

## **ANALYSIS OF THE RELATIONSHIP BETWEEN FUTURE FINANCING AND INVESTMENT IN NIGERIA**

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### **ABSTRACT**

The goal of financing and investing is the same: to bring money into an organization. However, they are two quite different actions. Obtaining money through borrowing, earning, or investment from outside sources is the act of financing. The act of investing involves acquiring funds by expanding businesses or buying investment goods like stocks, bonds, and annuities. A company's financing and investment activities are essential to its long-term success. Investors' options are also limited by the regulatory framework and liquidity restrictions. In order to investigate the relationship between future finance and investments in Nigeria from 1992 to 2021, this report analyzed that time period. The empirical results indicated a long-term unfavorable and negligible correlation between funding and investment in the future. Additionally, in the short run, Gross Domestic Product at Current Market Price (GDPCMP), Financial Sector Total Savings (FSTS), and Portfolio Investment in Reporting Economy (PIRE) were positive and significant at lag 1 while Interest Rate (INTR) and Gross Domestic Product at Current Market Price (FGF) were negative and significant at lag 1. With the exception of GDPCMP, which was positive and significant, and INTR, which was also positive but insignificant, variables FGF, FSTS, and PIRE were negative and significant over the long term. The report therefore suggests that capital regulation, liquidity difficulties, and improved and prudential supervision of financial institutions be put into place. The study's conclusions will help finance managers maximize performance by taking into account financially sensible heterogeneities when choosing a financing strategy.

**Key Words:** Internal Funds, Liquidity, Taxes, Regulatory Environment, Future Financing, and Investment

### **1.0 INTRODUCTION:**

Any financing that is done after the loan has been advanced is referred to as "FUTURE FINANCING," regardless of whether it involves the borrower issuing securities in the open market, debt, equity, convertible debt, or some

other type of financing. Any offering of shares of any class of corporate securities with the ability to vote, generally for the election of the company's directors, is considered future financing. Providing capital for investments, purchases, or business endeavors is the process

of financing. Financial institutions, like banks, are in the business of lending money to consumers, investors, and businesses to assist them reach their objectives. In any economic system, the use of funding is essential since it enables businesses to purchase goods that aren't within their immediate budget (Adam, Thomas, & Suzzane 2022).

In a similar line, funding is a means to use the temporal value of money (TVM) to employ predicted future cash flows for projects that have already been started. In order to create a market for money, financing also benefits from the fact that some people in an economy will have extra cash that they want to invest in order to earn returns, while others will need money to make investments (also in the aim of earning returns) (Adam, Thomas, & Suzzane 2022).

The term "finance" can refer to any of the three definitional issues—an organizational resource, an organizational function, or an academic discipline—that are interrelated. When used as a resource, finance is equivalent to money or purchasing power. It can be viewed as capital utilized to purchase additional productive resources including land, machinery, equipment, and labor. Lending (sometimes known as "credit financing") is a technique to move money from one person to another at a cost. In this way, financing for use in the economy can be obtained on the market at favorable and suitable terms.

A capital part of an organization's resources is finance. In contrast to other physical resources, which are directly useful to the company. This is due to the fact that the desire for money is derived. This is related to the idea that people want money for its ability to buy things rather than for its own sake. Finance's exchange value is primarily where its utility comes from. Acceptance of cash as a means of exchange has a feature that sets it apart from other organizational resources. In this situation, all other resources are paid for using finance. When seen as a resource for the organization, finance is employed to carry out both final and deferred payments. Final statement refers to the immediate exchange of money for products and

services. On the other side, a postponed settlement occurs after a credit transaction is completed. The promise of debt functions as a medium of exchange in a credit transaction. It allows a debtor the option to put off paying for a transaction until a specified later date (Akash Shah, 2021).

All final and deferred payment options that are accessible to an organization are included in its finances. These consist of money, bank balances, and checks, other readily available resources and lines of credit available to the organization for carrying out deferred transactions, in addition to any liquid financial assets appropriate for ultimate payment. This distinguishes the financial function from other organizational roles like production, marketing, and human resource management (Akash Shah, 2021).

The study of finance can be viewed as a profession carried out by persons who possess the theories and methods of financial management and control. Finance is an academic field that deals with the nature, applications, and administration of the finances of various market economy economic units, including household, corporate, public, and international financial units. Corporate finance deals with the control of financial resources. ... other readily available resources and lines of credit available to the organization for carrying out deferred transactions, in addition to any liquid financial assets appropriate for ultimate payment. This distinguishes the financial function from other organizational roles like production, marketing, and human resource management (Akash Shah, 2021).

The study of finance can be viewed as a profession carried out by persons who possess the theories and methods of financial management and control. Finance is an academic field that deals with the nature, applications, and administration of the finances of various market economy economic units, including household, corporate, public, and international financial units. Corporate finance deals with the control of financial resources. Corporate finance is the management of

financial assets and financial claims in specific establishments like businesses and industries. The financial or capital structure of these establishments, the sources of funding, and the financial analysis of corporations and organizations to identify their financial strengths and weaknesses are all addressed (Akash Shah, 2021).

Contrarily, INVESTMENT is the expenditure of money that results in net increases to the stock of physical capital; it is virtually entirely carried out by businesses. When the interest rate is low, the investors benefit. Investments are financial commitments made in anticipation of receiving rewards over a specific time frame. A project market manifests as of positioning in the financial market. Investments can be made in the form of purchasing real or financial assets, expanding a business, making acquisitions, replacing assets, etc. Capital budgeting decisions are referred to as certain types of investment decisions. Due to the scarcity of investable capital and the high opportunity cost, investing is one of the most important management decisions. Since most investments require a significant commitment of financial resources, poor choices could result in losses.

