International Journal of Advanced Multidisciplinary Research and Studies

Financial Market and Capital Allocation of Manufacturing Firms: Evidence from the Manufacturing Sector of the Nigerian Stock Exchange

[1] **Lawrence Nnamdi Okeke**, [2] **John Nonso Okoye**, [3] **Amalachukwu Chijindu Ananwude**, [4] **Onyinye Maria Eneh**
[1] Department of Marketing, Nnamdi Azikiwe University, Anambra State, PMB 5025, Awka, Nigeria
[2, 3, 4] Department of Banking and Finance, Nnamdi Azikiwe University, Anambra State, PMB 5025, Awka, Nigeria

Corresponding Author: **Amalachukwu Chijindu Ananwude**

Abstract

The increasing government spending which seems as the more the government spend, the poorer the people has become a great problem to the society at large. There is no doubt that Nigeria is endowed with abundant natural resources, but why these resources have not translated into national prosperity remains an intractable question. This study therefore examines financial market and capital allocation of manufacturing firms in Nigeria from 2002-2021. The objective of the study is to examine of financial market on capital allocation of manufacturing firms in Nigeria. The data used were secondary in nature and carefully sourced from the Central Bank of Nigeria (CBN) and Nigerian Stock Exchange (NSE). The Autoregressive Distribute Lag (ARDL) complimented by the Granger Causality test were the technique employed in analysing the data. The findings showed that all share index has an insignificantly negative association with capital allocation of manufacturing firms, turnover ratio has a negative, non-significant association with capital allocation for manufacturing firms, and market capitalization, on the other hand, revealed a negligible positive correlation between capital allocation and manufacturing enterprises in Nigeria. In addition, the granger causality test revealed that financial market variables: all share index, market capitalization, and turnover ratio have no significant effect on capital allocation of manufacturing firms. In order for the Nigeria manufacturing firms to be pivotal force in Nigeria economic growth and development, government should develop the manufacturing sector by maintaining steady exchange rate, low inflation rate so as for firms to achieve an increase balance of payment. There is also the need to provide adequate infrastructures (electricity supply, communication, good roads, etc.) for firms to operate effectively and efficiently.

1. Introduction

The growth of manufacturing industries has been one of the most significant features of the industrial development of every developing country. The manufacturing industries are one of the developing factors in Nigeria as it increases the gross domestic income of the economy and as such encourages financial marketing. In a typical developed country, there is a multitude of financial services enabling people to make payments; borrow at reasonable interest rates; save for retirement; and limit economic risks. These services are provided by various institutions acting in a complex network of regulations and relationships that together make up the financial system. The dominant feature of the modern financial system is a high pace of innovations, both in terms of their number and value. Thus, it is important to analyse their influence on the financial market. From a macroeconomic perspective, this system allows efficiency through decreased transaction costs, allocation of resources to productive use in enterprises and infrastructure, and the pooling of risks (Obstfeld, 2014) [11]. In developing countries, however, the situation is often quite different. The financial system is less developed and financial services are less widely available or of much poorer quality. The financial market handles the exchange of assets and is made up by several separate markets for various types of asset classes. Capital markets provide trading services for long-term securities such as shares and bonds (with a maturity of more than one year). Other markets include money markets (for shorter-term bonds); currency markets (for foreign exchange); commodities markets where anything from metals to grain is traded; mortgage markets for property debt; and derivatives markets with products based on the underlying assets of all previously mentioned markets and more (Saunders, 2013) [13].

There has been a growing concern on the role of financial market in economic growth and thus the financial market has been the focus of economic policies and policy makers because of the perceived benefits it provides for the economy. The financial

market provides the fulcrum for stock market activities and it is often cited as a barometer of business direction. An active capital market may be relied upon to measure changes in the general level of economic activities (Obadan, 2015) [10]. There have been so many challenges confronting the development of manufacturing firms in Nigeria. Some of these problems includes bad road network which hinders the movement of the company during supply, high rate of inflation which affects balance of payment, instability in exchange rate which affects turnover, poor monetary supply which leads to low manufacturing system.

