

Research Paper

Determinants of capital market development in Nigeria: a public governance approach

Submitted on 8th april 2025

Accepted on 13th may 2025

Evaluated by a double-blind review system

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ABSTRACT

Purpose: This study examined the determinants of capital market development in Nigeria through the lens of six indicators of public governance, during the period, 1996-2023.

Methodology: Autoregressive Distributed Lag (ARDL) technique was applied to the annual time series data on capital market development and governance indicators obtained from Central Bank of Nigeria's Statistical Bulletin and World Bank's Worldwide Governance Indicators respectively.

Results: The study found that government effectiveness, political stability, and rule of law positively and significantly impacted capital market development while voice and accountability had negative and significant impact on capital market development. However, control of corruption, and regulatory quality had no significant impact on capital market development in Nigeria.

Practical implication: Government effectiveness, political stability, rule of law, and voice and accountability are institutional determinants of capital market development in Nigeria.

Originality: The study recommends for the improvement of public governance quality in Nigeria by putting in place policies and programmes that will facilitate government effectiveness, political stability, and rule of law, which will stimulate the development of capital market in Nigeria.

Keywords: *Capital Market; Determinants; Institutional Quality; Public Governance; Stock Market.*

1. Introduction

The capital market as a financial market constitutes a source of medium and long term funds for economic agents to facilitate their operations, activities and programmes. Individuals through financial intermediaries in the capital market-the stockbrokers, access

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the financial resources in the market while business firms and institutions also source for funds to execute their business, trade and investment in the same market. The public sector, likewise, source for funds to finance their operations, projects, and programmes through capital market. By making funds available to different economic agents as well as serving as a platform where capital as a factor of production exchanges hands for productive, investment and trade purposes, the capital market serves as a financial stimulator of real sector activities and productivity. This is because almost every activity in the real sector comes with financial implications, in which case, funds are needed to execute them. Also, reiterated by Fapetu et al. (2021), capital market development, through its effect on consumption and investment, stimulates economic stability and growth.

The capital market, just like other financial markets, does not operate in vacuum but are surrounded by a web of factors and forces which tend to shape its performance and development. Thus, as the economic health barometer, the capital market could be affected by myriads of factors and forces both internally and externally. These factors have been classified into institutional factors, economic factors (micro and macro), behavioural factors, among others. Stock market development as a multi-dimensional concept could be examined from dimensions of market size, liquidity, volatility, concentration, integration, returns, resilience, and others (Babarinde et al., 2024). According to El-Wasal (2013), in his theory of stock market development, the four set of factors that determine stock market development are supply, demand, economic, and institutional factors. The institutional factors discussed in the theory are market infrastructure, banking sector development, political stability, education and public awareness, regulatory and legal framework. Specifically, the institutional factors influencing capital market development relate to the extent to which the institutional arrangements, mechanisms, and framework promote or deter the growth and expansion of the nation's capital market. Institutions here refer to a set of rules compliance procedures, and moral and ethical behavioral norms designed to constrain the behavior of individuals in the interests of maximizing the wealth or utility of principals (North, 1981; as cited in Abubakar, 2020).

Governance has been posited to be a key tool for the evaluation of the effectiveness of the use of human and material resources to facilitate both national and organizational growth and development (Agwanwo & Bello, 2019). It has been observed that quality of

governance plays a vital role in the stability, liquidity, and efficiency of the stock market of any country since the effectiveness of corporate governance framework is function of country-level governance systems in force in the environment of operations of such companies (Ndugbu et al., 2024a). Following this line of thought, public governance as a reflection of institutional quality can be considered as a framework for assessing capital market performance. According to the Worldwide Governance Indicators (WGI), public governance quality is six dimensional issues of: political stability and absence of violence/terrorism, voice and accountability, government effectiveness, regulatory quality, control of corruption and the rule of law (Kaufmann et al., 2010). Each of these indicators and all of them combined are a reflection of the quality of institutions/governance in a country.

