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FINANCIAL INTERMEDIATION AND INFLOW OF FOREIGN DIRECT INVESTMENT IN NIGERIA: AN APPLICATION OF ORDINARY LEAST SQUARE METHODS

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Abstract

This study examined the relationship between financial intermediation and inflow of foreign direct investment in Nigeria. Time series data were sourced from Central Bank of Nigeria Statistical Bulletin. Foreign direct investment was modeled as the function of private sector credit, core private sector credit, deposit mobilization and interest rate. Ordinary least square was used as data analysis methods. The estimated model found that 52.2% of the variation in the independent variables explained the dependent variable while 47.8 % of independent variables not included in this study explains the dependent variable. The estimated model further found that private sector credit, core private sector credit and deposit mobilization have positive and significant relationship with inflow of foreign direct investment while interest rate have negative and no significant effect on inflow of foreign direct investment. From the findings, the study conclude that financial intermediation determine the inflow of foreign direct investment in Nigeria. It recommends that Central Bank of Nigeria should enact reforms that must be directed at improving the quality of financial development indicators and its services to meet the needs of foreign and domestic investors and the economy at large. These include policies that will check the activities of banks management who launder the facilities meant for investors for private gains and efforts should be directed at the removal of impediments that block the short-term and long-term linkage between financial development and foreign and domestic investment in Nigeria.

Keywords: *Financial Intermediation, Foreign Direct Investment, Nigeria, Ordinary Least Square Methods*

1. INTRODUCTION

The complex nature of foreign direct investment suggests that only the most productive firms can successfully invest abroad on their own, while many other firms may benefit from the knowledge acquired by earlier investors, in particular by banks. The spread of foreign direct investment across countries with various institutions implies that multinationals have to deal with varying degrees of investor protection and market frictions. Financial intermediaries and financial markets could play an important role in overcoming these frictions because of their specialized ability to lower transaction costs and overcome information asymmetries. The range of investment decisions a multinational has to make include deciding on which country to invest in, whether to make a Greenfield investment or to buy an existing foreign firm, finding a suitable potential subsidiary and deciding on the share of ownership. The investment itself will entail transaction costs and call for optimal financing through host, home or internal credit markets while information asymmetries arise from institutional differences between the countries, differences about corporate culture, valuation of the target firm, sourcing of inputs, and sharing of technology. Besides financing projects directly, providing diversification of risk and offering cross-border payment services, banks specialize in acquiring and processing information about the firms they lend to and in addition they are well equipped to monitor investment projects. The fixed costs of engaging in relatively complex foreign direct investment and firms' heterogeneous productivity sort firms into domestic producers, exporters and those engaging in foreign direct investment in Helpman et al. (2004). Banks may be able to lower the costs of foreign direct investment and thereby widen the range of firms which is productive enough to invest abroad, and in addition increase the pool and quality of investment opportunities.

The role of financial intermediaries in attracting foreign direct investment include increase the size and quality of the pool of potential affiliates, bridge the institutional distance between home and host firms; help to efficiently organize internal capital markets and provide direct financing (Afolabi, A. and Laseinde, T. O. (2019).) . The first three information-based services could also be supplied by specialized service firms other than banks. However, if they are (strategic) complements to lending, banks' main source of income, then banks are the more likely suppliers (Spence (1976) for a general treatment). The results reveal that the first two channels which relate to information asymmetries are somewhat more likely than those related to direct lending or organizing internal capital markets. Because acquiring information takes time, such effects will be more beneficial beyond the short run. A firm wishing to expand abroad faces several investment decisions which, independent of whether expansion is horizontal, vertical or mixed , have to deal with information asymmetries between the parent and the investment opportunity. Although the multinational initiates the search based on technological requirements it cannot easily assess other dimensions of the target firm necessary for successful

investment. Secondly, banks may help to decrease institutional distance between subsidiaries and MNEs at the country level, where distance can be geographical, cultural, hierarchical and institutional or relate to differences in tax treatment between the destination country and the firm's home country. This channel predicts, consistent with this paper's findings, that banks from the same origin country are more important for foreign investment than similar services offered by either domestic host country banks or other foreign banks, and more so in relatively difficult host countries as measured by corruption and rule of law. The more involved a home bank is in the local market, the easier it will be to bridge these measures of distance. In addition, soft information through banks' direct investment should be more beneficial than hard information collected for cross-border lending.

The third channel relates to the internal financial organization of the multinational, which involves optimal capital allocation across affiliates and efficient payment services. Desai et al. (2004) found evidence that the financial organization of multinationals' activities is affected by depth of local credit markets, especially if creditor rights are weak. Local bankruptcy laws prevail such that local creditor rights matter more in the case of disputes, resulting in higher local interest rates. Foreign affiliates then depend heavily on the MNE's internal capital market for their financing. Banks which are familiar with the firm's operations and local imperfections in the external capital market may be able to help arrange financing within multinationals in the most efficient way, especially if institutions are weak. Manova et al. (2011) found that firms operating in an environment of relatively underdeveloped local credit markets who can rely on foreign parents for funding export larger volumes of a broader range of products to more countries. FDI is therefore a more productive organizational structure over arm's length relationships in sectors which depend on external capital or which have fewer collateralizable assets. Similarly, Argentinian firms are more likely to be foreign owned when they depend on external finance (Bustos, 2011).

This suggests that there is a role for financial intermediation by banks. A larger positive effect of banking FDI in more opaque markets by home rather than third-country or host banks also supports this channel. However, there is also some evidence that sectors which rely on external finance benefit more from home banking, although this could also capture that some sectors have more banking relationships. The fourth channel works through direct financing of multinationals' foreign operations by banks. For example, Klein et al. (2002) show that firms initiate fewer FDI projects if their home bank is in distress. Banking crises limit credit supply which multinationals need to inance investments. If funding is predominantly provided by its home bank than home country banking FDI to should have a stronger effect than third-country banking FDI, although firms may draw from both sources. However, in that case a positive effect of the volume of local lending is also expected.