Moreover, the high rate of tax imposed on manufacturing companies has been a source of discouragement to them. Also there has been a great challenge of company inability to keep using diesel to run their machine during production. Some identified problems that effective performance of manufacturing industries include partial commitment to the plan of a firm like when the owners of the firm just makes plan and are not fully committed to the plan and does not understand how strategic plan can improve their enterprise, lack of good leadership who will not advocate for and champion the strategic plan and keep the manufacturing industries on track, poor communication among team members as to how the new objective should look and feel, what steps to take, time frame of the plan, will affect the organizational plan, lack of resources to execute the plan, lack of flexibility in terms of change, poor production plan which will reduce the product quality and quantity of the manufacturing industries in the market thereby making sales to become low and the firm to be poor, improper job scheduling which will reduce employment rate thereby affecting youth empowerment and poor creativity in terms of diversification which will affect innovation (system of production) in the firm (Kashim, 2012) [7].

Similarly, deducing from the extensive studies on the theoretical expectations on the role of capital markets on economic growth which have formed the core of normative economics, the financial market is expected to contribute to economic growth through the transmission mechanisms of savings mobilization, creation of liquidity, risk diversification, improved dissemination and acquisition of information, provision of long-term, non-debt financial capital which enables companies to avoid over-reliance on debt financing, and enhanced incentive for corporate control amongst others. However, an x-tray on the path of "positive economics" which is concerned with "what is" rather than "what should be" reveals that the argument in the literature on the growth effects of financial market with respect to capital allocation has not been adequately resolved. The inconclusive nature of these theoretical and empirical studies provides the basis for a further empirical investigation on the relationship between financial market and capital allocation of selected manufacturing industries in Nigeria. Hence, this study seeks to examine the relationship between financial market and capital allocation of selected manufacturing industries in Nigeria.

We introduced the background to this study in section one. Consequent to this, the other parts of this study is organized as follows: section two reviews related literature, section three discusses the methodology utilized, section four details data analysis and result, while section five, conclusion was reached and recommendation were made.

2. Literature review
The Financial markets, are a type of marketplace that provides an avenue for the sale and purchase of assets such as bonds, stocks, foreign exchange, and derivatives. Often, they are called by different names, including "Wall Street" and "capital market". Simply put, businesses and investors can go to financial markets to raise money to grow their business and to make more money, respectively (Obstfeld, 2014) [11]. According to Wilson (2015) [14] a financial market is a market in which people trade financial securities and derivatives at low transaction costs. Securities include stocks and bonds, and precious metals. The term "market" is sometimes used for what are more strictly exchanges, organizations that facilitate the trade in financial securities, e.g., a stock exchange or commodity exchange. Trading of currencies and bonds is largely on a bilateral basis, although some bonds trade on a stock exchange, and people are building electronic systems for these as well, to stock exchanges. Grub (2013) [4] viewed financial market is a market where financial instruments are exchanged or traded. Financial markets provide the following three major economic functions: Price discovery, Liquidity, and Reduction of transaction costs. Price discovery function means that transactions between buyers and sellers of financial instruments in a financial market determine the price of the traded asset. At the same time the required return from the investment of funds is determined by the participants in a financial market. The motivation for those seeking funds (deficit units) depends on the required return that investors demand. It is these functions of financial markets that signal how the funds available from those who want to lend or invest funds will be allocated among those needing funds and raise those funds by issuing financial instruments. Liquidity function provides an opportunity for investors to sell a financial instrument, since it is referred to as a measure of the ability to sell an asset at its fair market value at any time. Without liquidity, an investor would be forced to hold a financial instrument until conditions arise to sell it or the issuer is contractually obligated to pay it off. Debt instrument is liquidated when it matures, and equity instrument is until the company is either voluntarily or involuntarily liquidated. All financial markets provide some form of liquidity. However, different financial markets are characterized by the degree of liquidity. The function of reduction of transaction costs is performed, when financial market participants are charged and/or bear the costs of trading a financial instrument. In market economies the economic rationale for the existence of institutions and instruments is related to transaction costs, thus the surviving institutions and instruments are those that have the lowest transaction costs.