Empirical studies on the role of public governance in capital market development are relatively few compared with avalanche of studies on macro-economic determinants of capital market development, particularly in developing countries. This may not be far-fetched from the state of public governance mechanism in these countries which are mostly deteriorating and of less quality when compared with the developed economies. Despite the state of things pertaining the public governance structure in a developing country like Nigeria, it is still pertinent to assess its role in capital market development. This will go a long way in sensitizing the stakeholders on the need for good governance and as well as its role in the financial system, particularly, the capital market end of the financial market of the country. Considering the foregoing, the study was carried out to investigate the institutional determinants of capital market development in Nigeria through the lens of the six-dimensional WGI. Therefore, the specific objectives of the study were to: (i). assess the impact of rule of law on capital market development in Nigeria; (ii). examine the impact of control of corruption on capital market development in Nigeria; (iii). evaluate the impact of regulatory quality on capital market development in Nigeria; (iv). determine the impact of government effectiveness on capital market development in Nigeria; (v). examine the impact of voice and accountability on capital market development in Nigeria; and (vi). assess the impact of political stability on capital market development in Nigeria.

2. Literature Review

2.1. Conceptual Review

2.1.1. Public Governance

Governance, also called public governance, can be defined as the exercise of political, economic and administrative power and authority in the management of natural resources, socio-economic and political affairs of a country in order to provide direction and common cause (Adeniyi, 2022; Ibrahim, 2016). Governance, in another parlance, has been described as the mechanisms and processes for managing societal affairs and country's economic and social resources for the good of its citizens (Izuchukwu et al. 2024). According to Ndugbu et al. (2024a), the legal process, political stability, level of corruption, transparency and accountability are key definitional ingredients of quality governance and their propensity to superintend the operations of the stock markets and their actors. Therefore, public governance as an indicator of quality of institutions in a particular country, involves the management and control, as well as the exercise of authority over the affairs and resources of a country for the good of the society.

According to the Worldwide Governance Indicators (WGI), governance is a multi-dimensional concept involving six broad aspects. The dimensions and their descriptions presented in Table I.

Table I: Six Broad Dimensions of Public Governance

Indicators	Description
Voice and Accountability	This reflects perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.
Political Stability and Absence of Violence/Terrorism	This measures perceptions of the likelihood of political instability and/or politically-motivated violence, including terrorism
Government Effectiveness	This reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.
Regulatory Quality	This reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.
Rule of Law	This reflects perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.
Control of Corruption	This reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as capture of the state by elites and private interests

Source: Kaufmann et al. (2010)

2.1.2. Capital Market Development

Capital market refers to that financial market where capital as a factor of production is sold and bought. Capital, in this context basically refers to financial resources packaged in form of securities like shares, stock, bonds, debentures, derivatives. Capital market has been described as a financial market where medium to long-term funds in the form of financial securities like bonds, loan stocks, shares, debentures and derivatives as well as other securities are traded (Babarinde et al., 2020; Babarinde & Enoruwa, 2021). In other parlance, A capital market is an institution or a financial market in which buyers and sellers come together for the exchange of financial instruments like stocks, bonds, equities, etc. (Adekunle, 2024). The market facilitates raising of capital for use in the real sector for trade and investment and consequently promoting business and economic growth (Babarinde, 2021). The capital market is a network of financial institutions and infrastructure that interact to mobilize and allocate long-term funds in the economy and allows business firms and governments to sell stocks and bonds, to raise long-term funds from the savings of other economic agents (Adekunle, 2024).

Although capital market development is multidimensional, but the size dimension of the market is one of the most popular lenses through which the development of the market is measured. One key indicator of the size of capital market is market capitalization. By capital market capitalization, it is meant to refer to the total market values of all securities listed on the capital market ascertained mathematically as the product of prices and number of securities listed on the capital market (Babarinde, 2021). Capital market capitalization relates the market size to the size of the economy and hence it is an indication of the market capability for capital mobilisation and risk diversification (Babarinde et al., 2024).

2.1.3 Trend of Capital Market Development in Nigeria

The Nigerian Exchange Limited, formerly called Nigerian Stock Exchange (NSE) started as the Lagos Stock Exchange. The Nigerian Exchange Limited, a subsidiary of the Nigerian Exchange Group, is the hub of the Nigerian capital market and market's apex regulatory agency is the Nigeria Securities and Exchange Committee.