In addition, there are some difficulties with investing in terms of future finance. Unless the investment instrument is tax-exempt, such as a municipal security, taxes on investment returns often must be paid. Additionally, the exact rate of return on investments must be calculated. In an effort to achieve their distinct goals, both investor groups are concerned with tax-sheltering laws or tax-deferred investments. Investor actions are also constrained by the regulatory framework. Institutional investors, for instance, must abide by federal, state, and municipal laws and ordinances when conducting business.

For instance, the prudent man legislation speaks about the fiduciary duty that professional investors have to look out for their clients' best interests (or investors). The Securities and Exchange Commission (SEC) and the Federal Reserve are just two of the organizations that control the investing industry (Fed). Both

investor groups are subject to liquidity limitations, which describe the ease and price at which an asset can be turned into cash. For instance, if a shareholder has a particular need to set money aside, an amount of money for a significant purchase is seen as a (liquidity) limitation. A liquid asset is one that can be swiftly and cheaply converted into cash. Treasury bills and other money market instruments are quite liquid, but bonds and other capital market instruments are less liquid. Real estate is the least liquid asset, whereas cash is the most liquid. Because it determines the investor's investment horizon, age can also be a constraint.

As previously stated, the investor's stage in life can influence both the investment objectives and the asset selection. For instance, if an investor anticipates needing a certain sum of money at some point in the future; he may want to consider investing in such a sensible decision for such investor that might be a bond whose maturity falls inside that time frame. As a result, the goal of this study is to examine how future funding and investment in Nigeria relate to one another.

## 2.0 LITERATURE REVIEW

### 2.1 Theoretical Framework

The major factor that determines investment is interest rate and this is influenced by savings. The investors will also be favoured when the marginal efficiency of capital is high. Marginal efficiency is defined as the expected rate of returns from additional unit of capital asset. It refers to the expected rate of profit per year on real investment of the most efficient type; it depends upon the entrepreneur expectation of future return. However, there will be no investment of profit expectation which is not very bright; this is the reason why investment falls to a low level during a depression despite all the encouragement to stimulate private investment (Revel, 1975).

The Keynes were at a different view, which they advocated that individual savings is a social virtue but rather supported the view that individual savings is greatly a social vice. Increase savings on the part of individuals will

result in a general curtailment in the expenditure. When savings increase, investment is very essential for the economic development of an economy. With increased investment, employment is bound to increase which will in turn increase demand, prices, profit and more production expansion. This expansion if properly utilized will lead to economic development of a country (Shaw, 1973). Investment results as a consequence of capital accumulation, which in turn depends upon savings (Ndulu, 1990). Savings by profit earners and their conversion into investment was the main actor responsible for the economic development of Nigeria in the 19th century.

According to Keynes' theory, this motive depends on the expected Marginal Efficiency of Capital (MEC) in relation to the expected rate of interest. The difference between the realized marginal efficiency of capital and the rate of interest is the opportunity cost of investment. The theory assumes that the expected return on investment is intrinsically volatile in view of the uncertainty that accompanies the main determinants of investment returns. But this is especially as far as private investment is concerned. In the context of growth, the accelerator principle suggests that increases in output lead to increases in investment.

This principle relates investment to GDP. It follows from the fact that the demand for machinery and factories is a derived one. Thus, if the demand for the goods that capital equipment produced rises and the existing industrial capacity cannot meet this demand, if production were to be increased, then new plant and equipment would be required. While new capital equipment is being built and installed, investment expenditure has taken place. If the desired stock of capital good increases, there will be an investment depend on changes in final demand, and hence changes in GDP. In this vein, the accelerator principle explains why a slowdown in growth of GDP can lead to negative growth in subsequent period through a fall in investment spending.

As result of the restrictive assumptions of the accelerator model, Hall and Jorgenson in [Nnana

et al, 2004] formulated the neoclassical approach. In this theory, the desired or optimal level of investment stock depends on the level of output and on the user cost of capital which in turn depends on the price of capital goods, the real rate of interest and the depreciation rate. The difference between the current and desired capital stock is created by lags in decision making and delivery, giving rise to the change in the capital stock. The deficiencies in this theory relate to the inconsistency of the assumptions of perfect competition and exogenously determined output. The assumption of static was inappropriate. These necessitated the formulation of an alternative theory by [Tobin, 1969].

The theory, referred to as Tobin's Q theory, emphasizes the relationship between the increase in the value of the firm due to the installation of additional capital and its replacement cost. Investment, therefore, is a function of the difference between the market value of the additional unit of capital and its replacement cost. This ratio (known as marginal Q) may differ from unity due to delivery lags, adjustment and installation costs. On account of measurement problems, marginal Q is proxy by the ratio of the market value of the entire capital stock to its replacement cost (the average Q ratio) Tobin's Q theory has been criticized on the following grounds.

The marginal and average Q will systematically differ if firms enjoy economies of scale or market power or are unable to sell all they want; The assumption of increasing installation cost is unrealistic; The cost of additions to an individual firm's capital stock is likely to be proportional or even less than proportional to the volume of investment because of the indivisibility of many investment projects and Disinvestment is more costly than positive investment as capital goods are often firm specific and so have little resale value. To deal with this point, [Arrow, 1999] suggests that investment can be considered irreversible in an extreme situation. This implies that investment decision can be viewed from the perspectives of reversibility and irreversibility.

While under conditions of certainty, irreversibility creates a wedge between the cost of capital and its marginal contribution to profit, under uncertainty (where irreversibility has important implications for investment decisions) irreversible investment can be adversely affected by risk factors [Caballero,1999]. This means that under uncertainty, firms acquiring additional capital presently stand the risk of being stuck with excess capacity in the future that cannot be costlessly eliminated. This notion amplifies the importance of uncertainty in investment decision making. The problem of uncertainty is more severe in developing countries where transformations inherent in development such as the establishment of new firms and new industries and the absorption of new technologies heighten uncertainty [World Bank 1993].