Financial intermediation arises due to information asymmetries and financial intermediaries incur search costs when channelling savings to entrepreneurs. Financial development is modelled as lowering the search costs and thus increasing the supply of external finance in the economy. As a provider of capital a multinational enterprise faces similar constraints. However, because there is usually no pooling of capital by multiple MNEs and no risk sharing the costs will be higher, making intermediation relatively more important. The banking literature emphasizes the importance of physical proximity between firms and lenders for effective monitoring and collection of soft information. The alternative of arm's length lending relies mostly on hard information, which is the type of information that is relatively easier to acquire and more accessible for MNEs as well. Possibly the best way to gain local soft knowledge on firms is by acquisition of or joint ventures with existing local banks. If this channel is operating cross-border lending should be less important than FDI by banks. This is indeed supported by the data. The idea that distance related agency and informational costs are very substantial for non-financial multinationals is suggested by the fact the even banks face these costs (Mian, 2006). Berger et al. (2001) find that South American foreign banks are more likely to lend to small Argentine businesses than other foreign banks. Arguably, these effects should be stronger for non-financial MNEs which do not specialize in overcoming agency and information transaction costs. Monitoring after investment could be an additional advantage offered by banks. Antràs et al. (2009) credit constraints; relationship specific investments and weak investor protection create the need to monitor investments, leading to vertical integration if monitoring is done by parent firms.

Desai et al. (2006) argued that because a considerable fraction of the funding for local affiliates of multinational investors often comes from the local debt markets, higher interest rates due to capital control increase the cost of capital and this discourages FDI. Thus capital control affects local investments by multinational firms because it affects local borrowing rates and increases the cost of repatriation. Finally, the costs associated with capital controls undoubtedly discourage many potential investors from establishing affiliates in the first place. Empirically, Desai et al. (2006) using US multinational firms' data, show that liberalization of capital controls are associated with considerable increases in the activities these firms conduct through their affiliates. Liberalization of capital controls appears to unleash faster growth in the business activities of multinational firms in the host countries. From this literature, the linkage between FDI and FMD passes through the adjustment of the cost of capital because financial market development reduces the cost of capital and therefore spurs investments in local companies or local affiliates of multinationals. The extant literature has not clearly established, at least empirically, a direct link between FDI and FMD, especially for African countries where stock markets are at their embryonic stages and these countries rely on huge amounts of foreign investments in order to lift their population out of poverty. The forgoing discussion relating to the link between FDI and FMD clearly suggests that the relationship between FDI and FMD is

endogenously determined. This study examined the relationship between financial intermediation and inflow of foreign direct investment in Nigeria.

2. LITERATURE REVIEW

2.1 CONCEPTUAL REVIEW

Financial Intermediation

Financial intermediation relates to the process whereby the financial institutions creating financial assets within the framework of the financial markets brings together the surplus and the deficit economic units in order to resolve their financial imbalance by means of a price related compensation mechanism called interest rate (Ezirim et al, 2012). This for deposit money banks involves deposit mobilization and credit allocation. The process involves the inflow side characterized with fund mobilization and the outflow which is referred to fund utilization (Ezirim, 2005). One of the intermediate functions of deposit money banks is bank lending. Bank lending is a major factor input to the growth and development of the economy. It is a mechanism for promoting the developing economy and remains very important despite the diverse opinions of researchers on the relationship between finance and economic growth and economic growth and finance. Banks constitute the medium for the implementation of the government monetary policies aimed at achieving the macro-economic goals of full employment, economic growth stability and Balance of payment equilibrium (Odior, 2013).

Research on financial intermediation and its impact on bank performance has received limited attention in the extant literature. While there have been a number of studies on the impact of financial intermediation on economic growth and development, there has not been much work on the relationship between financial intermediation and bank performance. Akoto and Nubieu (2014), however, did their work on the impact of financial intermediation on bank profitability using data on Ghana. Also, most of the few existing works have been done outside Sub Saharan Africa (SSA). Again, most papers examine the extent of financial deepening of the banking sector by analysing financial deepening indicators. In this research, bank performance is measured using two criteria: the health status of banks and return on assets. The health status is measured, by using the solvency index which is determined by the provision for loan loss as a percentage of total loans and advances. This is understood to represent how efficient banks are in recovering their loans and advances which is expected largely to influence bank profitability. Non-performing loan levels are one of the key measures of banking industry performance. When lenders record large percentage of their outstanding loans as non-performing loans, it hurts the financial performance of the lender. A rising non-performing loan can lead to deterioration or decline in bank profitability when interest incomes are not recovered and loan principal

has to be written off. The return on assets is a ratio of Profit before Tax to Total Bank assets (PBT/Total Bank Assets).

Supply Side of Financial Intermediation

The supply side of the financial intermediation function represents the financing function of a typical financial institution. Financing function, according to finance theory, is the function of the firm geared toward the sourcing and/or raising of funds from alternative sources in such a cost-effective and time-efficient manner as to enable the firm to achieve its objectives. Thus, four elements are cardinal in the financing function of firms: the alternative sources, the cost implications, time-efficiency, and objective criterion of the firm, e.g. maximization of owners' wealth. Efficiency in the conduct of financing function is attained when the business unit mobilizes funds from convenient sources that guarantee the attainment of cost effectiveness and time efficiency (Ezirim, 1996). This function is known as the supply side of the institution's intermediation function. The culmination of the funds' mobilization effort of a typical depository institution is the total portfolio of the various types of deposits (alternative sources of funds) generated by the financial intermediary (Ezirim, 1999, 2003). Funds are mobilized by the help of institutional and non-institutional arrangements, instruments and facilities provided by the financial markets. The complex whole or congeries of the financial markets, institutions, and instruments in a given economy is known as the financial superstructure (Goldsmith, 1969; Odedokun, 1987). It is taken to mean the most important institutional divides such as commercial banks and other deposit money banks, and insurance companies that operate in the financial markets to assist in the creation of financial instruments. Banks for instance create financial instruments in their depository function. For the banks, the major types of deposits are the savings, time, and foreign currency deposits, and current account or demand deposits. These make up the total deposit portfolio of banks.