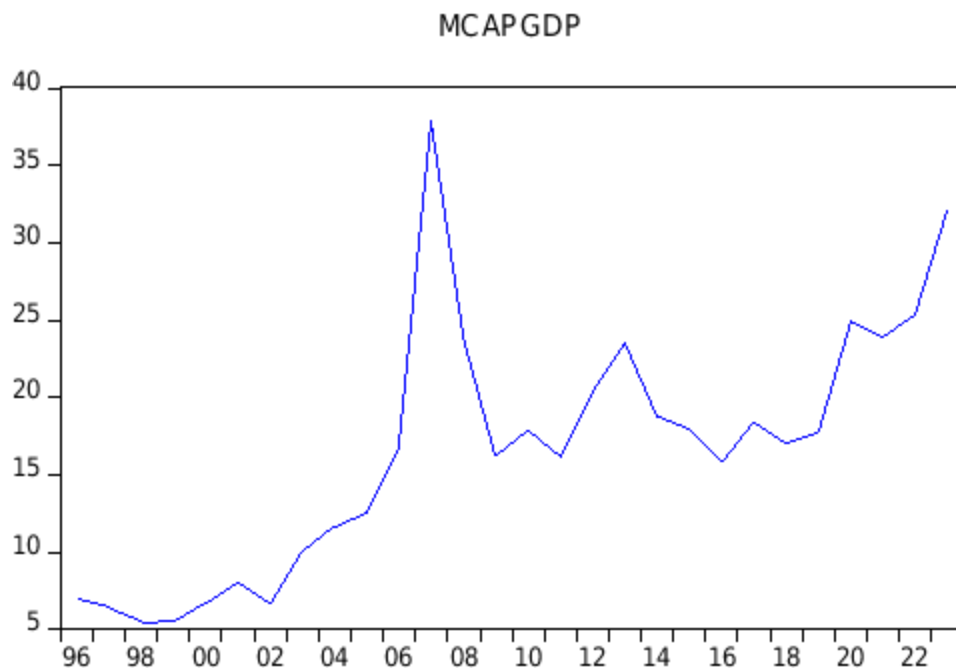
Historically, the Nigerian Exchange Limited which started operations with only 19 securities worth 80million Naira in 1961, had as at 1981, a total volume of transactions

standing at 10,199 units, which consisted of 10,081 industrial loan stocks and 118 units of government stocks but as at 2022, there was a total of 1,068,959 units of securities (composed of 933 bonds, 1,323 Equity-Traded Funds (ETF) and 1,066,703 equities) (Central Bank of Nigeria [CBN] Statistical Bulletin, 2022). In the same vein, as at 2022, 3.90billion Naira of bonds; 0.21billion Naira ETF; and 1,164.42billion Naira equities were traded, which culminated in a total of 1,168.53billion Naira securities traded in the Nigerian capital market.

Furthermore, statistics (CBN Statistical Bulletin, 2023) indicates that, as at 1981, the total capital market capitalization in Nigeria stood at 5billion Naira (composed of 1.90billion Naira equities and 3.10billion naira government securities) but in 2023 it increased to 75,202.90billion Naira (composed of 40,923.88 billion Naira equities; 23.02billion Naira Equity Traded Fund (ETF); 1,189.40billion Naira corporate bonds; and 33,066.60 billion Naira government securities).

The graphical trend of capital market capitalisation ratio (MCAPGDP) in Nigeria from 1996 to 2023) is depicted in Fig.1

Fig. 1: Trend of Capital Market Capitalisation Ratio in Nigeria (1996-2023)



Source: Author

According to Fig.1, the trend of capital market capitalisation ratio (MCAPGDP) in Nigeria which in 1996 stood at 6.9945 percent decreased to 5.4649 percent in 1998 but

from then it continued to rise slowly until its historical peak in 2006 with a figure of 38.01393 percent.

However, from 2007, the market has been experiencing decline in the capitalisation ratio even up till 2022 and the ratio of 32.0796 percent in 2023 was not up to the peak recorded in year 2006. This signifies that the Nigerian capital market has not still recovered fully from the 2007/2008 world financial crisis and stock market crash as reflected in the inability of the capital market to bounce-back or record a higher market capitalization ratio than the peak recorded in the pre-crisis year, 2006.

