place in each of numerous different baskets. One of two approaches to define the term "optimal" portfolio is to consider all of the portfolios that have that amount of risk (standard deviation) for example. From among them all, select the one which has the expected return that is beloved to be highest; and also, for any expected return, consider all the portfolios which have that expected return. From among them all, select the one which has the lowest risk standard deviation. Since the subject matter being investigated here bothers on how portfolio investment from abroad influence growth of the banking sector, portfolio management theory is apt in providing valuable insight in this study.

2.3   Empirical Review

Majeed, *et al.* (2021) investigated how direct investment from abroad affect the financial development across the one hundred and two (102) countries selected in four continents such as Asia, Europe, Africa, and Latin America for a period from 1990 to 2017. Quantitative data were sourced and analyzed using feasible generalized least squares and augmented mean group techniques. Hence, it was revealed that FDI had a very strong relationship with financial development as FDI evidently promoted financial development in Asia, Europe and Latin America.

Mohammed, *et al.* (2020) investigated the relationship between development of the banking sector, direct investment from abroad, and international trade in Nigeria by collecting and carrying out analysis on secondarily sourced data between 1981 and 2018. The data were

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analyzed by ARDL estimation technique and result showed that FDI has no effect on the development of banking sector in Nigeria in the long run. Hence, the study suggested that actionable trade policies that can attract FDI into Nigeria should be created.

Nwanji, *et al.* (2020) collected and analyzed data from secondary source to examine the impact FDI on the performance of fourteen selected Nigerian deposit money banks quoted in Nigeria from 2010 to 2017. The made use of Tobin Q quantitative method and the result suggested that development and performance in the deposit money banks were facilitated by the FDI inflows during the period considered, such that a positive influence between FDI and banks' profit maximization was revealed by the study.

Ayman and Muhammad (2019) researched into the association of foreign direct investments with financial development in Bahrain from 1978 to 2015. Quantitative data were collected and analyzed using ARDL estimator while the finding in the both short run and long run showed that FDI evidently had strong positive association with financial development level while a bidirectional causality was equally found flowing to financial development from FDI.

Adigwe, *et al.* (2018) examined the extent of the causality association between banking sector performance and direct investment from abroad between 1997 and 2015. Analysis of the secondary data collected was carried out by employing regression estimation technique, ARDL bound test plus the granger causality techniques; mutual causality flows between FDI and banks' operations like deposits and foreign exchange transactions was revealed while a significant unidirectional causal relationship was revealed between domiciliary activities and FDI.

Between 1988 and 2017, Adewunmi (2017) looked at how portfolio investment from abroad influences the Nigerian economic growth. Quantitative data were collected analyzed using the regression method, and the findings indicated that portfolio investment from abroad had a substantial influence on Nigerian economic growth, and it was advised that the Nigerian government should adopt more favorable trade policies and investment conditions to encourage the influx of portfolio investment from abroad.

3. Methodology

The study collected data obtained from secondary source. Specifically, data were collected from the Statistical Bulletin issued by the Central Bank of Nigeria of various issues, and covering 2010 – 2019 periods. Quantitative data used for this study was sourced from the secondary source through the Central Bank of Nigeria annual Statistical Bulletin of various editions from 2010 through 2019. These data are already made available, validated and easily accessible. The specified model was estimated using the multiple regression analysis of the ordinary least square (OLS) method which is the estimator that has minimum constant variance and most efficient among the group of unbiased estimators.

3.1 Model Specification

This study adopted the model specified in study of Akinbobola, *et al.* (2017); hence, the relationship between foreign portfolio investment and growth of the banking sector is linearly specified as follows:

$$BSG = f (EFPI, DFPI, EXCR)\dots\dots\dots\dots\dots\dots\dots\dots\dots\text{Equation (1)}$$

$$BSG = \beta_0 + \beta_1 EFPI + \beta_2 DFPI + \beta_3 EXCR + \mu \dots\dots\dots\dots\dots\dots\dots\text{Equation (2)}$$

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$$LnBSG = \beta 0 + \beta 1 LnEFPI + \beta 2 LnDFPI + \beta 3 LnEXCR + \mu t$$

Where:

BSG = proxy for the banking sub-sector growth proxy by total assets in the banking sub-sector;

EFPI = Equity Foreign Portfolio Investment, measured by the monetary value of investment from abroad in the equity capital of businesses in Nigeria.

DFPI = Debt Foreign Portfolio Investment which is measured by the value of bonds and other debt instrument purchased by foreigners in Nigeria via the capital market following the work of Adeleke (2004).

EXCR = Exchange Rate, measured by the average annual exchange rate reported CBN's bulletin.

μ = Stochastic

$\beta 0$ = Constant Term

$\beta 1 – \beta 3$ = Parameters to be Estimated.