The disequilibrium approach of (Malinvaud, 1980) and (Sneessens, 1987) view investment as a function of both profitability and demand for output. This approach suggests that investment decisions have two stages viz: The decision to expand the level of production capacity; and the decision about the capital intensity of the additional capacity (Malinvaud, 1980). The first stage depends on the expected degree of capacity utilization in the economy which provides an indicator of demand conditions; while second stage depends on relative prices such as the cost of capital and labour.

The implication of this dichotomy is that while factor proportions are assumed variable before the investment, and fixed after it, investment decisions take place under conditions in which firms may be facing current and expected future sales constraints. The disequilibrium model, however, has been criticized for the simplicity of its assumptions regarding expectations and its inability to explain price rigidities. The coordination failure model states that total investment depends on the inability of individual agents to successfully coordinate their investment decision in a decentralized economic system. Coordination problems derive principally from shortcomings in markets for information and risk sharing. Both types of problems exist in all economies but the

consequences tend to be worse in developing economies.

For example, in developing economies, information problems such as poor accounting standards; and a dearth of banks and other Journal of Poverty, Investment and Development institutions to monitor corporate performance mean that bond and equity markets are often weak or entirely absent. Also, limited market mechanism for sharing risk (firms often cannot buy insurance for the most serious risks they face) as a result of lower wealth levels in developing economies make households and firms more vulnerable. Monopolistic competition and increasing returns to scale are common causes of coordination failure. Against this background, the return on investment depends on the overall level of economic activities which in turn is positively affected by the volume of aggregate investment.

Financial constraints on investment are gaining prominence in the literature. **Stiglitz, (1993)** Suggests that at the micro level, firms may face binding financial constraints in domestic capital markets because interest rates are controlled or subjected to endogenous credit rationing. Restrictive monetary and credit policies affect investment in two ways. They increase the real cost of bank credit and by raising interest rates, increase the opportunity cost of retained earnings. Both mechanisms raise the user cost of capital and lead to a reduction in investment.

Asymmetric information, adverse selection and incentive effects may make interest Asymmetric information relates to a situation in which parties to a transaction do not have the same information. Thus, agreements are reached to the advantage of the party with more information. The acquisition of information, therefore, becomes critical to investment. Similarly, the adverse selection principle says that those who are most desperate to buy insurance for example are those at risk, so charging a high price for insurance will discourage those at less risk from buying insurance at all. In the case of credit, if interest rates reflect high demand for loans, marginal discriminate against marginal borrowers. Incentive or subsidies also cause

distortions in the market. Under these conditions, creditors prefer credit rationing and qualitative constraints to reliance on the market as most of them are unable to manage their risks due to inadequate information or the effect of adverse selection.

### **2.2.1 The Internal Funds Theory of Investment:**

Under the internal funds theory of investment, the desired capital stock and, hence, investment depends on the level of profits. Several different explanations have been offered. Jan Tinbergen, for example, has argued that realized profits accurately reflect expected profits. Since investment presumably depends on expected profits, investment is positively related to realized profits. Alternatively, it has been argued that managers have a decided preference for financing investment internally. Retained earnings and depreciation expense are sources of funds internal to the firm; the other sources are external to the firm. Borrowing commits a firm to a series of fixed payments. Should a recession occur, the firm may be unable to meet its commitments, forcing it to borrow or sell stock on unfavorable terms or even forcing it into bankruptcy (Mathew Blake, 2021).

Consequently, firms may be reluctant to borrow except under very favourable circumstances. Similarly, firms may be reluctant to raise funds by issuing new stock. Management, for example, is often concerned about its earnings record on a per share basis. Since an increase in the number of shares outstanding tends to reduce earnings on a per share basis, management may be unwilling to finance investment by selling stock unless the earnings from the project clearly offset the effect of the increase in shares outstanding. Similarly, management may fear loss of control with the sale of additional stock. For these and other reasons, proponents of the internal funds theory of investment argue that firms strongly prefer to finance investment internally and that the increased availability of internal funds through higher profits generates additional investment. Thus, according to the internal funds theory, investment is determined by profits (Mathew Blake, 2021).

In contrast, investment, according to the accelerator theory, is determined by output. Since the two theories differ with regard to the determinants of investment, they also differ with regard to policy. Suppose policy makers wish to implement programs designed to increase investment. According to the internal funds theory, policies designed to increase profits directly are likely to be the most effective. These policies include reductions in the corporate income tax rate, allowing firms to depreciate plant and equipment more rapidly, thereby reducing their taxable income, and allowing investment tax credits, a device to reduce firms' tax liabilities. On the other hand, increases in government purchases or reductions in personal income tax rates will have no direct effect on profits, hence no direct effect on investment. To the extent that output increases in response to increases in government purchases or tax cuts, profits increase. Consequently, there will be an indirect effect on investment (Mathew Blake, 2021). In the theory of crowding out physical capital investment, a larger budget deficit will increase demand for financial capital.

If private saving and the trade balance remain the same, then less financial capital will be available for private investment in physical capital. When government borrowing soaks up available financial capital and leaves less for private investment in physical capital, the result is known as crowding out. To understand the potential impact of crowding out, consider the situation of the Nigerian economy before the exceptional circumstances of the recession that started in late 2007.

At this point, you may wonder about the federal reserve. After all, can the Federal Reserve not use expansionary monetary policy to reduce interest rates, or in this case, to prevent interest rates from rising? This useful question emphasizes the importance of considering how fiscal and monetary policies work in relation to each other. Imagine a central bank faced with a government that is running large budget deficits, causing a rise in interest rates and crowding out private investment. If the budget deficits are increasing aggregate demand when the economy is already producing near potential GDP,

threatening an inflationary increase in price levels, the central bank may react with a contractionary monetary policy.