2.2. Theoretical Framework

This study derives its theoretical strength from the institutional theory of governance. The institutional theory pioneered by Meyer and Rowan (1977) considers institutional governance as the processes by which established structures, schemes, rules, norms, and routines serve as guidelines for controlling social behavior.

Therefore, governance quality could be examined within the framework of institutional theory which emphasizes the role of institutions in the management and control of the affairs as well as resources of a country in order to make the organisations and the society better. The theory relates to the institutional framework within which economic agents interact with one another in an economy that influences economic development (Alexiou et al., 2014; as cited in Utile et al., 2021). The institutional theory of governance states that the manner in which rules, norms, and regulations are established and managed by a higher authority constitutes a framework that guides social behavior in an areaas (Ndugbu et al., 2024a). Therefore, the institutional theory of governance is essential for understanding the institutional determinants of capital market development in Nigeria through the lens of public governance indicators.

2.3 Empirical Review

Ndugbu et al. (2024a) investigated the nexus between governance and All-Share Index (ASI) of the Nigerian capital market from 1991 to 2021. Evidence from Granger causality test revealed no directional causality between the variables; regulatory quality has a positive insignificant effect on ASI while rule of law and control of corruption have

negative insignificant effects on ASI in Nigeria. It was concluded that there is no significant nexus between governance and stock market index in Nigeria.

In a related study but using Autoregressive Distributed Lag (ARDL) technique, Ndugbu et al. (2024b) studied governance and its effect on stock market capitalization in Nigeria for the period 1991–2021. The study revealed that political stability has a significant positive effect on market capitalization while voice and accountability and governance effectiveness have negative insignificant effects on market capitalization in the short term. The study concluded that governance has an insignificant effect on stock market capitalization in Nigeria.

Furthermore, Savaria et al. (2022) assessed the impact of rule of law and regulatory quality on stock returns in Iran and selected emerging countries from 2000-2021. Evidence from system Generalized Method of Moments technique indicates that rule of law and regulatory quality have positive and significant effects on stock returns.

In Pakistan, the impact of governance on the performance of stock market from 1996 to 2018 was investigated by Khan et al. (2022) using ARDL, correlation and Granger causality techniques. The study concluded that governance (in its six dimensions as gauged by WGI) positively drive performance of stock market performance in Pakistan.

However, in Nigerian context, Fagbemi et al. (2021) studied the impact of regulatory quality on stock market performance between 1996 and 2019 using ARDL technique. The study revealed that regulatory quality had positive and significant influence on the performance of the stock market in Nigeria.

Also applying ARDL technique, Yakubu et al. (2021) examined the nexus between institutional quality and stock market development in Ghana from 1995Q1 to 2015Q4. The study established the existence of a significant short and long-run effect of institutional quality on Ghana's stock market development.

In another empiric on impact of governance quality on stock market performance in selected developed countries using the fixed effects model, Imran et al. (2020) found that control of corruption, political stability, government effectiveness, voice and accountability, regulatory quality, and rule of law exerted positive and significant impact on stock market performance in the study period, 1996 to 2018.

In another study from 2006 to 2017, Modugu and Dempere (2020) applied Indirect Least Squares (ILS) regression technique to study of governance quality and performance of stock markets of Gulf Cooperation Council (GCC) countries. The study found that political stability and rule of law had positive and significant effects; unlike regulatory quality, and voice and accountability which had negative and significant effect on stock market performance in GCC countries.

Focusing on Sub-Saharan Africa (SSA), Abu et al. (2019) investigated the impact of institutional factors on stock markets from 1996 to 2016, using Pooled Ordinary Least Squares, Fixed Effects, Random Effects and Generalized Methods of Moments techniques. The study found that institutional factors of governance effectiveness, regulatory quality, and voice and accountability have significant impact on market capitalization in the selected SSA.

In another study conducted by Umar and Nayan (2018), the impact of regulatory quality on stock market development in Africa was examined between 1996 and 2016. Using pooled mean group model, the study established that regulatory quality has a positive impact on the development of stock market in the selected African countries.