Capital allocation means distributing and investing a company's financial resources in ways that will increase its efficiency, and maximize its profits. It can also be seen as the process of dividing financial resources among several business functions and/or departments. The goal of capital allocation is to maximize output per dollar spent (Grub, 2013) [4]. A firm's management seeks to allocate its capital in ways that will generate as much wealth as possible for its shareholders. Diamond (2010) [2] opined that Capital allocation is about where and how a corporation's Chief Executive Officer (CEO) decides to spend the money that

the company has earned. Capital allocation means distributing and investing a company's financial resources in ways that will increase its efficiency, and maximize its profits. A firm's management seeks to allocate its capital in ways that will generate as much wealth as possible for its shareholders.

In term of theoretical underpinning, we restricted our discussion to the economic theory of production postulated by Nelson in the year 1981. The theory provides the analytical framework for most empirical research on productivity. At the core of the theory is the production function, which postulates a well-defined relationship between a vector of maximum producible outputs and a vector of factors of production. Historical analyses of total factor productivity change conceptualize it as the change in output level controlling for input levels, i.e., the vertical shift of the production function. Consequently, factor productivity has been given such labels as the "residual". A number of studies have attempted to characterize productivity change as embracing technological advance, changing composition of the work force, investments in human capital, reallocation of resources from lower to higher productivity activities, and economies of scale. This theory relates to this study as it involves capital allocation of resources in manufacturing firms which proportional affect financial market.

Empirical studies in the subject area in the context of Nigeria were not available on the internet thus the selection of just few nearest study in the subject matter. Mauro, Hassan and Ottaviano (2020) [9] evaluated an alternative measure that focuses instead on firm productivity. The measure was based on a simple theoretical framework that delivers clear predictions on the sign and the size of the elasticity of firm credit growth to current and future productivity growth depending on capital market frictions. When applied to the novel firm-level dataset of the Competitiveness Research Network (CompNet) set up by the EU System of Central Banks, the proposed measure leads to normative statements about the efficiency of credit allocation across the largest Eurozone economies, reversing the conclusions that would be reach through traditional measures.

Liu, Kim and Sung (2017) [8] investigates the association between business groups' influence and the capital allocation efficiency of firms outside the business group. They used a sample of Korean firms (1987 to 2010) to compute an annual index of the collective strength and dominance of large business groups (LBGs) per industry. They discovered that this index is negatively associated with non-LBG firms' industry-level capital allocation efficiency during a period characterized by underdeveloped financial markets and weak investor protection. The negative association is stronger in industries that may lack collateral or internal equity capital. They also found that the negative association strengthens when we limit our analyses to the index component exogenous to non-LBG firms' capital expenditures, suggesting that the relationship is causal. The results also survive a battery of robustness checks.

Hoang, Gatzer and Ruckes (2017) [6] analysed a unique survey dataset to examine the (micro) foundations of capital allocation in firms. Firms employ systems of interconnected measures to counteract agency problems, including layers of approval, divisional budgets, reporting requirements, and compensation schemes. When making funding decisions,

top management relies heavily on top-level, nonfinancial information. However, substantial parts of the capital budget do not require top management approval as firm's trade off the benefits and costs of decentralization. Even firms with active internal capital markets tilt capital allocation toward relatively even distributions. Within-firm agency problems may result in divisions' restricted access to internal capital.

Osinubi and Amaghionyeodiwe (2013) [12] examined the impact of financial market on the Nigerian economic development. The study was carried out between the period of twenty years (1993-2012). Secondary form of data was used collected from statistical bulletin 2013. Pie chart and regression was the statistical tools used for the analysis. The finding showed that financial market has a significant impact on the Nigerian economy. The researcher recommended that government should improve and invest on financial market to as to stabilize the economy.

Aluko (2012) [1] determined the relationship between of capital allocation and economic growth. The objective of the study was to determine the effect of capital allocation on economic development. The study covers a period from 1990-2010. Secondary form of data was used collected from statistical bulletin 2011. The data collected was analysed using correlation and regression as the statistical tools. The finding showed that capital allocation has a significant impact on the economic development. The researcher recommended that government should improve and invest on capital allocation so as to stabilize the economy.

Graham (2011) [3] assessed surveyed more than 1,000 CEOs and CFOs to understand how capital is allocated, and decision-making authority is delegated, within firms. They found that CEOs are least likely to share or delegate decision-making authority in mergers and acquisitions, relative to delegation of capital structure, payout, investment, and capital allocation decisions. They also found that CEOs are more likely to delegate decision authority when the firm is large or complex. Delegation is less likely when the CEO is particularly knowledgeable about a project, when the CEO has an MBA degree or long tenure, and when the CEO's pay is tilted towards incentive compensation. They studied capital allocation in detail and learn that most companies allocate funds across divisions using the net present value rule, the reputation of the divisional manager, the timing of a projects cash flows, and senior management's "gut feel." Corporate politics and corporate socialism are more important allocation criteria in foreign countries than in the U.S.

