

# **ENUGU FORUM POLICY PAPER 6**

## **DEBATING POLICY OPTIONS FOR NATIONAL DEVELOPMENT**

### **INVESTING IN NIGERIAN CAPITAL MARKET: Institutions, Traded Securities, Strategies and Prospects**



**AFRICAN INSTITUTE FOR APPLIED ECONOMICS**

# ENUGU FORUM POLICY PAPER 6

**Series Theme:**  
DEBATING POLICY OPTIONS  
FOR NATIONAL DEVELOPMENT

Topic:

## **INVESTING IN NIGERIAN CAPITAL MARKET: Institutions, Traded Securities, Strategies and Prospects**

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**PUBLISHED BY AFRICAN INSTITUTE FOR APPLIED ECONOMICS**

FIRST PUBLISHED 2005

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# ABOUT ENUGU FORUM

## INTRODUCTION

Opening new spaces for domestic policy dialogue is one of the most important potential gains of democratic governance. Democratic space creates public policy arena in which government can be engaged by private sector and civil society on what it is doing or not doing, and hence be pressured to perform. Since the return to democratic rule in 1999, there has been an upsurge of private sector and civil society engagement with governments on economic policy and development issues. But, the upsurge of civic advocacy on economic and development issues has not been matched with commensurate improvements in the quality of debates on policy alternatives and roadmaps for national development.

ENUGU FORUM is intended to provide a civic arena for proposing and debating policy alternatives and roadmaps towards social, economic and political progress of the country. It is hoped that the FORUM will foster interaction between government and non-state actors towards good governance, accountability and participatory democracy.

## IDENTITY AND MISSION

Enugu Forum is a civic platform devoted to intellectual conversation and of policy issues affecting the growth and development of the country. It was founded in 2001 to promote informed and credible avenues of stakeholder dialogue and policy advocacy. It seeks to improve the policy process through high quality debate and non-partisan discourse of alternative solutions to contemporary development questions.

The Forum deploys both intellectual and empirical insight to nurture a shared understanding and objective scrutiny of policy issues on social, economic and political development of the country.

## ACTIVITIES

Enugu Forum's activities take several forms:

- ◆ Public Lectures
- ◆ Seminars
- ◆ Workshops
- ◆ Conferences
- ◆ Roundtables

The activities bring together diverse stakeholders including government officials, private sector operators, independent think-pots and civil society to exchange and constructively critique perspectives and experiences on critical policy imperatives. Attendance is by formal invitation.

## OUTPUTS

The outputs of the Forum's activities take the form of communiqué outlining key outcomes of discussions, conclusions and recommendations. The presentations and proceedings are further developed into Occasional Papers, Working Papers or Policy Briefs widely circulated to inform, sensitise and enlighten stakeholders.

## STRUCTURE AND ORGANISATION

Enugu Forum is structured into a Steering Committee, a Coordinating Committee and the General Members. The Steering Committee governs the Forum through guides and policies agreed in consultation with the General Members. The Coordinating Committee executes the activities and programmes.

## MEMBERSHIP

There are two classes of membership: individual and corporate. The Forums' activities are open and can be attended by all interested persons but formal invitations are issued to members and designated guests only. To be a member, one needs to register in the appropriate category. Registration can be done during the Forum's events, or at the Host Organization - *African Institute for Applied Economics, Enugu*.

## SPONSORSHIP

Ownership of the Forum resides in the members. It is run on the goodwill contributions from corporate bodies and individuals. Sponsorship includes provision of venue, refreshments, logistics, and facilitation of Guest Speakers and Resource Persons.

## HOST INSTITUTION

The Enugu Forum is hosted by the African Institute for Applied Economics (AIAE) Enugu. AIAE is a non-governmental, not-for-profit and independent organization devoted to economic policy research for the purpose of promoting evidence-based decision making. It is located at 128 Park Avenue, GRA, Enugu, Phone: (042) 256644, 256035, 300096; Fax: (042) 256035. E-mail: [aiaeinfo@aiae-nigeria.org](mailto:aiaeinfo@aiae-nigeria.org), [aiae@infoweb.com.ng](mailto:aiae@infoweb.com.ng); <http://www.aiae-nigeria.org>

# ENUGU FORUM POLICY PAPERS

*Enugu Forum Policy Paper Series* publishes the proceedings and outcomes of workshops, conferences, seminars or public lectures held by the Enugu Forum. The Series provides documentation of the topical presentations, debate, comments and perhaps consensus at the Forum.