Demand Side Financial Intermediation

The level of the deposit portfolio is postulated to depend on the rates of interest paid on each type of deposit (R^D) and other macroeconomic factors. A notable factor that affects the ability of economic agents to save, and hence the level of deposits among the financial institutions is the disposable income (Y^d) of the economic agents. This is the remainder of income after applying tax to the total income of the agents. A proxy for the income of economic agents in a country is the per capita income (Y^P). By implication, the income tax rate (R^{yt}) prevailing in the country is also an important factor of influence. Perhaps a much more influencing factor in the realm of taxes as argued in Ezirim (1999) is the withholding tax (R^{Wt}) on interest rates paid by banks to their depositors. It is reasoned that higher withholding tax rates reduce the willingness of relevant agents in depositing money with banks. Economic units are naturally averse to taxation generally. Apart from these, it is postulated that the aggregate level of economic activity (GDP), which determines the

standard of living and welfare of the citizenry, would go a long way to determining the ability of economic units to make deposit with the financial institutions. A buoyant economy with high GDP has a promise of boosting deposits than a poor one. If the level of economic activity grows, it is expected that savings would generally grow. Ajakaiye and Odusola (1995) advance the ratio of foreign savings to GDP as an important variable posing an influence on the level of financial savings. In as much as we recognize the huge leakages in an economy like Nigeria by way of the activities of economic looters (and paradoxically, genuine foreign investors to other economies), we think that it is difficult to measure this variable. It however, assumed that a positive force attracting these Nigerian investors to invest in other countries is the strength of the foreign economy proxy by the strength of their currency. The relationship between Nigeria's local currency and the foreign currency is defined as the exchange rate. By implication, the foreign exchange rate (FER) prevailing in the country becomes a factor of influence on the level of deposits generated by the financial superstructure.

Deposits of Mobilization

A major role of banks in a financial market is that of financial intermediation, and deposits constitute a vital component of this process. Both commercial banks and microfinance banks need deposits to fulfil this objective. Deposit mobilization is one of the most important functions of the banking business. It is therefore an important source of the working fund for banks, generally and for microfinance banks in particular. Banks make use of loan and deposit services to effectively channel idle funds from the general public into valuable productive activities and other investment projects that could help people reach their goals. Bello (2005), and Nzotta (2014) were of the same view that the banking system is the backbone of financial intermediation through the mobilization and channeling of financial resources to investment activities and other end-users.

Deposit mobilization remains one of the important functions of banking all over the world. It is an important source of funding for both commercial and microfinance banks and has been proven by scholars such as Jhingan (2001), Agene (2002), Bakare (2011), and Orji (2012), among others, as an indispensable factor for increasing the sources of funding for banks to operate effectively. The mobilization of deposits plays a crucial role in providing satisfactory services to various sectors of the economy (Baye and Jason, 2006). However, the ability of banks to generate growth and economic development depends on the health, solidity and stability of the banking system itself (Alex, 2012). The relationship between bank deposit mobilization, the financing of bank credit and capital formation is traceable to the activities of the banking industry such as the mobilization of deposits and the creation of credits. However, it has been argued in the public domain that banks have not been performing effectively to improve capital formation in a bid to guarantee a sound financial system (Venkati, 2016). Capital formation or real asset investment is an important element

of economic development and growth. Large-scale capital formation is very beneficial. Existing share capital might need to be replaced by normal depreciation, plants might need to expand to benefit from economies of scale and be competent in increasing market demand (Uche |&| Ehikwe, 2001; Shantann et al., 2009).

Bank Credit to Customers

Chester (1920) defines Bank credit as credit extended by banks to borrowers. He stressed further that, Bankers frequently use the term in the plural, meaning advances made to their borrowing customers. Whether the borrower withdraws the amount of the proceeds of his loan in cash at once or leaves it on deposit with the lending bank, the loan in either case constitutes credit extended. Just as a merchant extends credit to he who pays for his purchase at a later time, so the banker extends credit to the business man who borrows money. Whether the money is taken from the bank at the time the loan is made, the next day, or ten days later, makes no essential difference; bank credit may take even the form of an overdraft. Credit has been described as a device for facilitating transfer of purchasing power from one individual or organization to another. As indicated by Oyatoya (1983) credit provides the basis for increased production efficiency through specialization of functions thus bringing together in a more productive union the skilled labor force with small financial resources and those who have substantial resources but lack entrepreneurial ability. In general, total domestic bank credit can be sub divided into two: credit to the private sector and credit to the public sector. It has been empirically proved that credit to the public sector is weak in generating growth within the economy because they are prone to waste and politically motivated programmes which may not deliver the best result to the populace while private credit had been observed to be the dynamic instrument of accelerated growth (Beck et al 2005; Levine 2002; Odedokun 1998; King and Levine 1993).

Private Sector Credit

The private sector is said to be the engine of economic growth for a country, especially, for developing economies (William et al. 2019). The private sector remains the nucleus that drives economic growth. Private sector funding (credit) is no doubt a driver of the real economy, particularly in developing economies like Nigeria where the financial markets are porous and near well developed to mobilize the needed resources to accelerate the desired level of economic development. The private sector is the part of the economy that is run by individuals and companies for profit and is not state controlled. Therefore, it encompasses all for-profit businesses that are not owned or operated by the government. Companies and corporations that are government run are part of what is known as the public sector, while charities and other non-profitable organization are part of the voluntary sector. From the above, private sector funding refers to various sources of fund to private investors. Private sector in Nigeria is expected to raise funds from two main sources: Equity

and debt. The sources of equity (sometimes called internal funds) include owners' savings and ploughed back profits. Often times, firms make use of debt (external funds) for expansion. These funds can be obtained from informal sources (that is friends/relatives, credit associations, co-operative societies) and also from formal sources (that is banks and governmental agencies).

Foreign Direct Investment

Foreign direct investment is an investment made by an individual or a company (investor) in a country which is not the country of origin of the investor, in the form of either establishing business or acquiring business assets in the country. Foreign direct investment is the extra resource a country needs in order to achieve economic growth. It is a combination of technology, marketing, capital and management. It provides a firm with new markets, marketing channels, easy admittance to new technology, skills, product, financing and production facilities. Foreign direct investment can be defined as a foreign investment that is a part or share of GDP which grows rapidly; it is turning into the largest origin of capital moving from developed countries to developing countries. Foreign direct investment leads to increase in investment and advancement in technology which in turns increases productivity and efficiency in the host country. The increased productivity and efficiency results to high output production for both local consumption and export. The export of goods and services brings foreign exchange revenue to the host country which serves as an engine for economic growth.

