

NIGERIA



\$32.13 Bn
Equity Market
Capitalization

\$27.90 Bn
Debt Market
Capitalization

169
Number of
listed
companies

33
Number of
issuers
(bonds)

—
Domestic
Equity Market
Cap/GDP

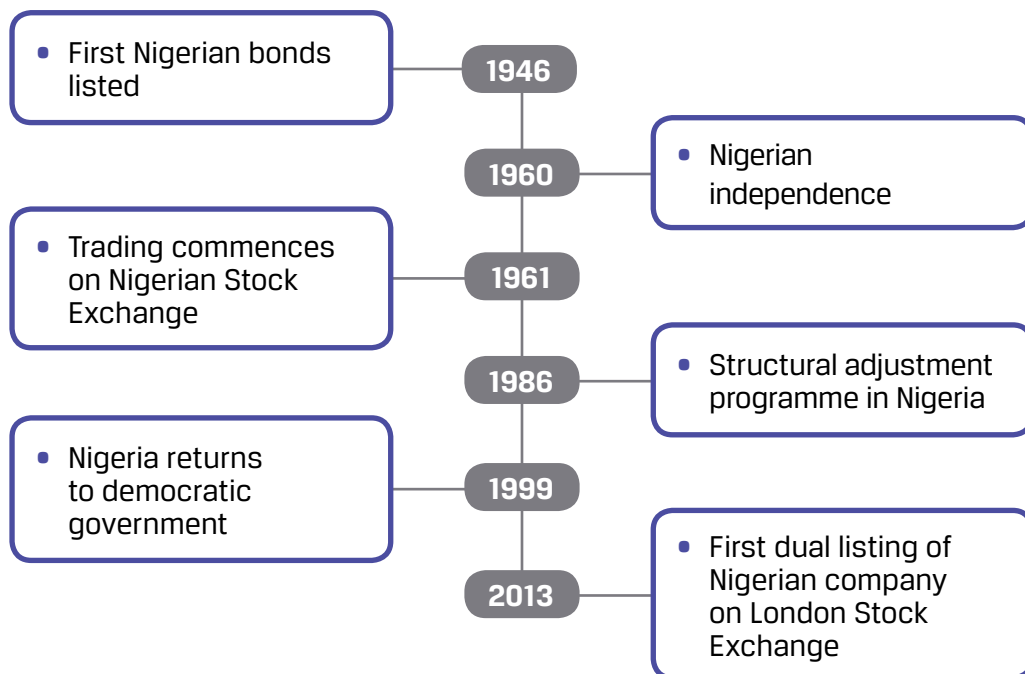
9.2%
Total Equity
Market Cap/
GDP

8
Domestic
Debt Market
Cap/GDP

76,825.3 Mn
Equity Market Share Volume Traded (Units)

\$929 Mn
Debt Market Total Nominal Traded

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Dave Uduanu, CFA
CEO, Sigma Pensions limited
Nigeria

The history of capital market activity in Nigeria dates back to pre-independence with the issuance of bonds by the British colonial authority to fund construction projects in 1946. Thereafter, more regular sales of government bonds and Treasury bills occurred in the lead-up to Nigeria's independence in 1960. Though a latecomer compared with the fixed-income market, the equity market commenced with the promulgation of the Lagos Stock Exchange Act (later renamed the Nigerian Stock Exchange) in 1960. Actual stock market trading would begin in 1961 with 19 listed securities and four market dealers. As with the rest of the world, where developments in the capital markets tend to mirror events in the wider economy, the evolution of Nigeria's debt and equity markets reflected the cross-currents across the political and economic environments.

At independence, Nigeria's policy framework was largely inward looking with emphasis on reducing British influence over large parts of the economy. This desire resulted in the passage of the Exchange Control Act (1962) and indigenisation decrees (1972), which limited foreign participation in the stock market. Despite the country's modest budget deficits, which should have tolerated the development of a vibrant bond market, the absence of institutional savings mechanisms meant that there was no viable buyer for government debt. This situation resulted in increased reliance on central bank financing of these deficits, which crowded out private sector borrowing activity.