It is intended to disseminate the Forum's intellectual discourse to a wider audience. The essence is to stimulate broader policy debate and promote multi-perspective dialogue on policy options.

*Enugu Forum Policy Papers* constitute an advocacy instrument to canvass alternative development solutions and policy roadmaps, for the overall purpose of enriching the policy discourse in the country. The Series also draws attention of government, private sector and civil society to salient dimensions of contemporary development challenges in Nigeria.

Series Editors:

*Eboh, Eric Chiedum*

*Ukeje, Stanley*

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*Ikpo, Kobi P.*

# INVESTING IN NIGERIAN CAPITAL MARKET: Institutions, Traded Securities, Strategies and Prospects

When it comes to making money, there is really nothing new to teach my fellow Nigerians. We understand the fundamental key to creating wealth – find a need, and fill it! When it comes to capital market, it seems there is also nothing new to teach a people with passion for real estate investments – landlords, to be precise!

My task is further made easier by the realization that you are a highly distinguished audience with diversified backgrounds, experience and business interests across various economic sectors and markets. This audience mix makes for a balanced and exciting discussion today. But I must let you know from the onset that I am not an economist by training – so pardon me for the limited theories!

Before delving into the core areas, I will like to capture the importance of capital market within the micro context. In his book, *Rich Dad, Poor Dad*, Robert Kiyosaki identified four (4) broad possible human occupations, *thus*:

1. *You can be employed by others*
2. *You can be self-employed*
3. *You can be an entrepreneur, or*
4. *You can also be an investor*

It is pertinent to note that options (1) to (3) are considered primary sources of income and savings for deployment by investors in (4) above. The act of investing is basically for custodian of wealth accumulated in the course of active employment and or business. It is therefore necessary for any individual or institution with income and savings to invest and the success or failure of such investment may make or mar the legacy or survival. This basic challenge confronts everyone no matter one's financial status, or academic pedigree.

The subject of capital market covers a wide range of issues, depending on your choice of perspective(s). We shall move from whole to part as it basically concerns us - as investors rather than corporate financiers, and as private clients rather than institutional investors.

My presentation shall be in three (3) parts, all aimed at enhancing our understanding Nigerian capital market framework as a viable investment medium:

- ✓ Financial markets – Money and Capital Markets
- ✓ The Nigerian Capital Market – Institutions and Traded Securities
- ✓ Nigerian Stock Market performance and prospects

## 1.0 FINANCIAL MARKET

### 1.1 The financial market is built on the following basics:

1. Individuals in primary occupations minimize current consumption to build up savings.
2. Stock of savings is made available to fund users (corporations/governments) at the current price of money, i.e. interest rate, subject to government interference.
3. In the formal sector, savers and users of their funds do not meet directly – they operate through financial intermediaries, such as: banks/deposit intermediary, stockbrokers/investment intermediary and insurers/risk management intermediary.

With the advent of universal banking in 2003, most Nigerian banks can now undertake all aspects of financial intermediation, ranging from retail banking, stockbroking/asset management, Issuing House to insurance and Registrar services.

4. Financial intermediaries issue financial instruments/claims to savers (financial assets) and users (financial liabilities) in exchange for the funds received or disbursed, respectively.

### 1.2 Financial market is classified into two broad segments based on tenor of the financial instruments issued:

#### Money Market:

This is the market for short-term financial instruments, with 1 – 12 months tenor.

*Instruments: Fixed Deposits, T-bills, CPs, BAs, etc.*

*Near-money attributes: Low risk, Low Return and High Liquidity*

*Institutions: CBN, Commercial/Merchant Banks, and Discount Houses.*

*It is important to note that money market instruments are essentially products of deposit intermediaries (such as commercial banks, discount houses etc) in the process of savings mobilization and the CBN as an instrument of short-term monetary operations.*

#### Capital Market:

This is the market for long-term financial instruments, with over 12 months tenor.

