Impact of Foreign Private Investment on the Development of Nigerian Capital Market

AJAYI Lawrence Boboye[1]

Department of Banking and Finance, Faculty of Management Sciences,

Ekiti State University, Ado Ekiti, Nigeria

ADEJAYAN Adeola Oluwakemi[2]

Department of Banking and Finance, Faculty of Management Sciences,

Ekiti State University, Ado Ekiti, Nigeria

& OBALADE Adefemi Alamu[3]

Department of Banking and Finance, Faculty of Management Sciences,

Ekiti State University, Ado Ekiti, Nigeria

ABSTRACT

The study examines the impact of foreign private investment on the Nigerian capital market using time series data from 1986 to 2014. ADF Unit root test, Johansen co integration test and error correction mechanism are used for the purpose of analyses. Capital market development is proxied by market capitalisation while foreign private investment is proxied by foreign direct and portfolio investments. Result of ADF test shows the data are stationary at first difference and that there is a long run co-integration among market capitalisation, foreign direct and portfolio investments. ECM results show that, both types of private investment have positive impact on market capitalisation but only the foreign direct investment is significant($0.0015 < 0.05$) in determining market capitalisation. The study concludes that foreign private investment has positive and significant impact on the development of capital market. Based on the findings of the study, effort should be made to encourage continuous inflow of both forms of investment in Nigeria.

Keywords: Market capitalisation, portfolio investment, direct investment, capital market, stock exchange.

INTRODUCTION

In the developing economies, saving is usually not enough for the level of investment that is necessary to ensure development. Alternative to this saving is foreign financial aid such as foreign direct or portfolio investment, concessional loans, or grants. The ultimate aim of any foreign assistance is to transform or contribute to economic welfare of the recipient (Obalade & Obisesan, 2015). It is generally recognized that government in developing economies have not only geared efforts to creating conducive environment for business to grow but also tried to create attractive business environment for foreigners to participate (Adaramola & Obisesan, 2015).

Right from the phenomenal integration of the Nigerian economy with the outside world, there has been remarkable surge of capital inflow in the form of foreign investment (direct and portfolio), overseas development assistance and bank loans. Recently, foreign portfolio investment appears to have taken the lead. Consequently, controversy had arisen regarding its impacts on the financial sector.

It has been pointed out that the role of capital market as a veritable channel for foreign direct investment is yet to be fully appreciated. One of the media for the inflow of foreign private investment is stock market. Foreign private investment may by in form of direct or portfolio investment. In literature, efforts have been made to examine the impact of private investment on Nigeria economy. Recently, there is a shift from economic impact of the subject to capital market impact. Adaramola and Obisesan (2015) examine the capital market impact of foreign direct investment. The current study differ by including the second component of foreign private investment i.e. foreign portfolio investment.

The study is divided into four sections. Section contains general introduction ad background to the study. In the second section, the theoretical framework is state and related empirical studies are reviewed. The research method and empirical results are given in section three and four respectively. The last section summarizes the entire study, draws conclusion; highlight the contribution to knowledge, recommendation as well as the suggestions for future study.

2. Literature Review

investments an investment made by a private individual or a private entity in a foreign country. This type of investment differs from other investments made by a foreign public or governmental entity in another country in that it is made by an individual or a private entity. It can either be direct or indirect in nature, that is, foreign direct investment and foreign portfolio investment. Foreign direct investment (FDI) is a direct investment into production or business in a country by an individual or company of another country, either by buying a company in the target country or

by expanding operations of an existing business in that country. Foreign direct investment is in contrast to portfolio investment which is a passive investment in the securities of another country such as stocks and bonds (Adeleke, Olowe, & Fasesin, 2014).

On the other hand, UNCTAD (1999) defined foreign portfolio investment as the transfer of financial assets by way of investment by resident individuals, enterprises and institutions in one country in securities of another country, either directly in the assets of the companies or indirectly through financial markets. Capital market is the fundamental part of financial market and it is associated with the savings, investment and economic growth of the country. Some growing countries are emerging with their tactics of bringing changes in their economies by considering foreign capital flows because of the global market as this market provides a vast opportunity to all the countries for their capital market development.

This study is underpinned by two gap model of public financial aid which is an extension of Harrod Domar (1946) theory. The first dimension of the model argues that development is a function of investment. In the developing world, however, available savings are usually not enough to achieve the target rate of investment and a gap exists between the two variables. This gap lead to the need for a transfer of resources from developed to the countries undergoing development process. A nation would be expected to obtain these transferred resources through or in the form of foreign exchange earnings. The irony is that those countries with saving investment gap usually do not generate sufficient earnings to balance their foreign transactions, talk more of having excesses. Hence the only means of obtaining the transferred resources in order to ensure that development takes place is by the way of foreign aid. Aid includes concessional lending, direct investment and official development assistance (ODA) (Obalade & Obisesan, 2015). Foreign aid in the form of foreign private investment in the recipient nation may be divided into foreign portfolio investment and foreign direct investment.