There is an agreement which states that FDI has serve as an advantage to local firms by increasing growth which leads to productivity and efficiency. Developed nations have agreed that productivity has been the key to domestic firms. The FDI's importance in export promotion is said to be debatable and it relies on it solely for the purpose of investment. The main agreement is that FDI spill over depends on the capacity of the host country in order to absorb the type of investment nature and also foreign technology. The relationship between economic growth and FDI is tagged conditional depending on the country it is passing through. It has been asserted the extent to which FDI contributes to growth depends on economic and social conditions or in short the quality of the environment of the recipient country (Zhang, 2001). Thus, employment opportunities are created through FDI in the hosting countries and this is done through direct employment in the domestic economy for operations, for forward and xvii backward connections, leads to more employment creation in the economy due to growth. Growth can be generated through FDI and a steady state of growth over a period of time reduces poverty (Ajayi, 2006).

Merits and Demerits of Foreign Direct Investment to Less Developed Country like Nigeria

i. Foreign Direct Investment (FDI) possesses certain advantages which are discussed as under:

ii. FDI not only provides finance hut also managerial, administrative and technical personnel, new technology, research and innovations in products and techniques of production which are in short supply in Nigeria.

iii. This may, in turn, encourage local enterprise to invest more itself in ancillary industries or in collaboration with foreign enterprise. In fact, foreign enterprise encourages local enterprise in two ways: directly by fostering local enterprise with men, money, and material, and by imparting training and experience to its personnel; and indirectly by creating demand for ancillary or subsidiary services (like transport and training agents) which are uneconomical for private foreign enterprise to provide Anyawale (2007).

iv. By bringing capital and foreign exchange FDI helps in filling the Foreign Direct investment and Multinationals savings gap and the foreign exchange gap in order to achieve the goal of national economic, development in Nigeria.

v. A part of the profits from direct foreign investment is generally ploughed back into the expansion, modernization or development of related industries.

vi. FDI adds more value added to output in the recipient country than, the return on capital from foreign investment in this sense, the social returns are greater than the private returns on foreign investment.

vii. FDI also brings revenue to the government of an LDC when it taxes profits of foreign firms or gets royalties from concession agreements.

viii. FDI helps in raising productivity and hence the real wages of Local labour. When foreign investment induced industrialization takes place, the real wages of the newly employed workers are higher than the real wages of workers in the rural sector of the economy. If FDI is in export-oriented industries, it leads to much higher social benefit than it is in import-substitution industries because the former have large backward and forward linkage effects. And if export industries are labour intensive, they also provide larger employment opportunities.

ix. Direct foreign investment also places less burden on the balance of payments of an under Nigeria country in the early stage of development. For, the time lag between the' starting of new business concerns and the reaping of profits is large. Moreover profits are likely to be small in the earlier stages of production. Thus the remittance

of profits from direct investment brings less pressure on the balance of payment. If FDI mainly flows into agriculture and extractive industries which produce primary goods for export, it further helps in easing the balance of payments position of Nigeria. In the case of a developing country like India, FDI has a greater salutary effect on the balance of payments since it helps in producing manufactured articles, not only for the domestic' market but also for foreign markets.

x. Lastly, FDI flowing into a developing country a1s encourages its entrepreneurs to invest in other Nigeria. Firms in India have started investing in Nepal, Uganda, Ethiopia and Kenya and others like Nigeria while they are still borrowing from abroad.

Demerits of Foreign Direct Investment

FDI has certain disadvantages in the form of costs to the recipient country which tend to offset its benefits.

i. The recipient country may be required to provide basic facilities like land, power and other public utilities, commissions in the form of tax holiday, development rebate, rebate on undistributed profits, additional depreciation allowance, subsidized inputs, etc Such facilities concessions involve cost in, absorbing on Nigeria resources that could be utilized elsewhere by the government.

ii. To attract FDI, Nigeria has to provide sufficient facilities for transferring profits, dividends; interest and principal. If these payments lead to a net capital outflow, they create serious balance of payment difficulties. Thus, the indirect costs of debt servicing and balance of payments adjustments create serious foreign exchange crisis thereby adversely affecting the national economy.

iii. No doubt, FDI increases investment, employment, income and saving in Nigeria, but it adversely affects income distribution when it competes with home investment, Capital and other resources may flow to foreign enterprises in preference to domestic enterprises. This may reduce profits in the latter, thereby discouraging local enterprise.

iv. Many foreign concerns operating in Nigeria, reserve all senior executive posts for their nationals and pay them very high salaries with' many perks which are a huge drain on the resource of the recipient country. At best, they train local nationals for lower and middle level posts having little independent decision making. Moreover, the lavish spending habits of foreign national have an undesirable demonstration effect on the nationals of Nigeria and create social tensions Adelgan (2000)

v. FDI brings in 'highly capital intensive technologies which do not fit in the factor proportions of Nigeria. Often obsolete and discarded machines and techniques are imported which involve high social costs in terms of replacement after a' few years.

vi. FDI also involves costs in the form of a loss of domestic autonomy when foreign firms interfere in policy-making decisions of the government of Nigeria which favours the foreign enterprises. Such interference is usually resorted to by the multinational corporations.

2.2 THEORETICAL REVIEW

Financial Intermediation Theory

Traditional theories of intermediation are hinged on transaction costs and information asymmetry, describing how institutions collect deposits or issue insurance policies and channel funds to individuals and businesses. However, over the years, the business of intermediation has evolved significantly, with declines in transaction costs and asymmetric information, but intermediation has increased (Allen & Santomero, 1998). Allen and Santomero (1998) in their work The Theory of Financial Intermediation suggested that the theories of intermediation need to be adjusted to account for substantial transformation in financial systems across various countries. Over the study period, many traditional financial markets expanded and new markets emerged, transaction cost decreased, and information became cheaper and more available. Despite these changes/transformations, the business of intermediation has not declined.