*Instruments: Equity, Bonds and Derivatives.*

*Investment attributes: Varied, depending on the type of instrument.*

*Institutions: SEC, NSE, Stockbrokers/Issuing Houses, Registrars, etc.*



*It is important to note that core capital market instruments are typically creations of corporations in the process of corporate financing (i.e. capitalization) and the governments (Federal, State or Local Governments) in the financing or re-financing of development, public debt and policy management.*

1.3 Since capital market is the focus of this seminar, a look at the basis of capital market as a financing mechanism is apt.

#### 1.3.1 PUBLIC LIMITED LIABILITY COMPANY, PLCS:

A public limited liability company (PLC) can raise fresh capital from the capital market by issuing of any of the following instruments for subscription in the primary market:

1. *Ordinary Shares*
2. *Preference Shares*
3. *Corporate Bonds*

Corporate issues decision is a function of the company's target capital structure, alternative cost of capital as well as proprietary interests.

It is perhaps easier for the average Nigerian to understand why a company should borrow or issue corporate bonds instead of raising money by issue of ordinary shares to new co-owners. Once the return on investment (ROI) is higher than the cost of debt, or applicable interest rate, the use of debt magnifies the return on owners' capital, but at a risk depending on the firm's debt/equity ratio.

Why should a firm go public, or raise new equity? The answer is beyond the scope of this session, but the rationale is evident in the fact that ordinary shares is by far the most traded class of financial instrument in all capital markets. Of the 265 securities listed on the Nigerian Stock Exchange as at December 2004, 207 were equities. This trend is expected to continue with successful implementation of the National Economic Empowerment & Development Strategy (NEEDS) vis-à-vis the on going banking industry re capitalization, sector reforms and privatization of public enterprises such as NEPA, NITEL, etc. However, the greatest boost to Nigerian equity sector will come from flotation of *eligible* indigenous blue chips, such as Dangote, Chanchangi, Ibeto, The Young, Honeywell, Eleganza, etc.

When an investor buys ordinary shares in a company, the investor becomes a co-owner of the company entitled to the following perks:

- Cash/Bonus Dividends declared from the yearly profit(s)
- Capital Appreciation over a period of time
- Right to Vote at Annual General Meetings of the PLCs
- Right to residual claims on the PLC's assets in the event of liquidation

Thus, equity interest is residual, and as such, riskier. However, in periods of boom and high company profits, equities benefit from the upside potential.

### 1.3.2 GOVERNMENT BONDS:

Government at various levels can raise money from the capital market by issuing:

1. *Development Stock/Bonds (FGN)*
2. *Development Bonds (Sgs)*
3. *Municipal Bonds (Lgs)*

The motivation for developing bond markets is particularly specific (related to satisfying particular borrowing needs efficiently) and particularly general (related to making financial markets function more effectively). The prime specific reasons for developing a bond market in most countries are to finance fiscal deficits or in the case of corporations, finance long maturity projects. The most fundamental general reasons are to (1) make financial market more complete with wide range of instruments to ensure significant asset/liability matches, (2) diversifying capital intermediation beyond the highly leveraged banking industry and (3) ensure easy transmission of the monetary policies.

Investors in corporate or government bonds are entitled to periodic interest payments, on a compounding or discounting basis depending on the stated coupon rate, and repayment of the face value on maturity of the bond.

Bonds are less risky as interest payment is a prior charge on company profit, before corporate tax and creditors are settled first in the event of liquidation. However, creditors are often worse off in periods of rising interest rate due to the inverse relationship between bond value and current interest rate. This is one of the reasons why the bond sector of the Nigerian Stock Exchange is moribund.

### 1.3.3 FUNDS:

There are two types of Funds:

Investment Trust Fund (Closed Fund): This is the case of a PLC offering its shares for subscription and the paid-up capital is, in turn, being invested in the securities of viable enterprises. The fund is managed and dividends declared to owners of shares at the end of the company's operation year. e.g Berkshire Hathaway owned by Warren Buffet "the Sage of Omaha".