Chigbu Ubah and Chigbu (2015) examined the impact of capital inflows on economic growth of developing economies; the case of Nigeria, Ghana and India from 1986-2012 . Augmented Dickey Fuller unit root test was employed to evaluate the stationarity of the data, while Johansen Co-integration was used to estimate the long-run equilibrium relationship among the variables. The casual relationship was tested using Granger Causality, and Ordinary Least Square method was used to estimate the model. The findings revealed that capital inflows have significant impact on the economic growth of the three countries. In Nigeria and Ghana, foreign direct and portfolio investment as well as foreign borrowings have significant and positive impact on economic growth.

Okpoto (2015) analysed the impact of foreign Private Investment on the Nigeria's economic growth from 1980 to 2013 using Augmented Dickey Fuller (ADF) and ECM to analyse the long

run relationship between real GDP and other variables in the model. In order to actualise this, the relationship between real GDP and foreign private investment, inflation, exchange rate and interest rate were considered. The findings revealed that the activities of FPI have impacted favourably in boosting economic activities in Nigeria within the period of study. In McRollins and Orji (2014), the implications of foreign portfolio investment in the Nigerian capital market was examined using the Error Correction mechanism and McKinnon Model. The result revealed that foreign portfolio investment and FDI proved significant by contributing meaningfully to Nigerian capital market development.

In the works of Abel, Ebele, and Ndi (2009) on the relationship between stock market development and private investment flows between 1970 and 2006, Vector error correction mode (VERCM) was used in estimating the relationship between investment growth, and stock market development .The Johansen Co integration model is adopted to examine the long-run trends in the variables. The study shows that development in the Nigerian stock market over the years was able to spur growth in domestic private investment flows, but unable to do so in the case of foreign private investment. Irfan (2014) examined the Impact of Foreign Direct Investment on Volatility of Pakistan Stock Market using regression Analysis. Market Capitalization was used as the dependent variable while the explanatory variables were FDI, GNP, Inflation. The result revealed that foreign direct investment has positive impact on the development of stock market in Pakistan. Ali , Nasir , Zeshan , Mohammad , and Tanvir (2012) in their works on the role of FDI on Stock Market Development They applied Ordinary Least Square (OLS) method of regression by using annual time series data for the period 1988-2009. The results disclose a positive impact of foreign direct investment along with other explanatory variables (domestic savings, FDI, exchange rate and inflation rate in developing Stock markets of Pakistan.

Adam and Tweneboah (2009) applied co integration technique to analyse how FDI impact stock market development in Ghana, their result shows that there is a long run and positive relationship between FDI, Nominal exchange rate and Stock Market Development. Adeleke *et al.* (2014)applied regression analysis of the ordinary least square (OLS) as estimation technique to determine the impact of the Foreign Direct Investment on economic growth in Nigeria between 1999 and 2013. The findings revealed that a positive and significant relationship exists between foreign direct investment and Nigeria economic growth. Using cointegration VAR model and Granger causality analysis of VECM, Abdullahi , Ladan and Haruna (2009) studied the impact of Foreign Private Investment (FPI), Interest Rate (INR) and Inflation rate (IFR) on Growth Domestic Products (GDP) in Nigeria for the period 1970 to 2009. The result depicts that there exists a uni-directional causality relationship between GDP and FDI and that some of the variables are Ganger causal of one another.

In assessing the impact of foreign direct investment on Nigerian capital market development from 1970-2010, Adaramola and Obisesan (2015), opined that foreign direct investment impact positively and significantly on market capitalization in Nigeria. The study employed OLS regression, ADF unit root test and Johansen co-integration test as estimation techniques. Eniekezimene (2013) conducted a study on the impact of foreign portfolio investment on capital market growth in Nigeria. Using Ordinary Least Square method to analyze the data gathered it was revealed that foreign portfolio investment has a positive impact on capital market growth in Nigeria. Aigheyisi and Edore (2013) investigated the effects of the inflows of foreign financial resources into Nigeria's and Ghana's economies, on the development of the countries' stock exchanges from 1988 to 2011. The authors recommended that the creation of conducive macroeconomic, socio-political environment required to attract more foreign direct and portfolio investments, as well as enhance the profitability of quoted firms whose securities are listed on the exchange and encouraging more firms to get listed the stock exchanges .Adopting market capitalisation–GDP ratio (MCR) as proxy for stock market development and external debt-GDP ratio (EXDTR), foreign direct investment (FDI), foreign portfolio investment (FPI), personal remittances received (PRR), official development assistance and aid (ODAA)) to GDP as explanatory variable, they employed multiple linear regression technique to analyse the data collected. Jarita D and Salina H. K (2009) examined the relationship between foreign portfolio investment (FPI) and Malaysia's economic performance. In particular, the study analyses the relationship between FPI and real gross domestic product (GDP) using the widely adopted Granger causality test. Using quarterly data covering the period from 1991 to 2006, The findings suggest that economic performance is the major pull factor in attracting FPI into the country.