Financial Intermediation theory focuses on how banks mitigate transaction costs and deal with issues stemming from information asymmetry between lenders and borrowers. This foundational perspective of financial intermediation is primarily attributed to the seminal work of Diamond and Dybvig (1983). They developed a model illustrating how banks as intermediary transform illiquid assets (loans) into liquid liabilities (demand deposit), therefore providing liquidity to the economy by meeting the liquidity preferences of depositors, through the process of maturity transformation. This process enables banks to meet depositors' withdrawal needs while financing long-term investments. However, this structure makes banks susceptible to bank runs, as the sudden and constant withdrawal of funds by a large number of depositors can lead to insolvency. Financial intermediation is linked to banks financial soundness, which includes factors such as capital adequacy, asset quality, and liquidity must be effective to prevent bank-runs and maintain financial soundness and stability in the economy.

The Internalization Theory of Capital Flows

Buckley and Casson (1976) coined the notion of internalization itself, based on the application of the market imperfections approach in an international context. In the theory, Buckley and Casson (2019) suggested that firms try to maximize profits under the imperfect condition existing in intermediate products by internalizing the key intermediate products such as knowledge, marketing, human capital and management expertise. They think the markets for key intermediate products are imperfect. Under the imperfect market conditions in intermediate products, firms link different activities through markets under common ownership and control. The linking of different activities through these markets, however involves significant time lag and transaction costs. Thus, firms want to bypass the external markets in intermediate products by creating internal markets in order to avoid the significant time lag and transaction costs. In other words, firms are encouraged to replace these external markets with their own internal markets for these products to avoid the above mentioned difficulties (Olotu & Oliogu, 2014). For reason of increase in profit, some transactions should be carried out within a firm rather than between firms. In other words, some transactions should be internalized to reduce transaction cost and hence increase profitability. There are technologies that are embodied in the mind of a group of individuals and not possible to sell to other parties.

New Economic Integration Theory

Krauss (1972) argued that, studies by Viner (1950) and Cooper and Massell (1965) have concluded that, a nonpreferential tariff policy (free trade) is superior to customs unions as a trade liberalizing device. In other words, these studies have concluded that the argument that the reason behind forming customs unions is a better allocation of resources is no longer valid. Therefore, one should stop analyzing the welfare impacts of customs union using static effects. As a result, Balassa (1962), and Cooper and Massell (1965) introduced another tool (dynamic effects) into the analysis of the welfare effects of economic integration, as a more efficient economic reason or rationale behind the formation of customs unions or economic integration schemes in general. Balassa's dynamic theory of economic integration proved that, the static analysis in terms of trade creation and trade diversion is simply not enough to fully capture or analyze welfare gains from economic integration. Allen (1963) and Balassa (1962) listed the principle dynamic effects of integration as large-scale economies, technological change, as well as the impact of integration on market structure and competition, productivity growth, risk and uncertainty, and investment activity. The same view is shared by Kreinin (1963). According to Brada and Mendez (1988) integration is assumed to raise investment and reduce risks. This can be explained by the fact that, a larger market will raise the expected return on investments and reduce uncertainty by enabling firms to lower their costs as a result of increased economies of scale, and a bigger pool of consumers.

Push and Pull Theory

This study is anchored on push and pulls theory. The pull factor theory attributes the flow of capital to be as a result of the domestic fundamentals of the recipient country. These domestic factors include creditworthiness of a country, improvement in fiscal and monetary policies and neighbourhood externalities (interest rate and the price earnings ratio of the host country) (Calvo, *et al,* 1996). Haque, Mathieson and Sharma (1997) identified an increase in domestic output and domestic money demand to be pull factors. Other domestic factors also include the performance of macroeconomic variables such as financial development, inflation, GDP growth rate, current account balance and gross domestic investment. Thus, to evaluate the level of sound economic policies and the sustainability of capital flows, investment environment, infrastructure as well as the quality of institutions are also included as key domestic factors. Many scholars (Chuhan et al, 1994 and Ul-Haque, Kamar, Mark, & Mathiesan, 1996) have identified pull factors to be the main significant factors that explain capital inflows of emerging economies in the 1990s. The authors argue that financial liberalisation among other factors such as privatization of public enterprise and improvement in macroeconomic conditions have improved the credit worthiness of developing countries leading to international capital mobility. Basu and Srinivasan (2002) provided evidence from Africa that, well-structured economic reforms coupled with political and macroeconomic stability and natural resources have attracted foreign capital like cross border capital to these countries. Similarly Asiedu (2002) found that poor policy and restrictions in trade hinders capital flows to Nigeria. Asiedu (2002) considered these factors to be paramount in explaining the proportion of foreign capital inflows of Nigeria.

2.3 EMPIRICAL REVIEW

Adegboyo, Keji and Fasina (2021) examined the impact of fiscal, monetary and trade policies in Nigeriqn economic growth from 1985 to 2020. This adopts endogenous growth model (AK model) as its theoretical framework. The unit root test results reveal that there is mixed level of stationarity in the variables. The bound test results show that the variables cointegrate. The ARDL long-run result shows that fiscal policies stimulate economic growth; while on the contrary, trade policies deter Nigerian economic growth. The short-run result shows that the fiscal policies have an inconsistent impact on Nigerian economic growth and thus differs from the long-run result; while government spending continues to drive economic growth in Nigeria, government revenues have no effect on the growth of the country. The result of the impact of monetary policies shows that interest rate impels growth ot the economy while money supply deters growth of the Nigeria's economy. Lastly, the trade policies maintain her negative influence on the economy in both the long run and short run.

Afolabi and Laseinde (2019) investigated the impact of manufacturing sector production on Nigerian economic growth from 1981 to 2016. Data for the Autoregressive Distributed Lag (ARDL) model and the Granger causality techniques on were obtained from the Central Bank of Nigeria statistical bulletin. The findings revealed unidirectional causality between RGDP and MCU, LMO, and LM2. The findings revealed that MCU has a positive impact on RGDP, while LMO also has a positive impact on GDP. Akinmulegun and Akinde (2019) investigated Nigeria's financial deepening and manufacturing sector performance from 1981 to 2017. OLS was used to analyze time series data obtained from the Central Bank of Nigeria (CBN) statistical bulletin and the World Bank Development Index. To assess the impact of the variables, the study used an error correction mechanism (ECM). The findings indicate that credit to the private sector has a positive effect on GDP, as does market capitalization. The study concluded that financial deepening had a significant impact on Nigeria's manufacturing sector performance.