In this situation, the higher interest rates from the government borrowing would be made even higher by contractionary monetary policy, and the government borrowing might crowd out a great deal of private investment. On the other hand, if the budget deficits are increasing aggregate demand when the economy is producing substantially less than potential GDP, an inflationary increase in the price level is not much of a danger and the central bank might react with expansionary monetary policy. In this situation, higher interest rates from government borrowing would be largely offset by lower interest rates from expansionary monetary policy, and there would be little crowding out of private investment. However, even a central bank cannot erase the overall message of the national savings and investment identity. If government borrowing rises, then private investment must fall, or private saving must rise, or the trade deficit must fall. By reacting with contractionary or expansionary monetary policy, the central bank can only help to determine which of these outcomes is likely.

## 2.2 EMPIRICAL FRAMEWORK

Empirical studies on investment in current assets have shown mixed results based on various sectors, environment and context. An empirical study by Abdullah and Tursoy (2021) on non-financial firms in Germany over 25 years found a significant positive relationship between capital structure and financial performance. They found that the lower cost of issuing debt and tax shield from the interest of the debt was the main course of the positive relationship. Hung et al. (2002) also found a positive relationship between capital structure and the financial performance of firms in Hong Kong. In another study, Khaliq et al. (2014) found that leverage significantly influences the financial performance of publicly listed firms in Malaysia.

Mujahid and Akhtar (2014) studied textile firms in Pakistan and found a positive relationship between capital structure and financial

performance. Several other studies have found leverage as a significant contributor to the financial performance of firms (Abu-Rub, 2012; Kodongo et al., 2015; Nerlove, 1968). Banks look at the financial performance of firms that are demanding more loans before advancing further debt funding. Firms demanding further loans must demonstrate higher financial performance to justify the need for more debt funding (Margaritis and Psillaki, 2010). Several other studies have found a positive relationship between capital structure and financial performance (Berger and Udell, 2006; Dessi and Robertson, 2003). On the contrary, some other empirical studies have resulted in an inverse relationship between capital structure and financial performance.

Anderson, et al (1990), tries to find the role of investment in economic growth and development by deriving an accounting relationship between the rate of economic growth and representing the rate, allocation and efficiency of investment. His analysis shows that investment plays greater role in a country's growth if it is used efficiently to increase the output. On the other hand if investment is made inefficiently it results in lower rate of growth of output.

Blomstrom, et al (1996) In their analysis of fixed investment and economic growth used Granger Sims Causality framework for 101 countries. Their findings show that growth has more causal effect on subsequent capital formation rather than capital formation on subsequent growth and fixed investment does not have a key role in economic growth.

Chow, (1993) Studied the role of capital formation in China's economy as well as in the five major sectors: agriculture, industry, construction, transportation and commerce. He found rate of return of capital in 1980 as 0.16, 0.20, 0.17, 0.26, 0.04 and 0.02 for aggregate economy, agriculture, industry, construction, transportation and commerce respectively. His analysis shows that from 1952 to 1985 China's aggregate income grew by an average rate of 0.06 and capital growth rate increased by 0.076. During this period capital growth rate

contributed in the growth of economy by an average rate of 0.045.

Khan, et al (1990) Used a simple growth model to test the effects of private and public investment separately on economic growth for 24 developing countries. Their findings show that private and public investments have different effects on the long-run rate of economic growth. Private and public investment plays larger and more important role in economic growth than public investment.

Potiowsky, et al (1992) Studied that effect of domestic capital formation and foreign assistance on the rate of economic growth for 58 developing countries. Their results do not show any great effects of domestic capital formation and foreign assistance on per capita rate of growth during the years of 1970-1980.

Ramirez, (2003) Used unit root and co-integration techniques to determine the long run relationship between GDP and investment for 90 countries using data from World Bank for the period 1960-1992. In the first step of our analysis they found GDP and investment integrated of different orders for 33 countries. Second step our analysis shows no co-integration between GDP and investment for 25 countries and 25 co-integration for 25 countries with both variables of order I(1). The other 7 countries with both variables of order I(0) are in long run relation and do not need cointegration test.

To determine the direction of causal effect between GDP and investment they used Granger causality test as the third step of our analysis. They found causality in the short run for 10, unidirectional causality from GDP to investment for 18 and from investment to GDP for 10 countries. The causality from GDP to investment is positive for 11 countries and from investment to GDP for 6 countries. Bi-directional causality is mostly positive between the two variables.

Iyoha, (1998], Analyzing the impact of investment on growth in Nigeria. Using data for the 1970-94 periods, he found that there is a 10 percent rise in Gross National Product (GNP) in

the short-run. He also found that, in the long-run, there is a 10 percent increase in per capita GNP. With these findings, he concluded that per capita GNP is highly economic growth and rapid development, it must pursue policies that will increase both the public and private investment, Aggregate investment in any economy comprises both the public and private investments. Although the prime motive of the public sector investment may be different from that of the private sector, they face the same challenges in financing their investment requirements.

According to Soumadi and Hayajneh (2012), more debt leads to higher interest payment depriving the firms of cash resources and restricting assets as they are used collateral. Several other studies have found an inverse relationship between capital structure and financial performance (Abor, 2007; de Jong et al., 2008; Gleason et al., 2000; Mateev et ., 2013; Simerly and Li, 2000). Empirical studies on the matter performed on firms in Nigeria and Ghana separately have also been inconclusive.

Oke et al. (2019), in a study of the effect of debt on capital structure performance for conglomerate firms operating in Nigeria, found a significant positive relationship between capital structure and financial performance. Akingunola et al. (2018), in a sample study of 21 listed non-financial firms, found inconsistent results when the measure of financial performance changed between return on equity (ROE) and Return on Assets (ROA). When the performance was measured as ROA, the study found a significant negative relationship between capital structure and financial performance. However, when performance was measured as ROE, the study found a positive relationship between short-term debt to total capital and long-term debt to total capital and financial performance.