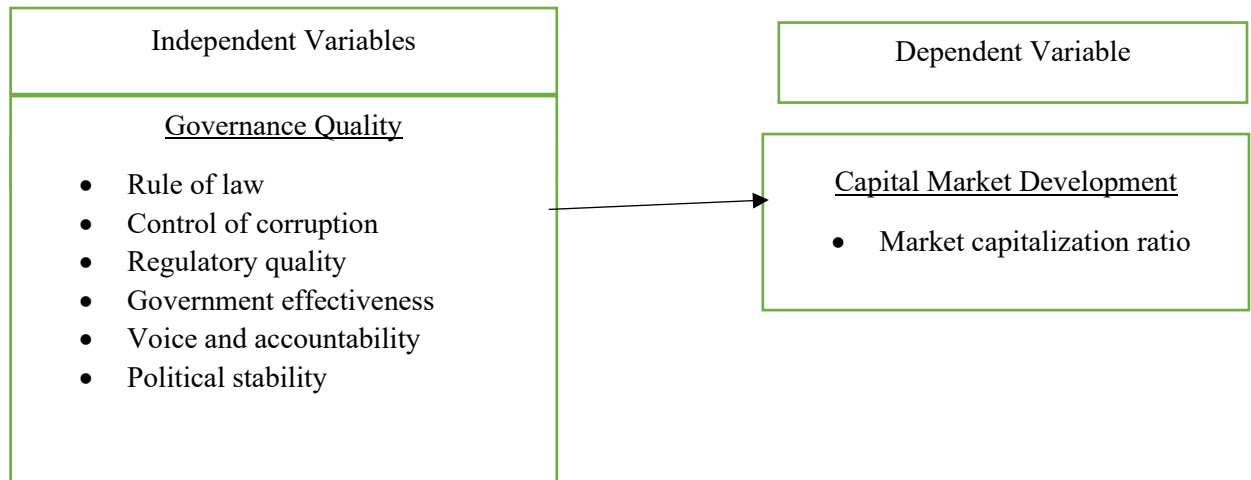
Furthermore, Manasseh et al. (2017) investigated the nexus between institutional quality and stock market development in Nigeria between 1985 and 2013 using ARDL technique. The study revealed among others, that institutional qualities of corruption control, and democratic accountability significantly influenced Nigeria stock market development.

Examining governance quality and its association with the performance of stock markets of selected countries, Boardi and Amegbe (2017) applied Fixed Effects model and found voice and accountability, political stability, government effectiveness, regulatory quality, rule of law and control of corruption had significantly affected stock market performance in the study period, 1996-2014.

2.4 Conceptual Framework

The conceptual framework of the effect of governance quality on capital market development is depicted in Fig. 2

Fig. 2: Conceptual Framework for the Study



Source: Author

3. Methodology

In investigating the institutional determinants of capital market development in Nigeria during period, 1996-2023, the study focused on the WGI's 6 governance indicators: control of corruption, government effectiveness, political stability, voice and accountability, rule of law and, regulatory quality. The dependent variable, capital market development, was measured as the ratio of capital market capitalization to gross domestic product.

In line with the ex-post facto research design, secondary data were employed in the study. The data used quantitative in nature and annual in frequency. The data were analysed using econometric techniques, particularly Autoregressive Distributed Lag (ARDL) technique for model estimation. Before the model estimation proper, the following tests were conducted: descriptive statistics, Pearson correlation test, Augmented Dickey-Fuller (ADF) unit root test, and F-Bounds cointegration test. After the model estimation proper, the following diagnostic tests were conducted: Breusch-Godfrey serial correlation LM, Breusch-Pagan-Godfrey heteroskedasticity, Ramsey RESET, and Jargue-Bera normality tests.