Akujiobi, Ndugbu, Michael and Akujiobi (2018) examined the relationship between public expenditure and capital formation in Nigeria, 1981-2018.Adopting the Ordinary Least Square Multiple Regression, the study revealed a significant relationship exists between public expenditure and capital formation in Nigeria. Also, the model indicated that three of the public expenditure components namely, total public expenditure on economic services (TES), total public expenditure on social and community services (TSC) and total public expenditure on transfers (TT) were statistically significant with all the explanatory variables meeting the a priori expectation with their positive coefficients. Based on the findings, the study concluded that public expenditure has positively contributed to the level of capital formation in Nigeria.

Amusa, Nwagwu, Yusuf and Sokunbi (2021) examined the relationship between fiscal policy and economic growth in which past studies have not fully explored in Nigeria. Data was collected from the Central Bank of Nigeria Statistical Bulletin from 1990 to 2017 and the study employed the Autoregressive Distributed Lag (ARDL) model and Error Correction Model (ECM) to address its objective. Consequently, the major findings that originated from the work could be submitted as follows. The result of ECM term confirmed that about 39% of the total disequilibrium in the previous year would be corrected in the current year. Therefore, it will take about two (2) years for the system to adjust back to its long run equilibrium path. Meanwhile, the estimated result shows that economic growth and government revenue have a significant positive relationship in Nigeria in the short run but the relationship becomes negative in the long run. However, recurrent expenditure has a significant negative relationship with economic growth in the short run but the relationship becomes insignificant in the long run. However, inflation rate has a significant positive relationship with economic growth in both short run and long run.

Andabai and Jessie (2018) examined micro-finance banks' credit and the growth of small and medium scale businesses in Nigeria; for the period 1990-2016. Secondary data were used and collected from the Central Bank of Nigeria statistical bulletin. The study employed Microfinance Banks' Credit to Small and Medium Businesses, Interest Rate and Broad Money Supply as independent variables while the growth of small and medium scale businesses as dependent variable was proxied by Gross Domestic Product. Time series econometrics estimation techniques were used to test the formulated hypotheses. The stationarity test revealed that all the variables of the study were stationary at first difference. Johansen co-integration test showed the existence of at least one co-integrating relationship at 5% level of significance. Vector Error Correction Model revealed that micro-finance bank credit had no short-run equilibrium significant relationship with growth of small and medium scale businesses in Nigeria. Causality test indicated that micro-finance bank credit had no causal relationship with growth of small and medium scale businesses in Nigeria. The study concluded that the activities of micro-finance institutions have not significantly contributed to the growth and development of small and medium scale businesses (SMBs) in Nigeria.

Aremu, Babalola, Aninkan, and Salako (2020) investigated the impact of government expenditures on critical sectors on economic growth in Nigeria (1984-2019). The study employed Autoregressive Distributed Lag model (Bound Test Co-integration Approach) to estimate both short and long run impact of Government expenditures on economic growth. The result revealed that government expenditure on defence impacts negatively on economic growth while government expenditure on agriculture enhances economic growth. Government expenditure on education, transport and communication did not impact on economic growth in the long-run.

Basil (2014) seeks to analyze the effect of fiscal policy on capital formation in Nigeria. The major Objective of the study is to ascertain the extent fiscal policy measures have improved or otherwise the quantum of capital stock available for investment, consumption, and savings purposes. The problem is that the desired capital stock for investment has fallen short of the actual quantum required for such purposes despite the fiscal policy measures put in place to stimulate the desired quantum. The objectives and hypotheses could be tested and empirically investigated using the multiple regression model and correlation analysis. The t-test statistic was used to test the effect of the explanatory variables on the dependent variable. Data is gotten through both primary and secondary sources. Most secondary data is gotten from the Central Bank of Nigeria Statistical bulletin of various issues. The study recommends that domestic prices, exchange rate, interest rate and other macroeconomic indicators should be fine-tuned to desired magnitudes to enhance the efficacy of the fiscal policy tools in boosting capital formation.

Bennett, Anyanwu, and Kalu (2015) examined the impact of industrial development on Nigeria's economic growth from 1973 to 2013. The model explained that the influence of industrial output on economic growth is not statistically significant, even though the sign obtained from its àpriori expectation is positive but not strong enough. Savings have a positive relationship with the economy and have a significant impact on it. Inflation has a negative impact on economic growth, whereas net foreign direct investment has a positive impact. Rsquared indicates a 76% increase in GDP. Chukwuedo, and Chukwunonso (2016) investigated the impact of financial deepening and domestic investment in Nigeria. To test the causality between the two variables, the Granger Causality test and OLS were used. A unidirectional causality between financial deepening and investment in Nigeria was discovered, with the causality running from the former to the latter. Furthermore, the report shows that financial deepening has a significant impact on Nigerian domestic investment.

Edekin Julius (2020) examined the relationship between Gross Fixed Capital Formation (GFCF) and Interest Rate in Nigeria, South Africa, Mauritius, Botswana and Egypt between 1980 and 2018. The finding from the trend analysis and the empirical evidence shows that the explanatory variables have positive and significant relationship with Gross Fixed capital formation however, the correction of the distortion in the short run to return to equilibrium on the long run differ significantly from country to country. The result revealed that Nigeria (9.6%) has the highest rate of macroeconomic sped of adjustment followed by Botswana (4.2%, Egypt (4.0%), Mauritius (3.3%) and South Africa (2.5%) respectively.

Ekpo, Daniel and Okon (2022) employed modified and extended aggregate production model to examine the effects of government expenditure at its' aggregate level on economic growth in Nigeria for the period (1981-2018) using bound test (ARDL) approach. The co-integration result indicates the existence of long-run relationship between total government expenditure (LTGE) and economic growth in Nigeria, ARDL results show that total government expenditure (LTGE) impacted positively on economic growth in Nigeria in line with Keynesian theory. The granger causality test result indicates the existence of uni-directional causal relationship from LGDP to LTGE for the observed period, in line with Wagner's theory. It is recommended that there should be proper utilization of public fund in the provision of security and critical infrastructure especially electricity supply and road infrastructure which are precursors to effective economic performance. Public fund should be properly managed to ensure accountability, transparency and fiscal responsibility in carrying out public assignment. It is believed that if corruption is tackled in the country, more public fund will be freed for development and public expenditure would impact more on the economic performance, hence, the fight against corruption in the country should be frontally confronted. Public institutions charged with the responsibility of handling corruption matters in the country should be overhauled and strengthen to ensure timely and proper handling of corruption matters.