BSG is the endogenous variable, while Equity Portfolio Investment (EPI), Debt Portfolio Investment (DPI), Exchange Rate (EXCR) are the exogenous variables. Furthermore, it is believed that the nature of interaction between the endogenous and the exogenous variables would be positive in this study. Hence the following relationships are anticipated: $\beta 1 > 0$, $\beta 2 > 0$, $\beta 3 > 0$. This aligns with the postulation of Keynesian theory that the savings and investment facilitate economic growth, and since banking sector is a sub-set of aggregate economy, it is expected that portfolio investment from abroad would influence growth of the banking sector positively.

4. Data Analysis and Discussion of Findings

This section presents the result of the analysis of the data collected in this study; hence, the results are as presented on Table 1.

Table 1: OLS Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	7.976145	1.042895	7.648080	0.0003
LEFPI	-0.072934	0.051474	-1.416927	0.2063
LDFPI	0.060819	0.015392	3.951327	0.0075
LEXCR	0.528242	0.143929	3.670160	0.0105
R-squared	0.915605	Mean dependent var		10.20791
Adjusted R-squared	0.873407	S.D. dependent var		0.279900
S.E. of regression	0.099588	Akaike info criterion		-1.486374
Sum squared resid	0.059507	Schwarz criterion		-1.365340
Log likelihood	11.43187	Hannan-Quinn criter.		-1.619148
F-statistic	21.69801	Durbin-Watson stat		1.593223
Prob(F-statistic)	0.001273			

Source: Author' computation, 2021.

From Table 1, the equation of best fit showing the linear association among the Growth of the banking sector (BSG), equity foreign portfolio investment (EFPI), debt foreign portfolio

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investment (DFPI) and exchange rate (EXCR) can be stated as:

$$BSG = 7.9762 - 0.0729EFPI + 0.0608DFPI + 0.5EXCR + Et$$

S.E: (1.0429)   (0.0515)   (0.0154)   (0.1439)

T.ratios (7.6481)   (-1.41697)   (3.9513)   (3.6702)

Prob.   (0.0003)   (0.2063)   (0.0075)   (0.0105)

The figures in the first set of parentheses are the estimated standard errors of the regression coefficients, the figures in the second set are estimated t-ratios, and the figures in the third set of parenthesis are the estimated p-values.

From the estimated regression model, it is obvious that while Equity portfolio investment from abroad (EFPI) maintains inverse and weak relationship with growth of the banking sector, debt portfolio investment from abroad and exchange rate both maintain direct and strong relationships with banking sub-sector's growth (BSG). Therefore, it follows that if exchange rate and debt portfolio investment from abroad are increased, it will cause banking sector to increase or grow. In other words, this result connotes that 1% increase or decrease in DFPI will cause about 6% increase or decrease in the average or mean value of the banking sub-sector's growth.

Similarly, 1% increase in EXCR will bring about 50% increase in the average or mean value of the banking sector's growth while the opposite is also true. On the contrary, 1% increase in EFPI is associated with 7% decrease in banking sector's growth and the reverse is equally true. In this case, EFPI shows a contradictory relationship with banking sub-sector's growth as the a priori expectation was that equity portfolio investment from abroad should enhance growth of the banking sector and not otherwise.

The multiple correlation co-efficient (R) is calculated as the square root of R^2 is 0.96 and it indicates a strong linear positive relationship between the exogenous variables (EFPI, DFPI and EXCR) and the endogenous variable i.e the growth of the banking sector (BSG) since the value is very close to 1. Also, the R^2 of 0.92 indicates that about 92% of the variation in the banking sector' growth (BSG) can be explained by the portfolio investment form abroad while the remaining 8% is accounted for by other factors not captured in the model but represented by stochastic term. This figure robustly increases the goodness of fit of the fitted regression model to the set of time series data. The R^2 as adjusted for the degree of freedom (n-k) associated with the sums of squares entering into the specified model is 0.87 which means that the specified model is not affected by the removal or addition of variables.

4.1   Test of Hypotheses

The decision rule for testing hypothesis remains that Null Hypothesis (H0) should be rejected and Alternate Hypothesis (H1) accepted if P-value is less than 0.05 and vice versa.

H0$_1$: Equity foreign portfolio investment has no significant relationship with Nigerian growth of the banking sector;

H1$_1$: Equity foreign portfolio investment has significant relationship with Nigerian growth of the banking sector;

From Table 1, the P-value of EFPI is 0.2063 which is more than the critical value of 0.05, we do not have enough reason to reject H0$_1$; this means that equity foreign portfolio

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investment has no significant relationship with the Nigerian growth of the banking sector.

H0₂: Debt foreign portfolio investment has no significant relationship with the Nigerian growth of the banking sector;

H1₂: Debt foreign portfolio investment has significant relationship with the Nigerian growth of the banking sector;

In this case, p-value of DFPI is 0.0075 which is less than the critical value of 0.05; thus, we do not have enough reason to accept the H0₂, which means that debt foreign portfolio investment has significant positive relationship with the Nigerian growth of the banking sector.