Addae et al. (2013), in a study of both financial and non-financial firms listed on the Ghana stock exchange, found a negative relationship between short-term debt ratio and financial

performance and a positive relationship between long-term debt ratio and financial performance. They also found a negative relationship between the total debt ratio and financial performance. Abor (2007), in a study of the relationship between capital structure and financial performance of SMEs in Ghana and South Africa, discovered a negative relationship between long-term debt and total debt ratio to financial performance. The empirical studies have found mixed results for the relationship between capital structure and financial performance.

Weill (2008) found that the association between capital structure and financial distress varies from one country to another. He also concluded that institutional factors in the country influence the relationship between capital structure and financial performance. The literature on the relationship between capital structure and financial performance or firm value is still being debated as empirical results have been mixed and inconsistent.

However, as Weill (2008) noted, the intuitional and country factors also influence the relationship between capital structure and the firms' performance. No study has examined the relationship between capital structure and firm performance for public firms operating in West Africa, considering the debt maturity and sectorial effects.

Greene and Villanueva (1990) studied the determinants of private investment in less developed countries for 23 countries between 1975-1987 periods, and found that the real deposit interest rate has a negative impact on private investment. Hyder and Ahmad (2003) investigated the slowdown in private investment in Pakistan. They found that higher real interest rate reduces private investment.

Mahmudul and Gazi (2009) in their study in Jordan on stock investment (based on the monthly data from January 1988 to March 2003) found that interest rate exerts significant negative relationship with share price for markets of Australia, Bangladesh, Canada, Chile, Colombia, Germany, Italy, Jamaica,

Japan, Malaysia, Mexico, Philippine, South Africa, Spain, and Venezuela. For six countries from this sample, they argued on the availability of significant negative relationship between changes of interest rate and changes of share price.

Recently, Olubanjo, Atobatele and Akinwumi (2010) simulated the inter-relationships among interest rates, savings and investment in Nigeria between 1993 and 2010 using two stages least square method. Their result suggested that a marked decrease in the real lending rate would not result automatically into increased domestic investment.

### 3.0 METHODOLOGY

#### 3.1 MODEL SPECIFICATIONS

Given that this study aims at analysing the relationship between future financing and investment in Nigeria, the functional form of the model specification is specified in equation (1):

$$FGF = f(PIRE, GDPCMP, INTR, FSTS) \quad (1)$$

where:

FGF = Federal Government Finances,

PIRE = Portfolio Investment in Reporting Economy

GDPCMP = Gross Domestic Product at Current Market Price,

INTR = Interest Rate,

FSTS = Financial Sector Total Savings

To estimate the above equation, we transformed the functional form into an estimated model in equation 2:

$$FGF_t = \alpha_0 + \alpha_1 PIRE_t + \alpha_2 GDPCMP_t + \alpha_3 INTR_t + \alpha_4 FSTS_t + \mu_t \text{ in equation} \quad (2)$$

The Auto Regressive Distributed Lag (ARDL) Model which uses a bounds test approach based on unrestricted error correction model (UECM) was employed here to estimate the relationship between Future Financing and Investment in Nigeria. Justification for using this model is because the use of ARDL test approach is predicated on its several advantages. Firstly, the ARDL efficiently determines the co-integrating

relation in small sample cases (Ghatak and Siddiki, 2001; Tang, 2003),

Secondly, the ARDL approach can be applied irrespective of whether the regressors are I (1) and I (0) or mutually co-integrated. If the nature of the stationarity of the data is not clear, then the use of the ARDL Bounds test is appropriate. The ARDL model is stated in equation 3:

$$FGF_t = \alpha_0 + \sum \gamma_i FGF_{t-i} + \sum \gamma_i PIRE_{t-i} + \sum \beta_i GDPCMP_{t-i} + \sum \beta_i INTR_{t-i} + \sum \beta_i FSTS_{t-i} + \mu_{it} \quad (3)$$

In order to obtain the co-integrating equation, equation 3 is transformed into 4 as follows:

$$\Delta FGF_t = \alpha_0 + \sum \gamma_i \Delta FGF_{t-i} + \sum \gamma_i \Delta PIRE_{t-i} + \sum \beta_i \Delta GDPCMP_{t-i} + \sum \beta_i \Delta INTR_{t-i} + \sum \beta_i \Delta FSTS_{t-i} + \phi_i ECT_t + \mu_{it} \quad (4)$$

where

$$ECT_t = Y_t - \alpha_0 - \sum_{i=1}^p \gamma_i \Delta Y_{t-i} - \sum_{i=0}^p \beta_i \Delta X_{t-i} \text{ and}$$

$$\phi = 1 - \sum_{i=1}^p \gamma_i \Delta Y_{t-i} \dots \dots \quad (5)$$

The Bound test procedure used equations 4 and 5 into 6 as:

$$\Delta Y_t = - \sum_{i=1}^{p-1} \gamma_i Y_{t-i} + \sum_{i=0}^p \beta_i \Delta X_{t-i} - \rho Y_{t-1} - \alpha - \sum_{i=0}^p \delta X_{t-i} + \mu_{it} \dots \dots \quad (6)$$

Then we test the existence of level relationship as  $\rho = 0$  and  $\delta_1 = \delta_2 = \dots = \delta_k = 0$

Where  $\Delta$  = difference operator,  $\mu$  = white noise error term.

### 3.2 Unit Root And Co-Integration Test Results

Since the validity of the ARDL approach relies on  $I(0), I(1)$  or a combination of both, it is important to first determine the time-series properties of individual variable that enter equation (3.3). This is done to know whether the variables are integrated of order zero or one or even more. Given that unit root testing procedures have their own limitations. Two unit root tests were considered for this research. These are the non-parametric Philip-Perron (PP)

test proposed by Phillips and Perron (1988) and the popular Augmented Dickey-Fuller (ADF) unit root test. Both the ADF and the PP test the null hypothesis that the series have unit root (variables not stationary).

### 3.3 Data Source and Econometrics Software.

The data used in this study was obtained from Central Bank of Nigeria (CBN) statistical bulletin 2021, the bureau of statistics 2021. The E-views 10.0 software was used in analysing the data while the Ms-Excel was used to transport the data.