Baghebo and Apere (2014) in an attempt to ascertain the impact of foreign portfolio investment (FPI) on economic growth as well as the long run determinants of FPI in Nigeria, it was discovered that foreign portfolio investment; market capitalization and trade openness has a positive long-run relationship with real gross domestic product in Nigeria using Augmented Dickey Fuller Unit Root test, . The variables considered were foreign portfolio investment, inflation rate, market capitalization, trade openness. Also. Ekeocha (2008) submitted that the volatility nature of Foreign Portfolio Investment does not affect its role as an important source of fund to support investment in any economy that has a wide saving-investment gap like Nigeria

Nuzhat (2009) conducted a study on the impact of Foreign direct investment (FDI) on economic growth in Pakistan, for the period 1980-2006. The study opines that foreign direct investment is an important catalyst for economic growth in the developing countries. It affects the economic growth by stimulating domestic investment, increasing human capital formation and by

facilitating the technology transfer in the host countries. The results of the study show a negative and statistically insignificant relation between the GDP and FDI Inflows in Pakistan. In the works of Gorg and Strobl (2004) on the impact of Foreign Private Investment on economic growth in Nigeria between 1970 and 2001, the ECM results showed that both private capital and lagged foreign capital have small and statistically insignificant effect on the economic growth. Furthermore the results seem to support the argument that extractive FPI might not be growth enhancing as much as manufacturing FPI.

3.0 Methodology

3.1 Model Specification

A regression model is derived from the theory of foreign investment and the modification of Adaramola and Obisesan (2015). The model is specified as follows:

$$LMCAP = f(LFDI, LFPI) \quad \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots \quad (I)$$

Presenting equation 1 in explicit form:

$$LMCAP = \beta_0 + \beta_1 LFDI + \beta_2 LFPI + U \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots \quad (2)$$

Where:

LMCAP = Stock market capitalisation

LFDI = Foreign direct investment

LFPI = Foreign portfolio investment

U = stochastic error term

Bo-B2 = coefficients of independent variables

From equation (2), the model can be specified in a time series form as;

$$LMCAP_t = \beta_0 + \beta_1 LFDI_t + \beta_2 LFPI + \mu \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots \quad (3)$$

Where: t = time series

3.2 Estimation Technique

3.2.1 Regression Analyses

The research is empirical and data are quantitative in nature, we shall test the above hypotheses using the Ordinary Least Square (OLS). Data described above shall be analyzed using ordinary least square (OLS) technique while the reliability of the predictors will be determined using standard error test.

3.2.2 Augmented Dickey-Fuller Tests

In order to guide against spurious regression, Augmented Dickey Fuller (ADF) unit root test shall be employed for stationarity of the variables. To determine the time series characteristics and order of integration of the variables, ADF unit root test developed by Dickey and Fuller (1979) is employed. The model is specified thus:

$$\Delta Y_t = \delta_0 + \lambda Y_{t-1} + \beta_i \Delta Y_{t-1} + \varepsilon_{t1} \text{ (for intercept)} \dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots\dots \quad (4)$$

$\Delta Y_t = \delta_0 + \lambda Y_{t-1} + \delta_1 t + \beta_i \Delta Y_{t-1} + \varepsilon_{t_2}$ *(for trend)* .... *(5)*

Where:

Y_t = Variable tested for unit root, Δ = first difference operator, t = time trend, ε_t= stationary disturbance error term.

3.2.3 Johansen Co-integration Test

Johansen co-integration tests for the possible long run relationship. It is necessary to determine whether the variables in equation (3) co-integrate. The trace test statistic proposed by Johansen is:

LR $_{trace}$ (r) = -T In (1-λ) the trace statistics and

For decision making, the computed values are compared to the critical values to determine the exact number of co-integrating equations. If the test statistic is greater than the critical values from Johansen's table, reject the null hypothesis that there is r co-integrating vectors in favour of the alternative hypothesis that there are r+1 co-integrating vectors (for trace).