H0₃: Exchange rate has no significant relationship with the Nigerian growth of the banking sector;

H1₃: Exchange rate has significant relationship with the Nigerian growth of the banking sector;

Also, p-value of EXCR is 0.0105 which is also less than the critical value of 0.05; thus, we do not have enough reason to accept the H0₃, which means that exchange rate has significant positive relationship with the Nigerian growth of the banking sector because high exchange rate is expected to enhance or encourage foreign portfolio investment in the country as naira becomes cheaper relative to other countries' currency, and thus encourage foreigners to invest more into the Nigerian economy.

4.2 Discussion of Findings

This study discovered that equity-based portfolio investment from abroad was inversely related to the banking sector's growth. The economic essence of the foregoing is that when there is increase in the equity-based portfolio investment from abroad in form equity, it does not translate to significant to growth in the banking sector; the possible explanation for this that, the returns on equity cross-border investment in portfolios are repatriated back abroad and not re-invested in in Nigeria. Also, frequent taking of profit on equity-based FPI may not allow positive equity-based FPI to actually manifest positively on the performances of the banks. Otherwise, equity foreign portfolio investment should be direct in association with growth of the banking sector in agreement with the argument in the Keynesian theory on Savings, Investment and growth. The result also contradicts the Markowitz Portfolio investment postulation. However, the result aligns with Adewunmi (2017) who revealed that cross-border portfolio investment has a weak effect on the growth of economy in Nigeria. The result however disagrees with Onyeisi, *et al.* (2016), Ayman and Muhammad (2019), Nwanji *et al.* (2020) all of whom revealed in their respective studies that FDI facilitated financial sector growth and financial performances of the banking sector.

In addition, this study revealed that a debt-based foreign portfolio investment had positive and significant effect on the growth of the banking sector. The foregoing translates that flow of foreign portfolio investment from abroad into the Nigerian banking sector in form of bond and other form of debt securities enhances the growth of the banking sector. Apparently, this is because this type of investment is usually long term in nature and carry fixed return rate. This thus allows banks to make the best use of the debt capital to generate sufficient growth prospects. This result thus agrees with Akinbobola, *et al.* (2017) and Baghebo and Apere (2014) who found that portfolio investment from abroad had direct and significant influence on Nigerian economic growth. This study also corroborates the work of Majeed, *et al.*

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(2021) that FDI has strong effect in promoting financial sector development, even across continents like Europe, Latin America and Africa.

4.4   Policy Implication of findings

The negative relationship revealed between equity-based portfolio investment from abroad and the banking sector's growth is not good for the banking sector and it is an indicator of the inefficiency reeling at the level of banks' management concerning the ability to utilize the equity capital raised from abroad efficiently to generate returns and improve the lots of the banks; this thus means that the expected benefits of the direct investment from abroad is not being harnessed through the banking sector to stimulate the Nigerian economy, translating that the monetary authority may have to tighten the supervision policy for the Nigerian banks' management and ensure that only the competent individuals who is embedded with requisite capacity effectively oversee the banks are employed as directors and managers in the sector. Furthermore, the debt portfolio investment from abroad, which has significant direct association with the banking sector's growth calls for deepening of available bonds and other debt instruments via the Nigerian capital market and their innovative packaging for the attraction of more foreign capital with a view of facilitating the growth of the Nigerian banking sector, and by extension, the growth of the Nigerian economy.

5.   Conclusion and Recommendations

The focus of this study is to evaluate the influence of portfolio investment from abroad on the banking sector's growth in Nigeria between 2010 and 2019. Portfolio investment from abroad is an investment made in the securities of the listed companies by the foreigners in anticipation of returns which can be dividends and interest rather than having significant ownership in the investee companies. Previous scholars have failed to look at the effect of direct investment from abroad on a desegregated economic growth like Nigerian banking sector, which is a gap this study tried to fill. Thus, in the specified model for this study, three variables, namely equity portfolio investment from abroad, debt portfolio investment from abroad and exchange rate were used as predictor variables while growth of the banking sector was proxy by the GDP of the sector. Consequent upon the analysis, it was discovered that equity portfolio investment from abroad showed negative relationship with growth of the banking sector, while debt portfolio investment from abroad and exchange rate all showed positive relationship with banking sector's growth. Thus, considering the findings reported, it is concluded that while equity-based portfolio investment from abroad is a negative and insignificant determinant of the banking sector's growth, debt-instruments-based portfolio investments from abroad are direct and strong determinants the Nigerian banking sector's growth during the scope under study.

Based on the conclusion of this study, it is therefore recommended that, Nigerian government should, via policy initiation, discourage immediate repatriation of equity foreign portfolio capital so as reverse the negative relationship revealed by this study trends and facilitate the growth of the Nigerian banking sector. Moreover, having found out that debt portfolio investment from abroad has significant direct relationship with banking sector's growth, Nigerian government is advised come up with policy or policies aimed at liberalizing the procedures and formalities for the cross-border movement of capital, especially for investment in debt instruments in Nigeria. Furthermore, in spite the benefits associated with falling value of naira with respect to direct investment from abroad, effective macro-economic policy that will stabilized and sustained the Nigerian economic productivities is recommended in order to stimulate the banking sector's growth.

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