However, following the slump in crude oil prices in the early 1980s, Nigeria's policy environment transformed with the 1986 adoption of a structural adjustment programme (SAP) that called for a liberalisation of the economy, advised by the International Monetary Fund (IMF). The post-1986 SAP era saw the repeal of inward-looking laws, such as indigenisation decrees and exchange control, as well as significant privatisation of public corporations, which induced a wave of stock market listings in the 1990s. The period also witnessed the introduction of a depository system and deregulated secondary market pricing of securities. For debt markets, while there were some fiscal reforms under the SAP era, central bank financing of budget deficits remained large, which curtailed the development of a liquid bond market.

Following the restoration of democratic rule in 1999 and renewed impetus for liberal economic policy reform aimed at attracting local or foreign private capital, Nigeria's capital markets entered a new era of growth (see **Table 1**). Key economic policy initiatives, which created domestic institutional savings pools (with the pension reform in 2004 and consolidation of the banking sector in 2005), alongside the creation of a debt management office in 2005 and caps on deficit financing from the central bank, provided a clear framework for the development of a liquid OTC debt market. At the end of 2018, the Nigerian Stock Exchange (NSE) was made up of 169 stocks, nine exchange-traded products, five REITs, and 130 bonds. Today, the NSE

TABLE 1. NIGERIA'S CAPITAL MARKET, 1985–2018

	1985	1990	1995	2000	2005	2010	2015	2018
Equity market cap/nominal GDP (%)	2.9	4.4	7.6	6.8	11.3	14.5	10.5	9.2
Bond market/nominal GDP (%)	2.0	0.8	0.2	0.1	1.7	3.7	7.6	8.0
Capital market depth (%)	4.9	5.3	7.8	6.8	13.0	18.1	18.1	17.1

Note: Capital market depth is defined as the sum of debt outstanding and stock market capitalisation as a ratio of nominal GDP.

Sources: Central Bank of Nigeria, Nigerian Stock Exchange, and Nigeria Securities and Exchange Commission.

is a member of the International Organization of Securities Commissions (IOSCO), the World Federation of Exchanges (WFE), the Sustainable Stock Exchanges (SSE) initiative, and the African Securities Exchanges Association (ASEA). Nigeria's debt market is the second most liquid market in sub-Saharan Africa, after South Africa, with a fully developed benchmark yield curve and fairly liquid secondary market for trading debt securities.

Looking ahead, the focus of Nigeria's equity market remains on improving stock market depth. Although in recent years, greater foreign portfolio investment flows and inclusion of some stocks in international indices has driven greater visibility, limited appetite by local institutional investors for Nigerian equities—because of the market's relatively weaker return profile amid high yields on government securities—has weighed on market resilience. In the light of recent weakness in Nigeria's macroeconomic profile and a wave of stock delistings, which exacerbated an already liquidity-challenged market, the Nigerian equity market faces significant hurdles over the near to medium term in the absence of significant policy reforms. For fixed-income markets, monetary policy has replaced fiscal policy as the key driver of debt market activity in Nigeria because the central bank had to shoulder the burden of

the adjustment to the oil price collapse in 2014–2016 amid a fiscal reluctance to devalue the currency. This monetary dominance has resulted in a constantly inverted yield curve where front-end interest rates are usually higher than long-term yields. The implications of the skew toward shorter-duration investment portfolios and borrowing needs as well as high short-term risk-free rates portend headwinds to debt markets over the next few years.

EQUITIES

Despite improved visibility for the Nigerian economy, the largest in Africa, the Nigerian equity market remains small, with a market cap/GDP ratio of 9% at the end of 2018. The problem of size is not entirely new; market cap/GDP averaged 2% between 1961 and 1985, which was reflective of the public sector dominance of most segments of the economy in the pre-SAP era. Notably, the pattern did not significantly improve following the indigenisation decree of 1972. Following a wave of structural reforms in 1986 that resulted in several rounds of privatisation, equity market activity improved with a pick-up in stock market listing and trading. However, market cap/GDP moved into the double digits in the 2000s after a strong run-up in crude oil prices and improved economic fundamentals drove a wave of IPO and capital