Guedj, Huang and Sulaeman (2009) [5] addressed the question "do conglomerate firms have the ability to allocate resources efficiently across business segments? They compared the performance of firms that follow passive benchmark strategies in their capital allocation process to those that actively deviate from those benchmarks. Using three measures of capital allocation style to capture various aspects of activeness, they showed that active firms have a lower average industry-adjusted profitability than passive firms. This result is robust to controlling for potential endogeneity using matching analysis and regression analysis with firm fixed effects. Moreover, active firms obtain lower valuation and lower excess stock returns in subsequent periods. The findings suggested that, on average, conglomerate firms that actively allocate resources across their business segments do not do so efficiently and that the stock market does not fully incorporate information revealed

in the internal capital allocation process.

3. Methodology
This study adopts an *ex post facto* research design using time series data from the period of 2002-2021. The data were sourced from the Central Bank of Nigeria (CBN) and National Bureau of Statistics (NBS). In order to activate the objective of the study, the major forces are to examine the relationship between financial market and capital allocation of manufacturing industries in Nigeria. The Autoregressive Distribute Lag (ARDL) technique is adopted to determine the equation with the use of E-views 10.0. Nevertheless, the granger causality approach was followed in determining the effect of financial market on capital allocation of manufacturing firms. ARDL is adopted to guard against bias and obtain the appropriate association of values measure. The study captured equations specified so as to test the relationship between the dependent and independent variables. The dependent variable is Capital Allocation (CAPA), while the independent variables are All Share Index (ASI), Market Capitalization ratio to real gross domestic product, (MKT), and Turnover ratio (TURN) of the capital market. The model for this study is stated as thus:

$$CAPA = f(ASI, MKT, TURN) \qquad (1)$$

Introducing log in the model to avoid the issue of outlier,

eqn. 1. Is transformed as thus:

$$LogCAPA_t = a_0 + a_1 Log\,ASI_t + a_2 Log\,MKT_t + a_3 Log\,TURN_t + \mu_t \qquad (2)$$

Where:
    CAPA = Capital allocation
    ASI = All share index
    MKT = Market capitalization ratio to real gross domestic product
    TURN = Turnover ratio
    a_0 = constant coefficient
    u = error term
    t = time trend

4. Results and discussion
Descriptive statistics of data
According to Table 1's descriptive statistics for the data from 2002 to 2021, Panel A reveals that the mean capital allocation for manufacturing businesses is 52.28118 with a 14.32443 standard deviation from year to year. This is proof that manufacturing companies boosted their average capital allocation by 52.2818%. The figures are 21.40000 for the minimum and 73.25000 for the maximum.

Table 1: Descriptive Properties of Data

	Mean	Std. Dev.	Min.	Max.	Obs.
Panel A: Capital Allocation	52.28118	14.32443	21.40000	73.25000	20
CAPA					
Panel B: Financial Market Variables					
ASI	28965.50	10115.33	12137.70	57990.22	20
MKT	23.48941	11.22654	9.400000	56.00000	20
TURN	8.467647	3.067093	5.470000	17.56000	20

Source: E-views 10 Data Output
Note: Mean = mean of the variables from 2002 to 2021; Std. Dev. = standard deviations of the variables; Min. & Max. =Minimum and maximum values of the variable, whereas Obs. = number of observations of the variables

The financial market variables: ASI, MKT, and TURN's respective means are 28965.50, 23.48941, and 8.467647, respectively, according to Panel B. The all-share index (10115.33) varied significantly from the standard deviation compared to market capitalization (11.22654) and turnover ratio (3.067093). For the all-share index, the minimum and maximum values are 12137.70 and 57990.22; for market capitalization, they are 9.400000 and 56.00000; and for turnover ratio, they are 5.470000 and 17.56000.

