MARKET LIQUIDITY AND STRATEGIES FOR IMPROVING LIQUIDITY IN THE CAPITAL MARKET

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Introductions

The capital market is the market for securities, where companies and governments can raise long-term funds.

It is a market in which money is lent for periods longer than a year.

The capital markets consist of the primary market and the secondary market.
TYPES OF MARKETS

The primary markets are where new stock and bonds are issues are sold (underwriting) to investors.

The Secondary markets are where existing securities are sold and bought from one investor or speculator to another, usually on an exchange.
MARKET LIQUIDITY

Market Liquidity: is a business, economics or investment term that refers to an asset’s ability to be easily converted through an act of buying or selling without causing a significant movement in the price and with minimum loss of value.

Features of liquid market

- It can be sold rapidly, with minimal loss of value, any time within market hours.
- The essential characteristics of a liquid market is that there are ready and willing buyers and sellers at all times.
LIQUIDITY

Another elegant definition of a liquidity is the probability that the next trade is executed at a price equal to the last one.

A market may be considered deeply liquid if there are ready and willing buyers and sellers in large quantities.

An illiquid asset is an asset which is not readily saleable due to uncertainty about its value or lacking a market in which it is regularly traded.
Measuring Liquidity

Å The liquidity of a product can be measured as how often it is bought and sold; this is known as volume.
Å Often investments in liquid markets such as the stock exchange or futures markets are considered to be more liquid than investments such as real estate, based on their ability to be converted quickly.
Å Some assets with liquid secondary markets may be more advantageous to own, so buyers are willing to pay higher.
Lessons

Countries with both liquid stock markets and well-developed banks grew much faster than countries with both illiquid markets and underdeveloped banks.

Furthermore, greater stock market liquidity is associated with faster future growth no matter what the level of banking development. Similarly, greater banking development implies faster growth no matter what the level of stock market liquidity.

Thus, it is not a question of stock market development versus banking development – each, on its own, is a strong predictor of future economic growth.
IMPORTANCE

Â Liquid equity markets make investment less risky—and more attractive—because they allow savers to acquire an asset—equity—and to sell it quickly and cheaply if they need access to their savings or want to alter their portfolios.

Â At the same time, companies enjoy permanent access to capital raised through equity issues.

Â By facilitating longer-term, more profitable investments, liquid markets improve the allocation of capital and enhance prospects for long-term economic growth.

Â Furthermore, by making investment less risky and more profitable, stock market liquidity can also lead to more investment. Put in a few words, investors will come if they can leave.
Strategies for improving liquidity in the capital market

Reduction in Monetary Policy Rate (MPR)
The MPR is the CBN reference lending rate and the rate at which it will lend to banks. It could be lowered say from 10.25% to 9.75% to boast liquidity in the system.

Reduction in Cash Reserve Ratio (CRR)
The CRR could be varied say from 2%, from 4%. Banks are required to maintain this cash reserve, a percentage of their deposit base, with the CBN.

Reduction in Liquidity Ratio (LR)
The liquidity ratio requirement could be slashed from 40% to 30%. Banks are required to maintain this ratio of their deposit base in liquid assets. When it is higher, they have less room for lending, for instance.
Other strategies

1. Share Buy-back
   Companies can buy back their issued and fully paid-up shares to a limit of 15% of outstanding shares.

2. Transaction fees can be reduced by half from 5% of the value to 2.5% of value of each transaction. The NSE reduced its charges lately.

3. Introduction of Market Makers
   The operation of market makers in the market can be introduced. These are meant to be major dealers with funding capacity (minimum paid-up capital N2 billion) and able to mop up shares and play other market-making roles.
strategies

4. Review Committees
set up committees to review corporate governance rules and the market structure and practices respectively.

To protect the market from illiquidity arising from confidence issues, a fine of N1 billion or imprisonment for three years for directors or officers of quoted firms to falsify or mis-state their company’s position in a prospectus could be imposed.

5. Floatation of stabilization fund. The government can float a fund to absorb and give liquidity when there is need
strategies

6. Reduction in fees and charges for market users
   The statutory fees and charges can be reviewed downward to encourage investors

7. Provide bank facilities. The banking system can assist with facilities by way of margin facilities through their stockbrokers to client to generate liquidity

8. Awareness of benefits of investing in the market: The regulators can help with road shows to diasporas communities on benefits of investing.
9 Contributory pension scheme. Currently we have a contributory pension scheme where every staff pays a minimum of 15% of his income of which 35% must be invested in capital market instruments. The percentage to be invested could be increased.
Conclusion

Given the important role well-functioning stock markets seem to play in economic growth, what can countries do to promote them? Fully answering this question is well beyond the scope of any single one hour discussion. Legal, regulatory, accounting, tax, and supervisory systems influence stock market liquidity. The efficiency of trading systems determines the ease and confidence with which investors can buy and sell their shares. And the macroeconomic and political environments affect market liquidity.
Thank you