Endurance, Ekomabasi, Ofonime and Moses (2022) examined the impact of fiscal policy on economic growth in Nigeria over the period 1970 to 2019, using annual data obtained from secondary sources. Specifically, the study examines the impact of government expenditure (capital and recurrent) on Nigeria's gross domestic product in regulated and deregulated fiscal regime. The econometric techniques of ARDL and Bound Cointegration were used to analyze the data. The results obtained from the analyses show that government capital expenditure had a significant negative relationship with economic growth in Nigeria in the deregulated period but an insignificant effect in the regulated period; while government recurrent expenditure had a significant positive relationship with economic growth in Nigeria in the deregulated period and an insignificant effect in the regulated period. The regression coefficient of the dummy variable (Regime) was positively signed and significant implying that there is a significant difference in the impact of fiscal policy across the two periods (regulation and deregulation). Thus, the study concluded that fiscal policy is more effective in the deregulated period compared the regulated period. Among the recommendations of this study are that the government should avoid extravagant capital expenditure

Ganchev and Todorov, (2021) examined three fiscal instruments- direct taxes, indirect taxes and government spending in EU countries with the ARDL method for the period 1999-2020. They proved that fiscal instruments could be used to stabilize Bulgaria's growth in the short run, but they are neutral in the long run. Direct tax revenue, government consumption, and indirect tax revenue are highly effective and can be used as tools for invigorating and stabilizing Bulgaria's private investment in the short run. Gbenga (2020) used Dynamic Ordinary Least Squares (DOLS) and pairwise Granger causality techniques to determine the role of foreign direct investment (FDI) in stock market development in Nigeria from 1981 to 2018. According to empirical findings, FDI plays a positive and significant role in the development of Nigeria's stock market. This study concludes that FDI is a catalyst for stock market development in Nigeria, implying that FDI plays a complementary role in the stock market. As a result, the Nigerian government should ensure an investor-friendly macroeconomic framework and implement policies to encourage FDI inflows into the country.

Gllogjani and Balaj, (2021) estimate the influence of the fiscal deficit on private investment in 6 countries of South-Eastern Europe. With the fixed-effects and dynamic linear regression and data, the study confirms that fiscal deficit and private investment for the transition economies of Southeast Europe, supporting the Keynesian theory. The main findings are that public debt, foreign direct investment, exports, and imports have a positive effect on private investment. They proved that public debt and imports have a positive influence on private investment, unlike exports and foreign direct investment, which showed an adverse effect on private investment.

Gurdal et al. (2021) studied fiscal policy in G7 countries (Canada, France, Germany, Italy, Japan, the UK, and the USA) and used annual data for the 1980 to 2016 period. They confirm the positive effects of the taxation policies pursued by the G7 countries on private investment. The main finding is that the taxation policies to be implemented based on the economic conjuncture of G7 countries are a powerful financial tool with the potential to serve the economic objectives to be achieved. Akani and Ruth (2020) examined the effect of financial intermediation on Nigeria gross fixed capital formation from 1985-2018 Nigeria gross fixed capital formation was proxy for dependent variables while banking sector credit, banking sector deposit, savings prime lending and maximum lending rates was proxy for independent variables. Ordinary least square methods of cointegration, granger causality test, unit root test and Vector error correction model. The study found that financial intermediation can explain 47.1 percent variation on Nigeria gross fixed capital formation.

Yeboua (2019) explored the influence of financial development on augmenting FDI's growth effects across 26 African nations using a panel smooth transition regression model (PSTR), analysing data spanning from 1990 to 2013. The research indicated the necessity of a basic level of financial development to harness the growth-promoting benefits of FDI, urging policymakers to enhance the efficiency of financial systems to capitalize on FDI's economic advantages. Pradhan et al. (2019) delved into the diverse causal interactions among financial development, FDI, and economic growth within G-20 nations from 1970 to 2016, employing a vector error correction model. Their findings revealed a variable short-term relationship among these elements but underscored the critical role of FDI and financial development in driving long-term economic growth, advocating for the development of robust and efficient financial systems alongside facilitating foreign capital influx to spur economic expansion.

3. METHODOLOGY

Ex-post facto research design was utilized because it enables exploring relationships between two or more variables. Secondary data were collected via Central Bank of Nigeria (CBN) Statistical bulletin. The study utilizes the secondary source because it provides a basis for purposeful research work and also gives a direction for the research work. The main tool of analysis is the Ordinary Least Squares (OLS) using the multiple regression method for a period of 35 years, annual data covering 1990– 2024. Statistical evaluation of the global utility of the analytical model, so as to determine the reliability of the results obtained were carried out using the coefficient of correlation (r) of the regression, the coefficient of determination (r^2), the student T-test and F-test. Justification of Methods and Techniques the technique deployed for this study is based on the parametric tool. A multiple regression tool has been preferred because it assists the researcher in ascertaining the relationship between the fiscal diversification and economic growth in which the Gross

Domestic Product (GDP) has been used as indices of economic growth significantly influenced by other independent variables of the fiscal diversification. Overall the technique is appropriate for achieving the set objectives of the study. One of the merits of the model is because it produces optimal results in predicting numeric output when properly structured.

Model Specification

The model for this study is based on fiscal policy theory of the Keynesian's economists. The current study considers the following model when estimating the effect of fiscal policy on foreign direct investment in Nigeria.

FDI = ***f (PSC, CPSC, DM, ITR)*** (1)

$$FDI = \beta_0 + \beta_1 PSC + \beta_2 CPSC + \beta_3 DM + \beta_4 ITR + \mu \quad (2)$$

Where

FDI = Foreign direct investment

PSC = Private sector credit

CPSC = Core private sector credit

DM = Deposit mobilization

ITR= Real interest rate

β_0 = Regression Intercept

β_1 - β_6 = Coefficient of the independent variables to the Dependent variable

μ = Error term

Data Analysis Method

The technique used in this study is the Ordinary Least Square (OLS) estimation technique. The test instruments in the OLS are the T-statistics and F-test which were used to test the significance of variables and the overall significance of the regression respectively. Other test instruments also employed were the Durbin Watson test which was used to test the presence or absence of auto correlation between and among the explanatory variables and the adjusted R square used to test the percentage variation of the dependent and the independent variables.