The link between governance quality and capital market development is specified in equation (1).

$$CMD_t = \beta_0 + \beta_1COC_t + \beta_2GEF_t + \beta_3PST_t + \beta_4REQ_t + \beta_5RUL_t + \beta_6VOIC_t + e_t \quad (1)$$

4. Results and Discussion

4.1 Descriptive Statistics

Table II: Descriptive Statistics

	CMD	COC	GEF	PST	REQ	RUL	VOIC
Mean	16.5937	-1.1783	-1.0438	-1.7333	-0.9232	-1.1318	-0.6991
Max.	38.0139	-0.9009	-0.8972	-0.5882	-0.6817	-0.8426	-0.3193
Min.	5.4649	-1.5020	-1.2133	-2.2111	-1.2928	-1.5125	-1.5537
Std. Dev.	8.2255	0.1339	0.0878	0.4075	0.1522	0.1828	0.2709
Skewness	0.5583	-0.6403	-0.3551	1.4169	-0.6750	-0.4134	-1.3887
Kurtosis	3.0589	3.2161	2.2399	4.2189	3.1971	2.5417	5.4484
Jarque-Bera	1.4588	1.9679	1.2624	11.1035	2.1722	1.0427	15.9936
Prob.	0.4821	0.3738	0.5319	0.0038	0.3375	0.5937	0.0003

Source: Author

Table II which presents the descriptive statistics, indicates the average capital market capitalization ratio between 1996 and 2022 to be 16.5937 per cent with its minimum and maximum values of 5.4649 and 38.0139 respectively. Given its mean exceeding its standard deviation (8.2255), market capitalization ratio could be said to be relatively stable around its mean value in the study period. The mesokurtic (kurtosis=3) and asymmetric (Skewness=0) nature of market capitalization ratio corroborates its normality.

All the mean value of the six dimensions of public governance are negatively signed, thus suggesting the extent of deteriorating quality in governance in Nigeria in the study period. In terms of normality using Jarque-Bera statistics, except both voice and accountability, and political stability which were not normally distributed, all other governance indicators are normal distributions.

4.2 Unit Root Test

Table III: Augmented Dickey-Fuller Unit Root Test

Variable	ADF Test in Level		ADF Test in Level		I(d)
	ADF-statistic	p-value	ADF-statistic	p-value	
CMD	-1.6444	0.4470	-4.8450	0.0007	I(1)
COC	-2.6067	0.1049	-4.3281	0.0023	I(1)
GEF	-3.5124	0.0154			I(0)
PST	-1.8274	0.3599	-1.5916	0.4682	I(1)
REQ	-2.4914	0.1285	-6.4335	0.0000	I(1)
RUL	-1.9633	0.3001	-3.3130	0.0246	I(1)
VOIC	-3.4560	0.0179			I(0)

Source: Author

The result of the Augmented Dickey-Fuller (ADF) unit root test in Table III reveals that, except voice and accountability (VOIC), and government effectiveness (GEF) which were stationary in level, all other variables (CMD, COC, REQ, and RUL) are stationary at first difference. The series are thus of mixed orders of integration of 1 and 0.

4.3 Cointegration Test

Table IV: F-Bounds Test of Cointegration

Test Statistic	Value	Significance Level	I(0)	I(1)
F-statistic	-5.4819	10%	-2.57	-4.04
		5%	-2.86	-4.38
		1%	-3.43	-4.99

Source: Author

The report of the F-Bounds test of cointegration in Table IV indicates that the null hypothesis of no levels relationship among the variables is rejected at the ideal levels of significance (1%, 5% and 10%). This is because the absolute value of the F-statistic exceeds the upper statistic of the three levels of significance. This implies the existence of a long-run relationship between public governance and capital market in Nigeria.

4.4 Model Estimation

4.4.1 Long-Run Model Estimation

Table V: ARDL Long-Run Estimates of Impact of Governance Quality on Capital Market Development in Nigeria

Dependent Variable:				
CMD				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
CMD(-1)	0.0623	0.2329	0.2677	0.7920
COC	1.6107	13.3885	0.1203	0.9056
GEF	33.6340	14.1152	2.3828	0.0284
PST	-15.6106	4.2001	-3.7166	0.0016
REQ	-8.6566	7.3256	-1.1816	0.2527
RUL	7.3882	12.4979	0.5911	0.5618
RUL(-1)	28.1415	12.6229	2.2293	0.0388
VOIC	-21.2226	7.3944	-2.8700	0.0102
C	43.6839	25.7186	1.6985	0.1066
R-squared	0.7727			
Adjusted R-squared	0.6717			
F-statistic	7.6502			0.0001
Durbin-Watson stat	2.0094			

Source: Author

The ARDL long-run estimates in Table V reveal that, government effectiveness, political stability, and rule of law to positively and significantly impacted capital market development while voice and accountability had negative significant impact on capital market development in Nigeria. However, control of corruption, and regulatory quality had no significant impact on capital market development in Nigeria in the long-run.