TABLE 2. NIGERIAN STOCK MARKET, 1985–2018

	1985	1990	1995	2000	2005	2010	2015	2018
Equity market cap (USD million)	5,511	2,470	2,606	4,235	19,562	52,527	50,130	32,133
Value traded (USD million)	0.06	0.03	0.08	1.0	7.9	21.2	19.9	14.1
Stock market turnover ratio	0.3	0.4	1.1	7.4	12.3	12.3	9.3	9.5
Average price-to-earnings ratio	4.3	7.0	6.8	7.1	12.8	10.0	17.8	9.3
Average dividend yield (%)	10.6	12.0	7.9	7.5	9.5	5.8	5.9	5.6
Number of stocks	96	131	181	195	214	217	190	169

Sources: Central Bank of Nigeria, Nigerian Stock Exchange, Nigeria Securities and Exchange Commission, and Bloomberg.

raising activity. However, fuelled by unchecked margin lending and questionable practices, the stock market had moved into bubble territory in 2007,²⁵ which subsequently corrected during the 2008 global financial market crisis and dented investor confidence. Although the market staged a rebound in 2012–2014, relative to emerging/frontier market peers, the Nigerian stock market remains small, as shown in **Table 2**, which suggests that the equity market is a poor proxy for broader economic activity. An examination of the sector weightings of the market and economic activity, shown in **Figure 1**, illustrates this point clearly.

The NSE is concentrated around three sectors: banking (33% of market cap), materials (32%

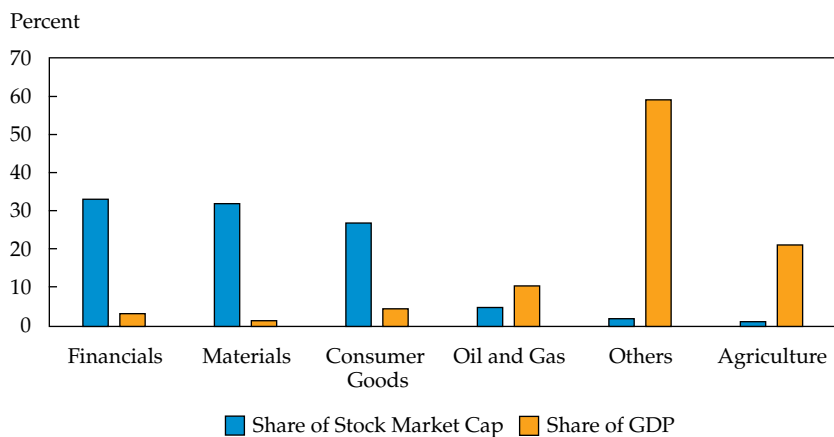
of market cap), and consumer goods companies (27%), which cumulatively account for less than 10% of economic activity. One reason for the poor economic representation of the NSE is the largely informal nature of some key sectors in the economy:²⁶ agriculture (21% of GDP), construction and real estate (12%), and trade (17% of GDP). In addition, other sectors, such as telecommunications (which accounts for 9% of GDP) and the Nigerian subsidiaries of large international oil companies involved in crude oil exploration, have (until recently) generally avoided stock market listing.

In terms of composition, foreign investor involvement in Nigerian equities significantly increased in 2012 following the removal of the

²⁵The NSE All Share Index has yet to recover from a record high of over 65,000 points in February 2008.

²⁶The Nigerian National Bureau of Statistics estimates that around 46% of economic activities belong to the informal sector.

FIGURE 1. SECTOR BREAKDOWN OF NIGERIAN STOCK MARKET VS. NIGERIAN ECONOMY



Sources: Nigerian Bureau of Statistics, Nigerian Stock Exchange, and Bloomberg.

mandatory one-year holding period for foreign portfolio investors, resulting in foreign transactions accounting for more than half of equity market activities. In recent years, developments around foreign exchange (FX) markets have played a key role in foreign portfolio investment (FPI) activity in the Nigerian bourse. Officially, Nigeria operates a managed float exchange rate regime, but the FX market architecture has been characterized by multiple exchange rate windows with arcane restrictions on participation and use of an opaque non-market system of FX pricing. This reflects the continued reluctance to move from the fixed exchange rate system, prevalent for large parts of Nigeria's post-independence history, to a market-driven exchange rate system.