## 4.0 DATA ANALYSIS AND INTERPRETATION

### 4.1 Unit Root Test

In this study, the Augmented Dickey-Fuller (ADF) unit root test was employed to test for the time series properties of the model variables. This is necessary as it helps to avoid spurious regression results. The ADF tests the null hypotheses that the series has a unit root (not stationary) as against the alternative that the variable has no unit root. The choice of lag length was based on Akaike and Schwartz-Bayesian information criteria and was selected automatically by E-views. The decision rule is to reject the null hypothesis if the ADF statistic value exceeds the critical value at a chosen level of significance (in absolute term).

These results are presented in Table 1. From Table 1, it can be observed that the variables FGF, GDPCMP and FSTS were stationary at level form which implies that the variables are integrated of order one ( $I \sim (0)$ ) whereas the variables PIRE and INTR were integrated of order zero ( $I \sim (1)$ ) as they were stationary at 1<sup>st</sup> Difference. The decision was based on the fact the ADF statistics was greater than the critical values at 5% significance level. Since the variables are integrated of order one and zero and none of the variables is integrated of order two. We therefore, applied the ARDL bound co-integration test.

### 4.2 ARDL Bound Co-integration Test

A necessary condition for testing ARDL bound co-integration test is that the variables be

integrated of either of order one or zero or both (Pesaran, Shin and Smith, 2001). Since all the variables were integrated of order one and zero, we proceeded to estimate the ARDL bound test. The null hypothesis of ARDL bound co-integration is that the variables are not co-

integrated as against the alternative that they are co-integrated. The decision rule is to reject the null hypothesis if the F-statistics is greater than the upper bound critical values at chosen level of significance. The result of the ARDL bound co-integration test is shown in Table 2.

**Table 1: Summary of ADF test results at 1% and 5% critical value**

Variables	ADF Statistics		ADF Critical Value		Optimum Lag Length	Order of Integration	Remark
	Level	1st Diff	1%	5%			
<b>FGF</b>	5.012094		-3.724070	-2.986225	5	I (0)	Stationary
<b>PIRE</b>		-6.100710	-3.679322	-2.967767	0	I (1)	Stationary
<b>GDPCMP</b>	3.120708		-3.737853	-2.991878	6	I (0)	Stationary
<b>INTR</b>		-6.511128	-3.679322	-2.967767	0	I (1)	Stationary
<b>FSTS</b>	5.115046		-3.670170	-2.963972	0	I (0)	Stationary

Source: Computed by the Researcher with Eview 10

**Table 2: ARDL Bound Co-integration Test Result**

F-Statistics	K	Significance level	Critical Bound Value	
			1,0 (Lower Bound)	1,1 (Upper Bound)
138.0355	4	5%	2.56	3.49
		1%	3.29	4.37

Source: Author's computation

From table 2 the F-statistics is greater than the upper bound at 1% and 5% level of significance. Thus, we reject the null hypothesis and conclude that there exists a long run relationship between federal government financing and investment in Nigeria. Therefore, we estimate the parsimonious result of the relationships between future financing and investment in the country.

### 4.3 Autoregressive Distributed Lag (ARDL) Result

#### 4.3.1. Short Run Parsimonious ARDL Result

The summary of Short Run Parsimonious ARDL result of the relationships between future financing and investment in Nigeria is presented in Table 3.

### Short Run Result Interpretation

The result in Table 4 shows the short run parsimonious result. The lag value of Federal Government Financing (FGF) is positively and significantly influencing its current value 1.226204 which suggests that an increase in the immediate past state of Finance will bring about improvement to the present relationship between future financing and Investment in the country. Imagine a central bank faced with a government that is running large budget deficits, causing a rise in interest rates and crowding out private investment. If the budget deficits are increasing aggregate demand when the economy is already producing near potential GDP, threatening an inflationary increase in price

levels, the central bank may react with a contractionary monetary policy.

In this situation, the higher interest rates from the government borrowing would be made even higher by contractionary monetary policy, and the government borrowing might crowd out a great deal of private investment. On the other hand, if the budget deficits are increasing aggregate demand when the economy is producing substantially less than potential GDP, an inflationary increase in the price level is not much of a danger and the central bank might react with expansionary monetary policy. In this situation, higher interest rates from government borrowing would be largely offset by lower interest rates from expansionary monetary policy, and there would be little crowding out of private investment.

However, even a central bank cannot erase the overall message of the national savings and investment identity. If government borrowing rises, then private investment must fall, or private saving must rise, or the trade deficit must fall. By reacting with contractionary or expansionary monetary policy, the central bank can only help to determine which of these outcomes is likely.

The coefficient of current Financial Sector (FSTS) is 0.260897 which means that a one per cent increases on FSTS will lead to about 2.6% improvements in the relationship between future financing and investment in Nigeria. However, the coefficient of FSTS at lag one is positive and significant. Theoretically the connection between private savings and flows of international capital plays a role in budget deficits and surpluses. Consequently, government borrowing and private investment sometimes rise and fall together. For example, the 1990s show a pattern in which reduced government borrowing helped to reduce crowding out so that more funds were available for private investment.

This argument does not claim that a government's budget deficits will exactly shadow its national rate of private investment; after all, private saving and inflows of foreign

financial investment must also be taken into account. In the mid-1980s, for example, government budget deficits increased substantially without a corresponding drop off in private investment. In 2009, nonresidential private fixed investment dropped by N300 billion from its previous level of N1,941 billion in 2008, primarily because, during a recession, firms lack both the funds and the incentive to invest.