Unit Trust/Mutual Fund (Open Fund): This is an open-end fund, which is offered, in smaller units to be able to source funds from big and small investors. There is a regular valuation to arrive at the net asset value of the fund, which leads to the bid, and offer price. The investors purchase units in the fund and are entitled to dividend payments, receiving Annual Reports and attending AGM's.

## 2.0 THE NIGERIAN CAPITAL MARKET

You can now visualize the capital market as a forum for trading and sourcing medium and long – term funds. The market can be divided into two broad categories, each with sub-markets.

Securitized capital market:

Stock Market: Quoted and Unquoted

Commodity Market: Coal, Gold, Cereals, Cocoa, Groundnut, etc

Derivative Market: Futures, Options and Mortgage Backed Securities.

Unsecuritized capital market:

Real Estate

Medium/Long term Bank Loans

Equipment Leasing

Project financing

Venture Capital

## 2.1 INSTITUTIONS:

The focus of this seminar is the core of capital market – the Nigerian stock market.

It is important to note that the mechanics of the stock market is not as simple as for example, operating a local bank account, where the bank staff and the customer meet *directly*. As a matter of rules and procedure, the stock market features a number of *registered market operators/consultants* in both the primary and secondary market segments:

1. Securities & Exchange Commission
2. Nigerian Stock Exchange
3. Stockbrokers
4. Issuing Houses
5. Registrars
6. Receiving Bankers
7. Trustees
8. Underwriters
9. Portfolio/Fund Manager
10. Investment Adviser
11. Rating Agencies
12. Professional Firms/Consultants: Accountants, Lawyers, etc.

Investment & Securities Act, 1999 Sec. 29 requires all capital market operators and such other intermediaries associated with the securities industry to register with the Securities & Exchange Commission and conduct all securities transactions in accordance with the conditions of the certificate of registration obtained from the Commission.

Due to time constraints, we will elaborate on the three (3) principal intermediaries in the stock market: Securities & Exchange Commission, the market regulator, The Nigerian Stock Exchange (NSE), the market hub and Stockbrokers, the investors' agents for most capital market transactions.

### 2.1.1 Securities & Exchange Commission (SEC)

The Securities & Exchange Commission is the regulatory apex organization for the Nigerian capital market, just as the Central Bank of Nigeria regulates the money market.

The Commission was established by the Investment & Securities Act, 1999 to regulate investment and securities business in Nigeria.

The key functions of the Commission as stipulated in Section 8 of the Act are as follows:

1. *Register and regulate all capital market operators, including securities exchanges*
2. *Register securities to be offered for subscription or sale to the public.*
3. *Register/approve and regulate the workings of venture capital funds, collective investment schemes (such as mutual funds), mergers, acquisitions and all forms of business combinations.*
4. *Prepare guidelines, organize and co ordinate capital market education*
5. *Protect the integrity of the securities market against abuses arising from insider trading, fraud or unfair trade practices.*

### 2.1.2 The Nigerian Stock Exchange (NSE)

Stock exchanges provide *secondary* markets for securities (i.e. ordinary shares, corporate or government bonds) issued by companies and governments in the process of raising funds from the *primary* segment of the capital market. It is a *Self-Regulatory Organization (SRO)* and provides *trading floors* for registered stockbrokers/dealing members of the stock exchange trading in *registered/listed* securities of *quoted* companies/government according the *Rules and Regulations of the Stock Exchange*. Manipulations, insider trading, money laundering and other securities industry malpractices are strictly prohibited on the stock exchange.

The Nigerian Stock Exchange (1977) was established in 1961 as Lagos Stock Exchange. It has witnessed tremendous growth in recent times and the trends is towards creating an international standard capital market satisfying the long-term financing/investment needs of Nigerian governments, companies and portfolio investments.