4. ANALYSIS AND DISCUSSION OF FINDINGS

4.1 Presentation of Results

Dependent Variable: FDI

Method: Least Squares

Date: 04/10/26 Time: 11:12

Sample: 1990 2024

Included observations: 35

Variable	Coefficient	Std. Error	t-Statistic	Prob.
PSC	0.963450	0.455887	2.661761	0.0117
CPSC	1.409412	0.617599	2.871299	0.0022
DM	0.513704	0.436939	1.975690	0.0445
ITR	-0.001476	0.023398	-0.063080	0.9508
C	1.375372	2.457415	0.559683	0.5869
ECM(-1)	0.672725	1.931395	0.348311	0.7342
R-squared	0.730128	Mean dependent var		5.51E-16
Adjusted R-squared	0.529662	S.D. dependent var		0.103337
S.E. of regression	0.147221	Akaike info criterion		-0.730405
Sum squared resid	0.238413	Schwarz criterion		0.157020
Log likelihood	29.95608	Hannan-Quinn criter.		-0.446510
F-statistic	14.18672	Durbin-Watson stat		2.191352
Prob(F-statistic)	0.000000			

Source: Extract from E-view 12.0

The regression result in the above Table 4.1 showed the relationship between financial intermediation and inflow of foreign direct investment in Nigeria. The R-squared value of 0.529662 explains that 52.2% of the variation in the independent variables explained the

dependent variable while 47.8 % of independent variables not included in this study explains the dependent variable. It furthers explains that the variables used in predicting the dependent variables are almost average appropriate which led the f-statistics probability value of 0.000000 revealing the significance of the model to this study. The Durbin Watson value of 2.191352 shows there is no evidence of autocorrelation among the variables specified for the study. The estimated model further found that private sector credit, core private sector credit and deposit mobilization have positive and significant relationship with inflow of foreign direct investment while interest rate have negative and no significant effect on inflow of foreign direct investment, the constant values explains the autonomy behaviour of the predicted value as it shifts upwards away from zero closer to one as revealed in the value 1.375372.

4.2 Discussion of Findings

The regression result found that 52.2% of the variation in the independent variables explained the dependent variable while 47.8 % of independent variables not included in this study explains the dependent variable. The estimated model further found that private sector credit, core private sector credit and deposit mobilization have positive and significant relationship with inflow of foreign direct investment while interest rate have negative and no significant effect on inflow of foreign direct investment, the constant values explains the autonomy behaviour of the predicted value as it shifts upwards away from zero closer to one as revealed in the value 1.375372. findings of this study is in line with empirical investigation of financial development and economic growth shows that financial development positively and significantly impacts the economic growth of Asian economies (Patra & Sethi,2023).

Sethi et al. (2023), shows that trade openness, foreign aid, Financial Development, and foreign direct investment have a significantly positive impact on the economic growth of emerging Asian economies. With panel data from 120 countries from 1997 to 2017, and estimated using the System GMM technique, Wen et al (2021), analyses the impact of financial development on economic growth, inflation and employment. Their empirical results reveal that financial development have a significant negative impact on economic growth. Peprah et al (2019) showed that the joint effect of financial development and remittances on economic growth is higher than their individual effects, and the threshold effect of financial development on economic growth suggests that over-expansion of the financial sector could have negative consequences on growth. Most studies like Adekunle et al, (2013), Asongu (2019), Rahman, Khan, & Charfeddine (2020), Ustarz & Fanta (2021) Chettri (2022), Poghosyan (2022), Oyadeyi (2023) support a positive effect of financial development on economic growth. Other studies like Akintola et al (2020) observed a negative relationship between financial development and economic growth. Ang, (2010), Ibhagui, (2019; Ciobanu, (2020); Yusuf et al (2020), Burlea-Schiopoiu et al., (2021); Orji

et al., (2021); Okeke and Chinanuife (2022); Yimer, (2023); Mwakabungu & Kauangal, (2023) showed positive long run effect of foreign direct investment on economic growth.

5. CONCLUSION AND RECOMMENDATIONS

5.1 Conclusion

This study examined the relationship between financial intermediation and inflow of foreign direct investment in Nigeria. The estimated model found that 52.2% of the variation in the independent variables explained the dependent variable while 47.8 % of independent variables not included in this study explains the dependent variable. The estimated model further found that private sector credit, core private sector credit and deposit mobilization have positive and significant relationship with inflow of foreign direct investment while interest rate have negative and no significant effect on inflow of foreign direct investment, the constant values explains the autonomy behaviour of the predicted value as it shifts upwards away from zero closer to one as revealed in the value 1.375372. From the findings, the study conclude that private sector credit has a significant impact on the dependent variable inflow of foreign direct investment since its value is less than the 5% statistical level, Core private sector credit has a significant impact on the dependent variable inflow of foreign direct investment since its value is less than the 5% (0.05) statistical level, That the independent variable deposit mobilization has a significant impact on the dependent variable inflow of foreign direct investment since its value is less than the 5% (0.05) statistical level, that the independent variable interest rate has no significant impact on the dependent variable inflow of foreign direct investment since its value is less than the 5% (0.05) statistical level.

5.2 Recommendations

i. Based on these findings from the long run, the study recommends that the Central Bank of Nigeria should enact reforms that must be directed at improving the quality of financial development indicators and its services to meet the needs of foreign and domestic investors and the economy at large. These include policies that will check the activities of banks management who launder the facilities meant for investors for private gains.

ii. Efforts should be directed at the removal of impediments that block the short-term and long-term linkage between financial development and foreign and domestic investment in Nigeria.

iii. The government should endeavour to create an enabling environment and provide infrastructural facilities for foreign and domestic investment performance to thrive given any global economic shocks and to improve economic productivity in Nigeria.

iv. Government institutions should embrace rigorous policy evaluations and impact assessment in lowering the cost of governance and deficit financing to reduce the negative effects of inflation in the short and long run. That is, before implementing new policies, government institutions should conduct thorough evaluations and impact assessments to identify potential shocks or unintended consequences and incorporate measures to mitigate these risks thereby providing macroeconomic stability when necessary.

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