Gross Domestic Product at Current Market Price (GDPCMP), as expected is negatively and significantly affecting the relationship between future financing and investment in the country. Specifically, the coefficient of GDPCMP suggests that a decrease in GDPCMP by one per cent will enhance the relationship between future finance and investment in the country by about -0.083523 units. Theoretically, an economy with reliable roads and electricity will be able to produce more. But it is hard to quantify how much government investment in physical capital will benefit the economy, because government responds to political as well as economic incentives. When a firm makes an investment in physical capital, it is subject to the discipline of the market: If it does not receive a positive return on investment, the firm may lose money or even go out of business.

The coefficient of Interest Rate is negative and significant by -31.15098 units, meaning that a decrease in Interest Rate will be a constraint to future financing and investment in Nigerian. Assume that government borrowing of substantial amounts will have an effect on the quantity of private investment. How will this affect interest rates in financial markets? The original equilibrium ( $E_0$ ) where the demand curve ( $D_0$ ) for financial capital intersects with the supply curve ( $S_0$ ) occurs at an interest rate of 5% and an equilibrium quantity equal to 20% of GDP. However, as the government budget deficit increases, the demand curve for financial capital shifts from  $D_0$  to  $D_1$ .

The new equilibrium ( $E_1$ ) occurs at an interest rate of 6% and an equilibrium quantity of 21% of GDP. In the financial market, an increase in government borrowing can shift the demand

curve for financial capital to the right from  $D_0$  to  $D_1$ . As the equilibrium interest rate shifts from  $E_0$  to  $E_1$ , the interest rate rises from 5% to 6% in this example. The higher interest rate is one economic mechanism by which government borrowing can crowd out private investment.

Again, an increase in the immediate past state of Portfolio Investment in Reporting economy (PIRE) by 0.089796 units and its coefficient is positively and significantly influencing its current value at lag one. Government can invest in physical capital directly: roads and bridges; water supply and sewers; seaports and airports; schools and hospitals; plants that generate electricity, like hydroelectric dams or windmills; telecommunications facilities; and weapons used by the military. In 2014, the U.S. federal government budget for Fiscal Year 2014 shows that the United States spent about \$92 billion on transportation, including highways, mass transit, and airports.

Public physical capital investment of this sort can increase the output and productivity of the economy. An economy with reliable roads and electricity will be able to produce more. But it is hard to quantify how much government investment in physical capital will benefit the economy, because government responds to political as well as economic incentives. When a firm makes an investment in physical capital, it is subject to the discipline of the market: If it does not receive a positive return on investment, the firm may lose money or even go out of business.

The coefficient of determination R-Square and its adjusted R-Square are 0.998725 and 0.996986 respectively. This shows a high fit of the model and further suggests that about 99.8% of the variations in the relationship between future financing and investment is explained by changes in the variables (Federal Government Finance, Portfolio Investment in Reporting Economy, Gross Domestic Product at Current Market Price, Interest Rate and Financial Sector Total Savings) included in the model while the remaining 0.2% of the variations is captured by the error term. The coefficient of error correction term which measures the speed of

adjustment to the long run equilibrium is appropriately signed and significant. Specifically, the coefficient of -2.221415 implies that about -2.22% of decrease in variation needed in enhancing the relationship between future financing and investment is incurred every year in Nigeria.

The economic implication is that dealing with climate change will require a reliable data infrastructure, because climate will become a new risk category in any risk management. The official sector is making substantial effort at the global level. Our immediate priorities are to improve the quality of climate disclosure, to harmonize global “green finance” standards, and to promote the sharing of best practices across borders. These shifts can also interact and present new risks. In Emerging Markets, for example, the advent of crypto assets and stable coins may be accelerating dollarization, and may be eroding the effectiveness of existing exchange restrictions and capital control measures even as the innovation brought by digital money is substantial.

Moreover, the widespread adoption of digital money will have profound implications for the banking sector. It will likely affect the traditional banking and financial ecosystem in four main ways: There will be increased pressure on the business model of traditional banks, due to competition for deposits. In their scramble for survival, banks may respond to diminishing profits by paying higher rates on deposits, taking greater risks, or attempting to raise lending rates; more generally, there may be a shift of credit intermediation away from banks and toward non-deposit taking institutions; It's possible that we may see a shift in value-added from commercial banks to Big Techs, due to their competitive advantage in gathering and analyzing data.

Big Techs may play a bigger role as distributors, facilitators and aggregators of digital money and financial services (such as wallet services, Amazon, and Alibaba). This could drive down the profits of traditional intermediaries and lead them to take more risk, to consolidate, and to reorganize their activity around back-end

treasury services. We may see the rise of decentralized finance — that is, automated and decentralized capital markets and related securities, trade finance, and lending. The market is still small, at this point: The value of assets in Nigeria contracts is about ₦1 billion, as of January 2021. But there are important potential implications for market structure and functioning, and challenges on how to appropriately regulate this space. It's also possible that we may see the reduced availability

of collateral. Fully-backed stable coins could immobilize central-bank liquidity and could put pressure on overnight interbank markets. That could affect shape and stability of the yield curve.

#### 4.3.2 LONG RUN ARDL RESULT

The summary of Long Run ARDL result of the relationships between future financing and investment in Nigeria is presented in Table 4

**Table 3: Summary of Short Run Parsimonious ARDL Result**  
**ARDL Model (4, 3, 3, 2, 4)**

Variable	Dependent variable = Finance			
	Coefficient	Std. Error	t-Statistic	Prob.
	1.226204**			
D(FGF(-1))	*	0.036947	33.18840	0.0000
	-			
D(FSTS)	0.432433**	0.030762	-14.05717	0.0000
	0.260897**			
D(FSTS(-1))	*	0.020832	12.52388	0.0000
D(GDPCMP)	0.021685**	0.000619	35.05028	0.0000
	-			
	0.083523**			
D(GDPCMP(-1))	*	0.007035	-11.87251	0.0000
D(INTR)	-4.628248	3.424452	-1.351529	0.2253
	-			
	31.15098**			
D(INTR(-1))	*	2.554053	-12.19669	0.0000
	-			
D(PIRE)	0.015936**	0.001336	-11.92535	0.0000
	0.089796**			
D(PIRE(-1))	*	0.003406	26.36057	0.0000
	-			
	2.221415**			
CointEq(-1)*	*	0.057008	-38.96654	0.0000
R-squared	0.998725			
Adjusted R-squared	0.996986			

\*\*\*[\*\*] denotes significant of variable at 1% [5%] significance level respectively.