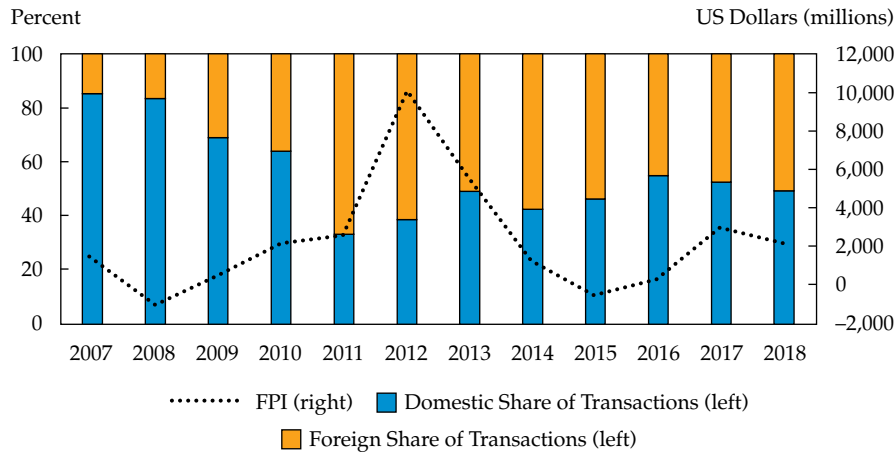
Following the slump in crude oil prices and the imposition of exchange rate controls in 2016, MSCI placed Nigeria under review for potential exclusion from the MSCI Frontier Markets Index, citing the significant decline in FX liquidity. These restrictions made it difficult for foreign investors to repatriate the proceeds of their investments on the Nigerian stock market (see **Figure 2**).

Following the relaxation of trading restrictions as well as the improvement in FX liquidity in 2017, MSCI announced that it would no longer look to remove Nigeria from the index in 2018, which drove a pick-up in foreign participation.

In terms of local participation, institutional investors (largely pension funds) are the bedrock and have accounted for around 60% of domestic transactions on the NSE over the last five years, as shown in **Figure 3**. Following reforms to the pension fund system in 2004, which introduced a mandatory contributory pension system, pension fund assets in Nigeria have expanded around 25% per year to NGN8.6 trillion (USD24 billion) as of the end of 2018. Pension fund holdings of equities (as a share of AUM) have progressively declined since 2008, as **Figure 4** illustrates. Specifically, following the adoption of a multi-fund approach to investing fund assets, which tries to stratify investor profiles into funds that mirror demographic features and risk appetite, there is potential for equity holdings by pension funds to reverse the declining trend observed in recent years. Crucially, the multi-fund plan looks

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FIGURE 2. FOREIGN PORTFOLIO INVESTMENT FLOWS INTO NIGERIAN EQUITIES, 2007–2018



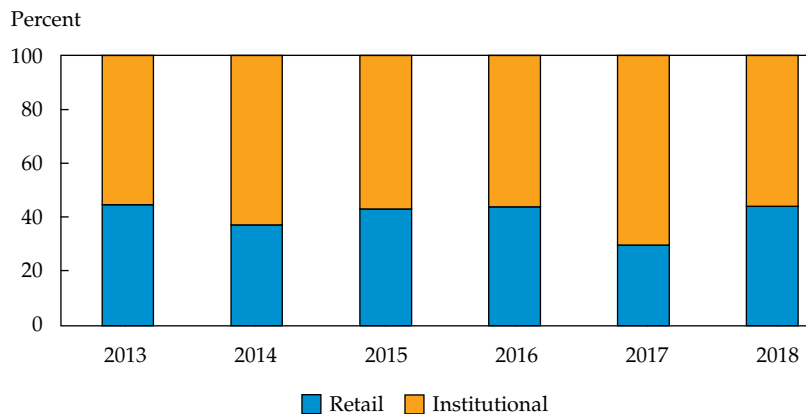
Sources: Nigerian Stock Exchange and Central Bank of Nigeria.

to introduce minimum equity positions for pension funds of 10%, which would help provide a layer of resilience to stock market valuations.