Some vital information and profile of the stock exchange are as follows:

*Address:* *The Stock Exchange House*  
*2-4 Customs Street, Lagos*  
*Tel: 234-1-2660287, 234-1-2660305*  
*Fax: 234-1-2668724, 234-1-2668281*  
*Internet: www.thenigerianstockexchange.com*  
*E-mail: nse@linkserve.com.ng*  
*Reuters Code: NSX*

Branches/ Trading floors:	Eight (8) situated at Lagos (Headquarters), Abuja, Port Harcourt, Ibadan, Benin, Kano, Yola and Onitsha
Market Participants:	Registered stockbrokers/dealing members.
Instruments Traded:	Equities, Government and Corporate bonds.
Market Capitalization:	N1.701 trillion as at March 21, 2005
Market Index:	The Nigerian Stock Exchange All-Share Index was 23,844.45 as at 31 <sup>st</sup> December 2004. On 18th June 2004, the index attained an all-time high of 30,703.46 before dropping to its year-end position. As at 21 <sup>st</sup> March 2004, the index is now 20,951.49. The performance of the index reflects the difficult economic environment quoted companies are currently operating.
Trading Regulations:	Trading takes place on any of the trading floors of the NSE on Mondays to Fridays between 10:00 – 12.00 hours. Bids and Offers are matched by stockbrokers using the Automated Trading System (ATS). There is a 5% limit on daily price movements.
Delivery and Settlement:	Transaction cycle is now T + 3 days. The exchange's delivery and settlement system is built on the Central Securities Clearing System (CSCS), which demands prior (1) verification and deposit of shares for sale and (2) lodgement of investors' funds with the Settlement Banks before any dealing.
Technology:	NSE has Remote Trading capability, allowing brokers to trade on the floor and investors, to monitor the market, and even enter orders from remote locations on a real time basis via internet. It recently introduced a Fraud Alert System to shareholders via GSM/e-mail before trades can be executed on their stocks lodged in the CSCS.
Rating:	Compliant with global standards set by World Federation of Stock Exchanges in terms of technology and market scrutiny regime.

### 2.1.3 Stockbrokers

Stockbrokers: are the principal intermediaries, especially in the secondary market segment. In this capacity, a broker is an agent of a principal and he is paid commission for his services. There are currently over 200 registered stockbrokers

## 2.2 TRADED SECURITIES:

The Nigerian Stock Exchange lists and deals on financial instruments issued by PLCs quoted on the Exchange subject to the provisions of Sec. 32 (1) of the Investment & Securities Act, 1999: *"No person shall transfer, issue, sell, offer for subscription or sale to the public, securities or investments ... unless such securities or investments are registered by the Commission (SEC) and prior approval for the transfer, issue, sale, offer for subscription or public offer for sale to the public has been granted by the Commission."*

Ordinary shares, such as – NBL, Guinness, Zenith, FBN, Texaco, Oando, UACN etc

Government Bonds -

The comprehensive list of securities traded on the NSE are contained in the NSE Daily Official List, which are usually published by major dailies and business journals, such as BusinessDay, Financial Standard, Business Times. Any individual desirous of understanding the stock market is advised to develop interest in reading and tracking the Daily Official List and in business and corporate news, generally. Key to Understanding the Stock table, published by BusinessDay provides the basic guide to the Daily Official List.

In the Daily Official List, securities are listed under two segments:

First-Tier

Second Tier

Information contained in the List Include:

Please do not be deceived by the *meager* daily kobo gains/losses reported in the Daily Official List – quite a lot of money can be made/lost in the stock market!

Notwithstanding the two persuasive schools of Value determinants:

- Earnings
- Interest rate
- Market psychology

Two Schools:

- Fundamental

## 3.0 NIGERIAN STOCK MARKET PERFORMANCE AND PROSPECTS

Frankly this is not the best time to deliver a lecture on Nigerian stock market, let alone making a buy or sell recommendations to new converts in the stockmarket (Prior to July 6, 2004 one could easily get such investment advice from a beer parlour or barbing saloon!).