**Table 4: Long Run ARDL Result**  
*Dependent variable = Federal Government Financing (FGF)*

Variable	Coefficient	Std. Error	t-Statistic	Prob.
FSTS	-0.370958	0.030088	-12.32909	0.0000
GDPCMP	0.103506	0.005385	19.22103	0.0000
INTR	1.579061	3.943646	0.400406	0.7027
PIRE	-0.050144	0.003861	-12.98821	0.0000
C	-144.4773	50.27828	-2.873553	0.0283

\*\*\*[\*\*] denotes significant of variable at 1% [5%] significance level respectively.

#### Long Run Result Interpretation

The long run result in table 4 shows that FSTS and PIRE have negative and significant influence on the relationship between federal government financing and investment position while GDPCMP has positive and significant influence and INTR have positive and insignificant influence on the relationship between future financing and investment position in Nigeria. Under the internal funds theory of investment, the desired capital stock and, hence, investment depends on the level of profits. Several different explanations have been offered. Jan Tinbergen, for example, has argued that realized profits accurately reflect expected profits. Since investment presumably depends on expected profits, investment is positively related to realize profits.

Alternatively, it has been argued that managers have a decided preference for financing investment internally. Retained earnings and depreciation expense are sources of funds internal to the firm; the other sources are external to the firm. Borrowing commits a firm to a series of fixed payments. Should a recession occur, the firm maybe unable to meet its commitments, forcing it to borrow or sell stock on unfavorable terms or even forcing it into bankruptcy (Mathew Blake, 2021).

#### 4.4: Discussion of Test of Hypothesis

##### Hypothesis 1

H<sub>0</sub>: FGF, FSTS, GDPCMP, INTR and PIRE are not statistically significant on the relationship between federal government financing and investment in Nigeria. From Table 4, the

probability value for FGF, FSTS, GDPCMP, and PIRE are less than 0.05 respectively; we therefore accept the alternative hypothesis and conclude that indeed there is statistical significant effect of these variables on the relationship between federal government financing and investment in Nigeria. But Interest Rate (INTR) probability level is greater than 0.05, we therefore reject the null hypothesis and conclude that there is no statistical significant effect on the relationship between future financing and investment in the Nigerian economy.

According to the internal funds theory, policies designed to increase profits directly are likely to be the most effective. These policies include reductions in the corporate income tax rate, allowing firms to depreciate plant and equipment more rapidly, thereby reducing their taxable income, and allowing investment tax credits, a device to reduce firms' tax liabilities. On the other hand, increases in government purchases or reductions in personal income tax rates will have no direct effect on profits, hence no direct effect on investment. To the extent that output increases in response to increases in government purchases or tax cuts, profits increase. Consequently, there will be an indirect effect on investment.

#### 5.0 CONCLUSION

In conclusion, the analysis of *the relationship between future financing and investment* deals with the operation (running or management) of the firm itself. This includes managerial functions like investment and financing

decisions, planning and forecasting, and dealing with the financial markets. So, you have ample choices to start a professional career in the fields of accounting, finance and investments, in particular.

Depending on the choices we, as a society, resolve to make: I imagine that we can envision a relatively optimistic scenario, a relatively pessimistic scenario — and also something in-between. In an optimistic scenario, society would reap the benefits of wise planning — by reducing carbon emissions and restraining the rate of global warming; by adopting wise regulation that captures the benefits of digital innovation; by promoting sensible safeguards that allow us to respond to new trends and protect against emerging risk, some of which we discussed; and by adopting far-sighted social policies that protect public health, preventing a resurgence of the pandemic. We can take practical steps that maximize our up-side potential.

In a more pessimistic scenario, society might delay making the hard choices that confront us — by hesitating to take strong action to limit carbon emissions, until the environmental effects of climate change intensify; by neglecting the risks that may accompany digital technologies, until we invite instability; by delaying the adoption of sound regulation, thus risking speculative excess in our financial markets; and by letting down our guard on public health, thus allowing for a resurgence of the coronavirus and its variants. We have to hope that we reach a social consensus that minimizes our down-side risk.

Perhaps the most likely outcome is somewhere in-between the “best case” scenario and the “worst case” scenario: where we delay — either through inertia or inattention — making the difficult choices that we know we must make, sooner or later. For all of society’s sake, let’s hope that we have the wisdom and the courage to make sensible decisions sooner, rather than later.

## 5.1 POLICY RECOMMENDATIONS

The crisis has forced anew the debate on whether macroeconomic policy should be concerned with high asset price increases and leverage. It has also underscored the deficiencies in national financial regulation and supervision. The study therefore proposes the following policies:

1. Policymakers should promote “green finance” while managing risks to the financial sector during the transition. This is vital, in order to avoid macro-financial disruptions in the future.
2. Government must strengthen the climate information architecture — which includes data, disclosures, and principles for sustainable finance classifications (including taxonomies).
3. Nigerian government must pay close attention to financial-stability risks by improving climate risk-assessment frameworks and by developing proper mitigation strategies. That entails conducting diagnostic exercises to measure physical risks and transition risks, and carrying out climate-risk stress-testing for the banking and corporate sectors, when needed.
4. Adaptation strategies must incorporate climate risks in regulatory and supervisory frameworks — aiming to develop a prudential framework.
5. It is vital to adapt monetary policy, and central-bank operations to incorporate the macroeconomic implications of climate change.

The world economy in 2040 will be shaped by the effectiveness of these climate-related actions taken today particularly in related to climate transition risks.

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