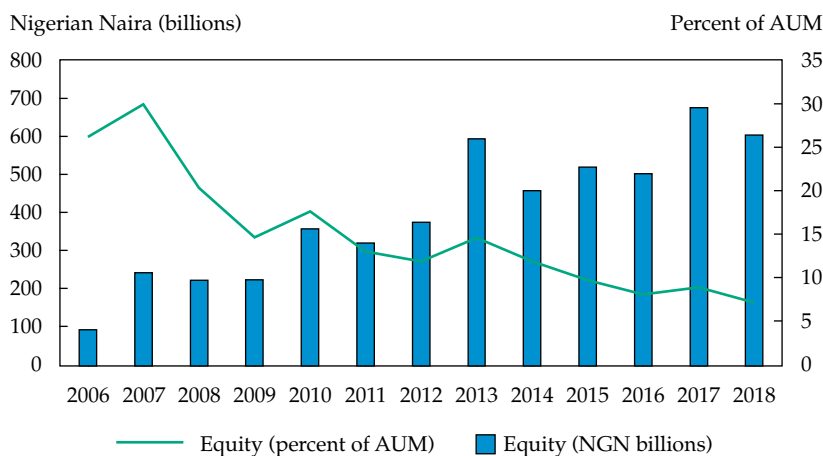
In a bid to address the problem of thin domestic capital pools, the NSE entered into a partnership with the London Stock Exchange to provide an

avenue for dual listing of Nigerian-based entities looking to raise equity capital from international markets while remaining available to local investors. This was pioneered with the dual listing of indigenous upstream oil and gas company Seplat Petroleum in 2013 and, more recently, with telecommunications firm Airtel Africa in

FIGURE 3. DOMESTIC EQUITY PARTICIPATION: INSTITUTIONAL AND RETAIL SHARES, 2013–2018



Source: Nigerian Stock Exchange.

FIGURE 4. PENSION FUND INVESTMENT IN NIGERIAN EQUITIES, 2006–2018

Sources: Central Bank of Nigeria and National Pension Commission.

2019. The development allows local companies of sufficient scale to tap offshore capital markets without closing the opportunity for local investors to gain exposure.

The NSE pushed the development of alternative assets, such as REITs, exchange-traded funds in gold, and bonds. In a bid to create a pipeline of future stock market companies, the NSE created a platform (the Alternative Securities Market, or ASeM) for small and mid-sized fast-growth companies to tap equity markets at relatively low cost and to improve visibility to potential investors.

DEBT

Nigerian debt markets (see **Table 3**) have a long history, going back to 1946 with the sale of GBP300,000 worth of bonds by the UK colonial government to execute a 10-year development plan.²⁷ Debt market activity gathered further steam with the establishment of the Central Bank of Nigeria (CBN) in 1958, which allowed

²⁷The 10-year bond was issued at a yield of 3%.

for issuance of the first set of Nigerian Treasury bills in 1960. However, for much of the post-independence period leading up to 2007, a combination of high interest rates (more than 20%), sovereign dominance of paper issuance of short maturities (less than one year), and the absence of large institutional capital pools (such as insurance or pension funds) meant that secondary market trading was insignificant. Indeed, debt instruments were only redeemable to the CBN at maturity. Consequently, the debt market was dominated by primary market issuance of short-term federal government paper with limited sales of sub-national and corporate debt. A collapse in oil prices in the early 1980s, which triggered an economic crisis requiring difficult structural reforms, led to a collapse in debt market activity in the period between 1981 and 2000.

Following the return to a democratic government in 1999, the Nigerian government embarked on significant debt market reforms with the introduction of a Debt Management Office (DMO) in 2003 and the establishment of a defined-contribution pension system in 2004,

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TABLE 3. NIGERIA'S FIXED-INCOME MARKET, 1985–2018

	1985	1990	1995	2000	2005	2010	2015	2018
Government debt (USD million)	3,501	378	38	19	2,833	12,872	35,333	27,198
Corporate debt (USD million)	400	89	25	37	76	374	1,048	703
Total debt outstanding (USD million)	3,902	467	63	56	2,909	13,246	36,380	27,901
Average daily value traded (USD million)	1.3	0.1	0.0	0.0	0.3	0.0	1,207	929
Turnover ratio (%)	8.1	3.8	1.0	0.1	2.2	0.0	822.8	825.7