3.2.4 Error Correction Mechanism

We shall also apply Error Correction Model (ECM) for the determination of short run dynamics and direction of errors between dependent and explanatory variables i.e. to investigate the short-run dynamics in the relationship between market capitalization, foreign direct investment and foreign portfolio investment. The significance of error correction model lies in its ability to correct spurious regression results on time series data. Hence from equation (4), the error correction model (ECM) can be respecified as:

Δ LMCAP= β_0 - β_1 LFDI$_{t-1}$ + β_0 + β_2 LFPI$_{t-1}$ + β_0 + ECM$_{t-1}$ + β_0 + Σt............................ (6)

Where:

ECM$_{t-1}$ = Error correction term

t-1 shows the variables were lagged by one period

Σt = white noise residual

3.3 Expected Results

$\beta_1$and β_2 are expected to be > 0. On a priori, we expect that the relationship between LMCAP and LFDI as well as LMCAP and LDPI to be positive. The signs of the estimated coefficients are thus expected to be greater than zero respectively since rise in foreign investment will lead to a rise in market capitalisation.

3.4 Sources of Data

For the purpose of this study, the data used for the analyses are entirely secondary. They are market capitalization, foreign direct investment and foreign portfolio investment. They are obtained from Central Bank of Nigeria Statistical Bulletin, Federal office of statistics and other Nigerian Stock Exchange fact book.

4.0 Results and Findings

4.1 Regression Result

Table1: Ordinary Least Square Regression Result

LMCAP	CONSTANT	LFDI	LFPI
B	-9.881205	1.317301	0.078169
Standard Error	0.795937	0.082581	0.047981
t-statistics	-12.41456	15.95167	1.629155
Prob.	0.0000	0.0000	0.1197
f-statistic = 275.7486 (0.0000), DW = 2.44, Adj. R^2 = 0.9632			

Source: Computation Using Eview 7 statistical package

The result in table 4.1 is presented in equation form as:

LMCAP = -9.881205 + 1.317301 LFDI + 22.90676 LFPI

This equation shows that the LFDI and LFPI have positive effect on LMCAP. This implies that LMCAP increases with increase in both LFDI and LFPI. Holding all other factors other than LFDI and LFPI constant, A % increase in LFDI and LFPI brings about 1.32% and 0.08% in LMCAP respectively. However, C relates negatively with LMCAP. Putting LFDI and LFPI aside, a % change in other factors brings about 9.88% reduction in LMCAP. The probability values of the C and LFDI are less than 5% while LFPI is greater than 5%. This means that LFPI is not statistically significant in determining LMCAP. The test of autocorrelation is inconclusive as shown by Durbin Watson of 2.44. Probability of f-statistic is less than 5%, hence the model is of good fit. Adjusted R^2 of 96.32% revealed that significant proportion of changes in LMCAP can be explained by LFDI and LFPI.

4.2 Stationarity Tests

Table 2: Results of the unit root tests @ level

Variables	ADF Test Statistics	Makinnon Critical Value @ 5%	Remark
LMCAP	1.004311	2.976263	Non-stationary
LFDI	2.222009	2.976263	Non-stationary
LFPI	1.509667	3.052169	Non-stationary

Source: Computation Using Eview 7 statistical package

Table 3: Results of the unit root tests @ 1ˢᵗ difference

Variables	ADF Test Statistics	Mackinnon Critical Value @ 5%	Order of stationary	Remark
LMCAP	4.214843	2.981038	1(1)	Stationary

| LFDI | 8.802530 | 2.981038 | 1(1) | Stationary |
| LFPI | 5.125424 | 3.052169 | 1(1) | Stationary |

Source: Computation Using Eview 7 statistical package

Since all the variables are non-stationary at level with the exception of ECM as shown in table 2, we proceed to unit root test at first difference where all the variables become stationary. The results in table 3 show that ADF test statistics are greater than the Mackinnon critical values at 5%.