From a mere 19 listed securities in 1961 when the Nigerian Stock Exchange took off, it has grown to 265 as at 31 December 2004. This is made up of 12 Federal Government Development Stocks, 6 State Government Bonds, 48 Industrial Loans, 3 Preference Stocks, 207 Equities (191 on the 1st Tier List, while 16 are on the 2nd Tier Securities Market). In 2004, the number of equities listed at NSE (1st Tier List) rose to 207. In particular, the spate of new listings ahead of December 2005 deadline for N25 billion minimum capitalization for Nigerian banks will further push up the number of listed equities in the banking sub-sector.

Similarly, other new companies seeking to go public include Dangote Group, which is concluding arrangement to seek public quotation by the second quarter, and its successful listing will usher in more indigenous manufacturing firms on the Nigerian Stock Exchange. Also MTN Nigeria is also gearing up to get listed by the second half of the year.

In determining what shares to buy or sell at any point in time two major factors to consider are liquidity (turnover) and market capitalization. As at December 2004. The 20 most active stocks by turnover volume were:

1. Standard Trust Bank Plc	-	1.036 billion shares
2. IMB International Bank Plc	-	931.7 million shares
3. Liberty Bank Plc	-	820.2 million shares
4. Union Bank Nig. Plc	-	799.5 million shares
5. First Bank of Nigeria Plc	-	727.6 million shares
6. Omega Bank Plc	-	653.3 million shares
7. Access Bank Plc	-	641.5 million shares
8. UBA Plc	-	632.6 million shares
9. Guaranty Trust Bank Plc	-	580.4 million shares
10. Cooperative Bank Plc	-	538.0 million shares
11. UTC Nig. Plc	-	531.7 million shares
12. Wema Bank Plc	-	498.1 million shares
13. Nigerian Breweries Plc	-	495.3 million shares
14. Gulf Bank of Nigeria Plc	-	441.1 million shares
15. Manny Bank Plc	-	439.4 million shares
16. FSB International Bank Plc	-	397.3 million shares
17. Intercontinental Bank Plc	-	384.1 million shares
18. Inland Bank (Nigeria) Plc	-	348.2 million shares
19. Chartered Bank Plc.	-	347.8 million shares
20. NAL Bank Plc	-	276.7 million shares

And the 20 most capitalized stocks were:

Company	Market Capitalisation (N'Bn)
1. Nigerian Breweries Plc	323.67
2. Guinness Nigeria Plc	138.04
3. First Bank of Nig. Plc	94.43
4. Zenith Bank Plc	94.14
5. Union Bank Nig. Plc	93.96
6. Nestle Nigeria Plc	79.06
7. Nig. Bottling Co. Plc	75.03

8. Guaranty Trust Bank Plc	70.14
9. Oando Plc	64.11
10. Total Nigeria Plc	61.96
11. Cadbury Nigeria Plc	59.05
12. Conoil Plc	53.92
13. Unilever Nigeria Plc	46.91
14. Standard Trust Bank Plc	44.46
15. Mobil Oil Nig. Plc	44.23
16. Texaco (Nig) Plc	42.92
17. Oceanic Bank International (Nig) Plc	37.80
18. African petroleum Plc	29.81
19. Intercontinental Bank Plc	28.03
20. United Bank for Africa Plc	26.92

#### 4.0 PROSPECTS

We are optimistic about economic growth from the second half of 2005. We hope that the privatization programme would be energized in 2005 with the planned sale of some pseudo-monopoly corporations like NITEL, refineries/petrochemical plants, Pipeline and Products Marketing Company (PPMC), NICON Insurance, Peugeot Automobile of Nigeria (PAN), and Volkswagen of Nigeria.

Also, with the effective implementation of the National Pension Reform Act 2004 by the Nation Pension Commission by June 2005, we posit the emergence of another wave of institutional investors thereby boosting demand for shares.

Barring any unforeseen government policy changes, we expect the first half of 2005 to witness minimal growth outside of the banking sector as banks hasten to complete their capital raising activities. We also expect that the market capitalization will be driven in large part by the listing of a few previously unquoted banks prior to expected merger discussions.

In the meantime, we anticipate that opportunities will arise to acquire good value stock at discounted prices. Our analysts believe that general market activity should increase from the second or third quarter as the emphasis changes from capital raising to mergers, thereby reducing the cash pressure on the stock market

Thank you.