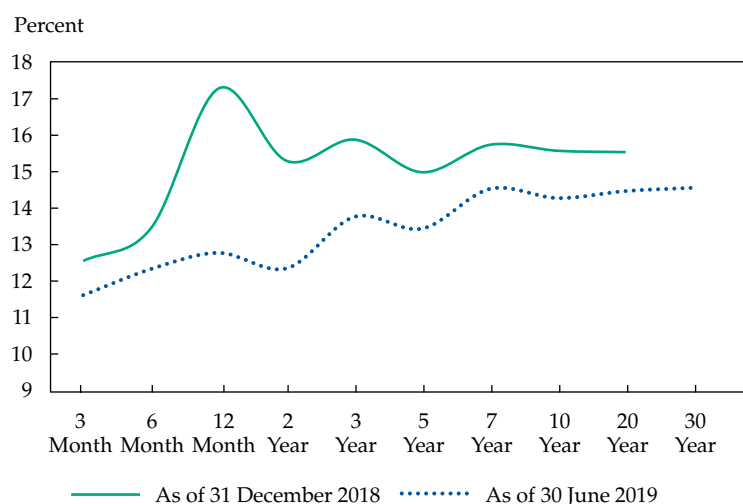
Sources: CBN and FMDQ Securities Exchange OTC.

as well as a consolidation drive in the banking sector in 2005. These developments were by-products of the adoption of a policy support instrument (PSI) framework with the IMF-created conditions for the emergence of a thriving debt market. In addition, this period saw a drastic reduction in Nigeria's external debt profile following a debt relief agreement in 2005 and substantial repayments that resulted in a

marked improvement in Nigeria's debt metrics and lower fiscal dominance.

The establishment of the DMO improved visibility around government borrowing and allowed for the creation of a sovereign NGN yield curve in 2007, which today stretches to 30 years with regular monthly issuance along key benchmark rates of 5-, 7-, and 10-year maturities (see **Figure 5**). On the demand side,

FIGURE 5. THE NAIRA YIELD CURVE



Source: FMDQ Securities Exchange OTC.

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rapid growth in the pension fund industry created a natural demand source for matching government bond supply. With the introduction of banks as primary market makers and a small, local, non-pension asset management industry, active trading of bonds with the provision of two-way quotes helped drive greater visibility within Nigerian debt markets. However, this market was largely over the counter (OTC), and thus data over the scale of the improvement in trading activity were understated until the establishment of an exchange (the FMDQ Securities Exchange OTC, or FMDQ OTC) for fixed-income trading backed with regulation in 2013. In the first year of operations of the debt market exchange, average daily traded value of the debt instruments was USD814 million (up from less than USD1 million in 2013).

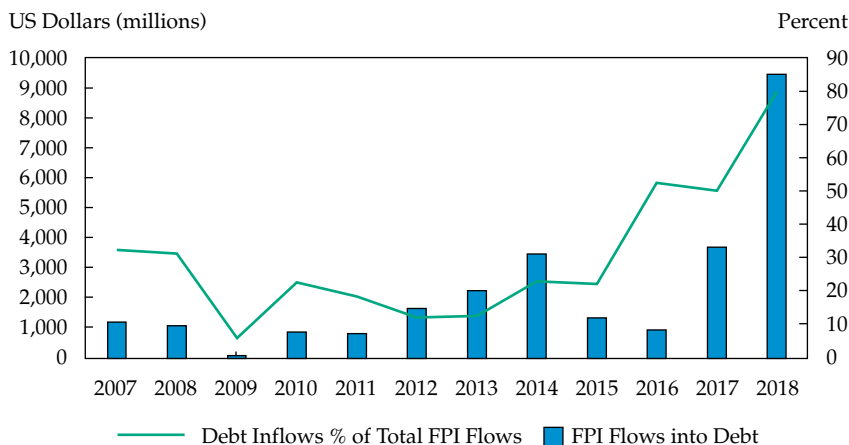
In terms of market participants, foreign investor activity in Nigeria’s debt markets prior to the reform in the mid-2000s was limited, largely because of capital account controls that mandated a one-year holding period. Following the removal of this restriction in 2011, foreign

inflows improved, and in 2012, J.P. Morgan announced the inclusion of Nigeria’s local currency bonds in its Government Bond Index-Emerging Markets. This event was followed by inclusion in 2013 in the Barclays EM Local Currency Liquid Government Bond Index. The index additions improved visibility on market depth as well as volumes and allowed for better price discovery. The flow of foreign investor activity is illustrated in **Figure 6**.