4.3 Johansen Co-integration Test

Table 4: Results of Johansen co-integration test

Hypothesized No. of CE(s)	Eigen Value	Trace Statistics	5% Critical Value	Prob.**
None*	0.631131	37.98626	29.79707	0.0046
At most 1	0.534413	18.04000	15.49471	0.0202
At most 2	0.128503	2.750857	3.841466	0.0972
LMCAP = -1.423216 LFDI - 0.042129 LFPI				
(0.04611) (0.03256)				

Source: Computation Using Eview 6 statistical package

In order to establish whether the variables co-integrate in the long run, johansen co-integration test is carried out. The result of the test is in table 4. The results show that there is a long run co-integration among LMCAP, LFDI and LFPI. This is because trace statistic is greater than 5% critical value at none* hypothesized. Our results produce two co-integrating equation out of which one is chosen based on highest log-likelihood of 43.39385 in absolute term. Co-integration equation in table 4 reveals that there are negative relationships between LMCAP and LFDI on one hand and between LMCAP and LFPI on the other hand. The implication being that a % increase in LFDI and LFPI shall lead to 1.423216 % and 0.042% decrease in LMCAP respectively. The standard errors are given in parentices. It shows that only LFDI provides a significant explanation for changes in LMCAP because its average coefficient is greater than standard error.

4.4 Error Correction Model

Table 6: Over-parameterized ECM results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(LMCAP(-1),2)	-0.082670	0.185588	-0.445449	0.6639
C	-0.031793	0.079590	-0.399459	0.6966
D(LFDI,2)	0.787143	0.242135	3.250848	0.0069

D(LFDI(-1),2)	0.145674	0.164185	0.887256	0.3924
D(LFPI,2)	0.040763	0.030030	1.357401	0.1996
D(LFPI(-1),2)	0.007996	0.028579	0.279776	0.7844
ECM(-1)	-1.599453	0.359547	-4.448521	0.0008
R^2 = 0.662963, Adj. R^2 = 0.494444, f-stat = 3.934066 (0.020825), DW = 1.56				

Source: Computation Using Eview 7 statistical package

Table 6: Parsimonious ECM results

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(LMCAP(-1),2)	-0.072005	0.170957	-0.421189	0.6796
C	-0.037633	0.071564	-0.525865	0.6067
D(LFDI,2)	0.650977	0.168744	3.857780	0.0015
D(LFPI,2)	0.038661	0.025198	1.534277	0.1458
ECM(-1)	-1.542099	0.325753	-4.733949	0.0003
R^2 = 0.640985, Adj. R^2 = 0.545248, f-stat 6.695248(0.002675), DW = 1.462342				

Source: Computation Using Eview 7 statistical package

In the error correction model, we have the over parameterized and parsimonious error correction model. Over parameterized ECM is estimated by setting the lag length long enough as to ensure that dynamics of the model has not been constrained by a too short lag length. In the over parameterised model, Variables whose coefficients are significant or closer to being significant are extracted for the estimation of parsimonious ECM. The parsimonious ECM presented in Table 6 shows that there truly exists long-run equilibrium relationship among the variables. This is evidenced by the coefficient of one period lag of ECM which is statistically significant and correctly signed (ECM -1.542099) with a probability value of 0.0003. The result shows that about 154% of the short-run inconsistencies are being corrected and incorporated into the long-run equilibrium relationship annually. The specific effect of each of the LFDI and LFPI on the MCAP is shown in the coefficient column of table 6. It can be seen that LFDI and LFPI have positive effect on LMCAP. A % increase in the two variables will bring about 65% and 3.8% increase in LMCAP, all other things being equal. The result further shows that only LFDI is found to be statistically significant in determining LMCAP. F-statistic test shows that the model is of good fit, Durbin Watson statistic shows that the model is free of autocorrelation while degree of determination shows that about 55% of changes in LMCAP can be explained by LFDI and LFPI after adjustment.

5.0 Concluding Remark

The study investigates the impact of foreign private investments on the development of Nigerian Capital Market using time series data between 1986 and 2013. The study employed the Johansen

Co-integration technique to determine the long run effect of foreign direct and portfolio investments on stock market development proxied by Market Capitalization. The result shows that dynamic long-run association exists among the variables. The error correction model results show that the variables have short run association which can actually be felt in the long run. The short-run inconsistencies have been corrected because ECM coefficient is significant with correct negative sign.

Based on the findings of the study, the study concludes that foreign direct investment has a positive and significant impact on the national capital market while foreign portfolio investment has positive but insignificant impact. Suffice to say that foreigners prefer huge investment in the developing world since foreign direct investment requires physical presence or significant proportion of ownership. The insignificance of portfolio investment points out to the fact that foreigners are not favourably disposed to this form of investment in the developing world. Foreign portfolio investment does not afford foreigners the opportunity to participate in the running of the business. Hence the insignificance of foreign portfolio investment could be traced to lack of trust in locally managed companies.

Given the positive impact of the foreign private investment on the Nigerian capital market, effort should be made to encourage the continuous inflow of both forms of investment in Nigeria. The regulatory framework of the market should also be enhanced to ensure equitable dealing. Further study is suggested on the economic impact of portfolio investment in Nigerian economy.

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