Unit Root Test
Utilizing the Augmented Dickey-Fuller (ADF) and Philip Peron (PP), we conducted unit root tests on the variables in three sets: intercept, intercept & trend, and none. The variables were found to be stationary and free of the stationarity fault that is typical of the majority of time series data in Tables 2 through 3's unit root output.

Table 2: ADF Test Result

Variables	Intercept	Intercept &Trend	None	Remark
Capital Allocation				
CAPA	-2.355074	-5.629344*	1.349075	Stationary/1(1)
Financial Market				
ASI	-4.062536*	-3.718252**	-0.403240	Stationary/1(0)
MKT	-4.098488*	-4.080670**	-4.240011*	Stationary/1(1)
TURN	-5.514241*	-3.665614	-5.698528	Stationary/1(1)

Source: E-views 10 Data Output
Note: * and ** denote significance level at 1% and 5% respectively, whereas 1(0) and 1(1) represent integration order at level and first difference respectively

Table 3: PP Test Result

Variables	Intercept	Intercept &Trend	None	Remark
Capital Allocation				
CAPA	-2.849308	-5.629344*	1.163087	Stationary/1(1)
Financial Market				
ASI	-3.689840*	-3.121379	-0.037874	Stationary/1(0)
MKT	-4.119490*	-4.218824**	-4.270381**	Stationary/1(1)
TURN	-10.57317*	-12.98918*	-9.209981*	Stationary/1(1)

Source: E-views 10 Data Output
Note: * and ** denote significance level at 1% and 5% respectively, whereas 1(0) and 1(1) represent integration order at level and first difference respectively

Long Run Relationship

To demonstrate that financial market variables: all share index, market capitalization to RGDP, and turnover ratio have a long-term relationship with the capital allocation of manufacturing firms in Nigeria, the Autoregressive Distribute Lag (ARDL) was used to estimate the long-term association. The ARDL output in Table 4 shows that, at a significance level of 5%, the relationship financial market variables: all share index, market capitalization to RGDP, and turnover ratio and capital allocation of manufacturing firms in Nigeria is significant. Greater than the lower and crucial values of 2.79 and 3.67, respectively, is the f-statistic of 4.19.

Table 4: ARDL Long Run Relationship

T-Test	5% Critical Value Bound		Remark
F-Statistic	Lower Bound	Upper Bound	
4.190433	2.79	3.67	Null Hypothesis Rejected

Source: E-views 10 Data Output

Short Run Relationship

All share index shows an insignificantly negative association with capital allocation of manufacturing businesses in Nigeria at level according to the short run estimate in Table 7, however at lag one, a significant positive link between the two was discovered. Similar to this, turnover ratio has a negative, non-significant association with capital allocation for manufacturing businesses at level estimate, while at lag one, it has a negative, significant link. The market capitalization, on the other hand, revealed a negligible positive correlation between capital allocation and manufacturing enterprises in Nigeria. Manufacturing businesses' capital allocation would be valued at 77.39 if all share index, market capitalization, and turnover ratio were remained constant. The capital allocation of manufacturing firms in Nigeria is reduced by a factor of 0.00053 and 3.08608, respectively, for every percentage increase in the all-share index and turnover ratio at level. However, a unit rise in market capitalization would lead to a 39.67 percent increase in capital allocation for Nigerian manufacturing companies. Adjusted R-square analysis revealed that the combined influence of the financial market variables all share index, market capitalization, and turnover ratio was responsible for changes in capital allocation of manufacturing businesses in Nigeria of 34.79 percent. However, the p-value of 0.12, which is bigger than 0.05 with f-statistic of 2.33. The Durbin Watson statistic of 2.26 does not suggest any element of autocorrelation. The 2.26 Durbin Watson statistic does not indicate any autocorrelation.

Table 5: Short Run Relationship

Variable	Coefficient	Std. Error	t-Statistic	Prob.
CAPA (-1)	-0.068708	0.252416	-0.272200	0.7916
ASI	-0.000525	0.000455	-1.153932	0.2782
ASI (-1)	0.000935	0.000384	2.438751	0.0374
MKT	0.396651	0.405230	0.978831	0.3532
TURN	-3.086075	1.215640	-2.538643	0.0318
TURN (-1)	-1.649132	0.996768	-1.654480	0.1324
C	77.38910	21.08690	3.670008	0.0052
Adjusted R-squared	0.347953	Durbin-Watson stat		2.2643
F-statistic	2.334077	Prob (F-statistic)		0.1220

Source: E-views 10 Data Output

Robustness of the Model

The results of this study's further testing of the estimated model's stability using the serial correlation LM test, the heteroskedasticity test, and the Ramsey Reset Specification are shown in Table 8. The serial correlation LM test reveals no serial correlation between the model's variables (p-value: 0.3731 > 0.05). The model was also shown to not have a problem with heteroskedasticity (p-value: 0.3025 > 0.05). The Ramsey Reset Specification, however, all support the model's fitness (p-value: 0.152224 > 0.05).

