



Firm-specific, and institutional determinants of corporate investments in Nigeria

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Abstract

We examined the effect of institutional quality and firm-specific factors on corporate investment in Nigeria using fifty-four (54) quoted non-financial firms within the period of 2002–2012. We applied dynamic panel estimator proposed by Arellano–Bond (1991). The results showed that regulatory quality, corruption, political stability and control of corruption have insignificant effect in determining corporate investments in Nigeria. Our results also confirmed that firms' firm-specific factors influenced corporate investment in Nigeria. While firms' cash flow displayed positive and significant effect on investment other factors had negative effects on investment. Our results showed that investment is constrained to internally generated fund, despite the existence of capital market. In addition, the spillover effect of tightening monetary policy during the period of study had increased the cost of borrowing thereby having a negative effect on investment in the real sector. We recommended that when the monetary authorities are focusing on inflation targeting, they should also not lose sight of its impact on corporate investment and other productivity growth of firms; which is the source of long term sustainable growth and development of economies.

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Keywords: Institution; Nigeria; GMM; Firm-specific; Investment

1. Introduction

Firms often face the problem of financing in every worthwhile investment decision making. Corporate investments could be funded either internally, such as retained earnings, accumulated profits in the form of various reserves, depreciation provision, or externally, which include but not limited to debt/external loan. In finance literature, studies show that corporate investments can be affected by firm-specific or financial factors such as leverages (debt), cash flow (retained earnings), sales, and stock of Liquid assets (Adelegan Ariyo, 2008; Inessa Zicchino, 2006). These authors state the roles played by financial factors on corporate investment and express different conclusion. While some debunk the view of the neoclassicists (Modigliani Miller, 1958) of irrelevance financial factors (e.g. Bhagat Obreja, 2013) other authors express that, in an imperfect capital market, internal and external capitals are not perfect substitutes (Hu Schiantarelli, 1998). Meanwhile, those authors that debunk neoclassicists' views, empirically, come up with mixed results. Some authors affirm that financial factors have positive effect on investment; others confirm negative relationship (Bhagat Obreja, 2013). The neoclassicists state that financial factors enter through the cost of

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capital which, in turn, is independent of the way the firm finances growth and investments. This independence arises because capital markets are assumed to be perfect which may not be true in the modern capital market system.

Of recent, another trend of empirical studies emerges which analyzes institutional factors as another constraint and relate these factors to many finance and economic variables. For instance, Scholars (e.g. [Sarkar Hasan, 2001](#)) believe that the level of institutional quality (in terms of corruption, rule of law and political stability) varies across economies, industries and regions. On this basis, the effect of institution also differs among industrial setting. Studies relate institutional quality with variables such as growth, foreign direct investment and domestic investment. While on the nexus between institution quality (such as control of corruption) and investment, the available evidences provide mixed results as well ([Mauro, 1995](#); [Tanzi Davoodi, 1997](#)). Some show that a corrupt institution does not deter investment to expand and grow (e.g. [Tanzi Davoodi, 1997](#)), other studies take the opposite view by emphasizing that corruption deters investment ([Mauro, 1995](#); [O'Toole Tarp, 2014](#)). [Tanzi and Davoodi \(1997\)](#) states that corruption increases public investment but inefficient productivity arises (also see [Asiedu Freeman, 2009](#) for the nexus). [Wheeler and Mody \(1992\)](#) show that institutional quality has no significant effect after using US-firm level data. We note that most of these studies are cross-countries studies focusing on developed and emerging economies while studies on sub-Saharan Africa and/or a single country study is largely absent. Specifically, little or nothing is known about sub-Saharan African countries despite the fact that the effect of institutional quality may vary across regions and countries. Our study fill this gap by examine the effect of institutional and financing constraints on corporate investment in Nigeria. This study is a single country study using Nigeria as a case study.

This study deviates from other studies in a number of ways. Firstly, we study institutional quality along with other variables specifically financial factors that determine corporate investment. Our choice of Nigeria is based on the fact that the country is experiencing high rate of deficiencies in terms of institutional quality. Corruption as at high rate, political instability coupled with terrorism problems (e.g. [Bokoharam](#)) are perceived to be some of the disturbing phenomena in the country. Our study period spanned from 2002–2012; this is because the trend of Nigerian corporate investment has changed drastically. Before year 2000; corporate investments continuously increasing and highly encouraged; however, the current trend shows that investment opportunities in Nigeria have stifled by the increasing levels of uncertainties in the macroeconomic environment coupled with high poor institution. Nigerian business environment has moved backwards in terms of investor protection and the ease of starting a business (Nigeria was rated 133rd out of 183 countries in *doing business*, see [World Bank, 2012](#)). The capital market exhibits various level of imperfections; these include imposition of price caps on share price movement, regulation of interest rates, presence of asymmetric information, agency costs and political instability which resulted in thinness of trading, low market capitalization and low percentage of turnover level among others ([Adelegan Ariyo, 2008](#)). In our analysis, we include fifty four (54), listed non-financial firms in Nigeria capital market ranging from manufacturing, conglomerate, oil companies to mention, but few. The remainder of this paper is sectioned into 4 parts. Next part discussed the literature review, followed by methodology, results and discussion while conclusion ends the paper.

2. Literature review

2.1. Institutional quality and investment

The links between institutional quality and investment have been highlighted in the theoretical and empirical literature. The evidence that country-level factors (such as institutional quality) can impact on capital investment implies that regulators and policymakers could influence capital structure and investment decision, and hence cost of capital and firm value, through control of corruption, regulation quality and rule of laws. Therefore, regulators and policymakers, through their influence on capital structure of firms, could impact on quality of corporate governance at firm level ([Lemma Negash, 2013](#)). Theoretically, it has been opined that the impact of institutional quality on firm's level investment is unclear. Some authors, for example, are of the opinion that corruption weakens the structure of institutional environment and it raises operational cost, creates uncertainty and thereby deterring investment ([Shleifer Vishny, 1993](#); [Wei, 1997](#)).

Institutional quality could be a determinant of Investment because good governance is associated with higher economic growth and development, which has the tendency to attract more investment. Poor and weak institutions would enable corruption among others to add to investment costs and reduce profits which is likely increase the sunk cost of doing business makes investors highly sensitive to uncertainty, including the political uncertainty that arises

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