4.4.2 Short-Run Model Estimation

Table VI: ARDL Short-Run and Error Correction Regression Model of Institutional Determinant of Capital Market Development in Nigeria

Dependent Variable: CMD				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	43.6839	7.8448	5.5685	0.0000
RUL	7.3882	7.8885	0.9365	0.3614
ECT	-0.9376	0.1710	-5.4819	0.0000
R-squared	0.5610	Durbin-Watson stat		2.009436
Adjusted R-squared	0.5244			
F-statistic	15.3359			0.0000
Prob(F-statistic)				

Source: Author

According to the result of the ARDL short-run and error correction regression model in Table VI, rule of law had positive but non-significant impact on capital market development in Nigeria. The error correction term (ECT) (-0.9376) which was negatively signed and statistically significant suggests that the existence of long-run link between governance quality and capital market development in Nigeria and any short-run disequilibrium is corrected at a higher rate to restore equilibrium in the long-run.

4.5 Diagnostic Tests

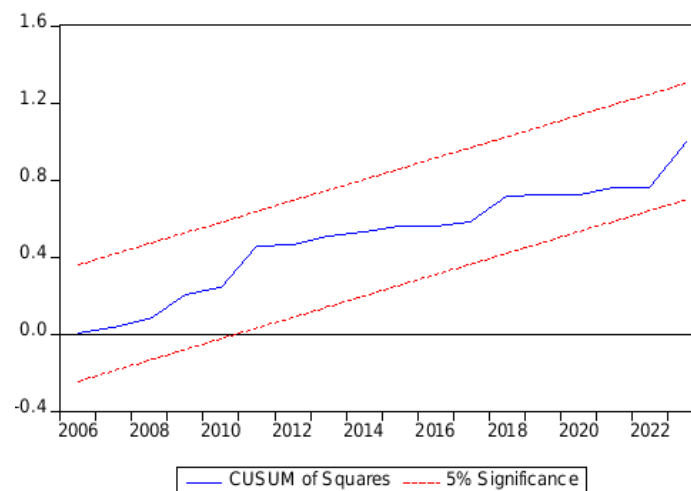
Table VII: Diagnostic Tests

Test	Coefficient	Prob.	Remarks
Normality	Jargue-Bera 15.2311	p-value 0.4930	There is normality
Breusch-Godfrey serial correlation LM	F-statistic 0.6202	p-value 0.4418	No serial correlation
Breusch-Pagan-Godfrey heteroskedasticity	F-statistic 1.2275	p-value 0.3386	No heteroscedasticity
Ramsey RESET	F-statistic 1.0244	p-value 0.3257	No misspecification error

The diagnostic tests summarized in Table VII reveal that the ARDL model estimated are normal, free from serial correlation, homoscedastic and suffers no misspecification.

Furthermore, the assessment of the model stability was conducted using CUSUM of squares test and the result is depicted in Fig. 3

Fig. 3: CUSUM of Squares



Source: Author

The CUSUM of squares depicted in Fig. 3 suggests that the model is relatively stable and its coefficients could be relied upon for use in policy formulation, forecasting and control.

5. Conclusion

This study examined the institutional determinants of capital market development in Nigeria through governance quality using ARDL technique. The study found in the long-run, that government effectiveness, political stability, and rule of law positively and significantly impacted capital market development while voice and accountability had negative significant impact on capital market development in Nigeria. However, control of corruption, and regulatory quality had no significant impact on capital market development in Nigeria in the long-run. The short-run analysis suggests that rule of law had positive but non-significant impact on capital market development in Nigeria. These findings align with the institutional school of thought on capital market behavior as public governance indicators were found to have significant impacts on the development of capital market in Nigeria in the study period, 1996-2023.

The study concluded that government effectiveness, political stability, rule of law, and voice and accountability are institutional determinants of capital market development in Nigeria. The study recommends that Nigerian government should implement policies and programmes that will improve Nigerian capital market performance through the instrumentality of public governance quality, particularly, government effectiveness, political stability, and rule of law.

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