On the local side, debt market participants in Nigeria closely follow the “habitat theory”: Banks with regulatory requirements for liquidity and significant reliance on deposits focus extensively on short-term instruments to ensure a balance between assets and liabilities. On the long end of the curve, pension funds, with their long-term liabilities, tend to dominate the bond segment with outsized holdings of federal government of Nigeria (FGN) bonds (over 70% of assets under management).

In terms of issuance trends, the local debt market has traditionally been dominated by FGN

FIGURE 6. FOREIGN PORTFOLIO INFLOWS INTO NIGERIA'S DEBT MARKETS, 2007-2018



Source: Central Bank of Nigeria.

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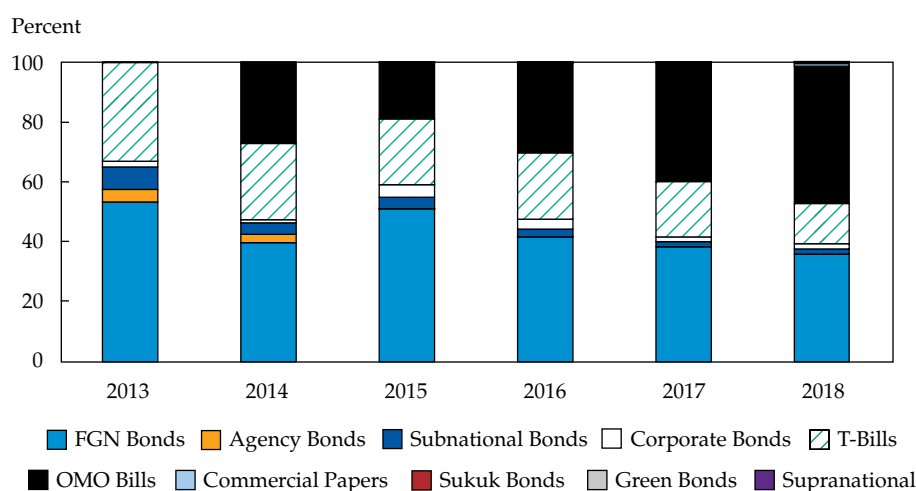
bonds; they accounted for 36% of debt market cap in 2018. Following the FX-induced crises of 2016—a fallout of reluctance by Nigerian policymakers to devalue the exchange rate in the aftermath of the drop in oil prices—the CBN embarked on ultra-tight monetary policy with issuance of short-term open market operation (OMO) bills. In seeking to rein in USD demand, the CBN issued large amounts of these sterilisation securities, which have become the dominant instrument in Nigeria’s debt markets (46% of debt market cap), with the total supply in excess of government debt at the end of 2018. Short-term FGN T-bill securities (government debt instruments with maturities between three months and one year) accounted for 13% of outstanding fixed-income securities at the end of 2018. In recent years, more than half of fixed-income securities in Nigeria are risk-free short-term instruments (with a tenor of not more than one year), and the bills issued by the CBN have become the key driver of short-term interest rates. A flat-to-inverted yield curve

is now a persistent feature of the Nigerian debt market.

The DMO has made further attempts to diversify in terms of instrument type with the sale of FGN savings bonds (FGNSBs) for retail investors, *sukuk* bonds for investors with Islamic preferences, and Green Bonds. However, these securities remain insignificant relative to T-bills and bond instruments, as shown in **Figure 7**. Given the fiscal and monetary dominance of debt markets at high interest rates, the supply of corporate and sub-national borrowings is subdued, with the outstanding amount of these segments at under 5% of the total debt market.

In terms of trading volumes, the short-term risk-free instruments (OMO bills and FGN T-bills) are the most liquid segment (at 63%), followed by FGN bonds (13%); repo transactions make up 26% of fixed-income transactions. Most non-sovereign instruments are infrequently traded given the small volume on issue. In Nigeria’s pursuit of monetary tightening,

FIGURE 7. DEBT INSTRUMENTS WITHIN OVERALL DEBT MARKET, 2013-2018



Source: FMDQ OTC.

the elevated yields on government instruments have attracted significant offshore holdings of short-term risk-free securities in Nigeria, with foreign portfolio investors accounting for 34% of outstanding OMO bill instruments at the end of 2018.