Table 6: Diagnostic Test

	F-statistic	Prob.
Serial Correlation LM Test	1.237115	0.3467
Heteroskedasticity Test	0.748375	0.6260
Ramsey Reset Specification	0.152224	0.7066

Source: E-views 10 Data Output

Granger Causality Test

By using the Granger causality paradigm, this study determined the effect of financial market variables on the capital allocation of manufacturing enterprises in Nigeria. Table 7's results show that market indicators for the financial sector, such as the all-share index, market capitalization, and turnover ratio, have no discernible influence on how capital is allocated to manufacturing companies in Nigeria. The observation that there is neither a unidirectional nor a bidirectional causal relationship between the financial market and the capital allocation of manufacturing enterprises forms the basis of this argument. At a significant level of 5%, there is no causal relationship between all share index, market capitalization, and turnover ratio and capital allocation of manufacturing enterprises. In the same vein, there is no causal link between the capital allocation of manufacturing enterprises and the market capitalization, share index, and turnover ratio at a substantial level of 5%.

Table 7: Granger Causality Test

Null Hypothesis:	Obs	F-Statistic	Prob.	Remarks
ASI does not Granger Cause CAPA	18	0.11007	0.8968	No Causality
CAPA does not Granger Cause ASI		0.41900	0.6687	No Causality
MKT does not Granger Cause CAPA	18	0.34323	0.7175	No Causality
CAPA does not Granger Cause MKT		1.26691	0.3233	No Causality
TURN does not Granger Cause CAPA	18	2.83749	0.1057	No Causality
CAPA does not Granger Cause TURN		1.71744	0.2288	No Causality

Source: E-views 10 Data Output

Major Findings

This study notes with great interest that this is the first study on the effect of the financial market on capital allocation of manufacturing firms in Nigeria in recent years; consequently, relating our results with earlier studies in the Nigerian environment was challenging due to the lack of empirical literature online. Despite this, it is with disappointment that this study found that, according to the results of the Granger causality test in Table 6, the financial market variables: all share index, market capitalization, and turnover ratio have no significant effect on the capital allocation of manufacturing firms. The manufacturing firms' reliance on commercial banks for capital to boost operation, despite it being at a high rate coupled with the devastating effect of inflation in the country, is supported by the financial market's minimal impact on the capital allocation of manufacturing firms. This study's findings support those of Hoang, Gatzer, and Ruckes (2017) [6], who found that businesses actively reallocate financial resources around divisions through internal capital markets in order to seize opportunities for more lucrative investments.

5. Conclusion and recommendations

The effect of financial market on capital allocation of manufacturing firms in Nigeria from 2002 to 2021 was the intent of this study. The study is of the perspective that efficient capital allocation from the financial market to manufacturing firms will in no small measure improve the performance of the firms and in ultimate, contribute to the manufacturing sector contribution to gross domestic product. However, from the finding of this study, the financial market in Nigeria has not been able to efficiently mobilize and allocate long and medium-term funds to the manufacturing sector. This may be attributed to the underdeveloped nature of the Nigerian financial market embroiled the developing stage of the financial system. In the regard, the study concludes that the financial market has no significant effect on capital allocation of manufacturing firms in Nigeria. In order for the Nigeria manufacturing firms to be pivotal force in Nigeria economic growth and development, the study recommends that government should develop the manufacturing sector by maintaining steady exchange rate, low inflation rate so as for firms to achieve an increase balance of payment. Government should reduce tax rate (import and export duties) that is impose on the firms so as to help improve the economic system of the country. There is also the need to provide adequate infrastructures (electricity supply, communication, good roads, etc.) for firms to operate effectively and efficiently.

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