Given low external debt ratios (in 2018, 5.1% of GDP), Nigeria became active in the euro-bond market, with a debut USD500 million issue in 2011. Further forays followed in 2013 (USD1 billion), 2017 (USD4.8 billion), and 2018 (USD5.4 billion). The decision to tap foreign debt markets reflects cost considerations; the weighted average interest expense on these bonds is presently 7.5%, compared with 14.2% for Naira bond issuances. The presence of a sovereign USD curve catalysed a wave of issuances by Nigerian corporates (especially banks) that sought to finance M&A activity in the energy sector. However, following the economic crisis of 2014–2016, the corporate eurobond space has seen a wave of redemptions with no desire by banks to refinance maturing issues.

CHALLENGES AND OPPORTUNITIES

Fiscal and monetary dominance of the debt market will result in an overconcentration of private savings in risk-free instruments, which will, in turn, curtail growth in other asset classes (equity, corporate debt, and alternatives) that are necessary for a deeper and more resilient capital market. As such, Nigeria's economic policymakers must embark on comprehensive reforms that address the underlying drivers of imbalances that necessitate large paper issuance—particularly, reducing fiscal deficits and reforming FX market architecture toward a framework that is consistent with long-run economic aspirations. Successful reforms across

both fronts will help reduce incentives for limited risk taking by local fund managers, which will encourage developments of financial products across equity and debt market segments for both surplus savings and deficit units.

Pension fund reform in Nigeria greatly bolstered the demand for investment products, and following that success, further attempts at creating institutional capital pools should be pursued. Relative to pension funds and banks, Nigeria's insurance industry remains small, with total industry assets of USD3.6 billion at the end of 2018 (pension funds: USD25 billion; banks: USD107 billion). Improved compliance with laws that mandate general and group life insurance across the public and private sector, as well as moves to consolidate the sector (presently composed of close to 60 participants), would help widen the breadth of the long-term institutional buy side of the capital market.

Furthermore, policies should seek to reduce overconcentration on risk-free instruments—for instance, via the implementation of minimum holdings of variable-income instruments to reduce overconcentration in fixed income as well to drive the adoption of fair value accounting treatment of fixed-income instruments versus redemptive value treatments. In addition, working toward the development and promotion of standard benchmarks as the basis for performance evaluation will greatly level the playing field among fund managers.

Nigerian equities have seen a wave of delisting activity in recent years alongside a drought in primary market activities. To improve stock market depth in the near term, more work is required to incentivise listings of the Nigerian subsidiaries of international companies located in critical economic segments on the NSE, such as in the upstream oil and gas space. In the immediate term, proposed plans to sell down

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joint venture assets of the Nigerian government should include stock market listing as part of the deal, which will help improve transparency around the notoriously opaque oil sector. Over the medium term, a policy of conducting exits of government stakes in public corporations during a privatisation round on the stock market should be adopted. In addition, policies that increase trading (e.g., securities lending) should be encouraged while transparency around ownership and related-party activities is improved.

The importance of a transparent, consistent, and fair regulatory process to handle market infractions by issuers and investors is crucial for improving market confidence. Also needed is a constant rapport on ethical practices and self-regulation through industry groupings (pension fund operators, asset managers, brokerages, banks, and so forth) to ensure that the market develops a preference for ethical and fair competition.

Finally, a focus on improving the financial education and sophistication of market participants is crucial. Toward this end, a standard course of financial literacy that provides an adequate understanding of the workings of capital markets should be incorporated into the educational curriculum at secondary and tertiary levels. In addition, financial institutions should

be encouraged to hire undergraduate interns in market-facing roles to further demystify investment securities to the retail public. These steps should be supplemented by regular events that create awareness and deepen appreciation of capital markets.

Policy reforms should seek to improve the ability of investors to provide sound corporate governance oversight and sustainability practices in firms seeking to raise capital. To ensure that investors are incentivised, Nigerian regulators should look to adopt a stewardship code for pension fund managers and other institutional investors in the market.

The recent listing of the two telecommunications giants in Nigeria—MTN Nigeria and Airtel Africa—at a combined market cap of about USD10 billion could be a sign of things to come for the Nigerian market. The listing of other large-cap companies in the energy and oil sectors could see the exchange easily topping the USD100 billion mark in market cap. In addition, an increase in equity holdings by the top 10 pension fund managers in Nigeria could potentially lead to an additional inflow of USD3 billion of fresh capital into the market. Africa's largest economy could soon be punching close to its weight in its stock market cap.