



The Role of Regulatory Reforms in Enhancing Capital Formation: Evidence from Nigeria's Ease of Doing Business

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Abstract

The study seeks to examine whether regulatory reforms impact capital formation in Nigeria. Regulatory reforms have featured prominently in development programs and policies of developing economies over time as government seek quick fix to improving investment climate and capital accumulation. Regulatory reforms that Nigeria has experienced overtime appear not to have been effective as investment has continued to be weak and volatile over time. This raises question on how regulatory reforms translate to improve investment climate thereby impacting capital accumulation in the country. The study therefore seeks to establish both short- run and long- run effects of regulatory reforms on capital formation using ARDL estimator for period 1991 to 2024. The empirical results confirm long- run relationship among variables studied and indicate that ease of doing business significantly affect capital formation in Nigeria in long-run. On the contrary, results on short- run relationship between regulatory reforms and capital formation does not indicate significant relationship. The negative and statistically significant error correction term indicates that about 52.5 percent of short run deviation from long run equilibrium is corrected yearly. Fiscal variables such as inflation are also found to have important role to play in capital formation. The study concludes that regulatory reforms influence capital formation through long- run institutional effect and not short- run effect. Continuous improvement on regulatory efficiency as well as development in the financial sector reforms is highly recommended.

Keywords: ARDL, Capital formation, Ease of doing business, Investment, Regulatory Reform.

1. Introduction

Capital formation plays an important role in economic growth and development. Theoretically and empirically, an increase in capital formation leads to increased productivity, technological advancement, employment generation, and sustainable economic growth (Solow, 1956). Developing economies such as Nigeria suffer severe investment gaps that negatively affect the standard of living. However, capital accumulation remains a problem in Nigeria as it has not met expectations in recent years. Studies reveal that gross fixed capital formation levels have ranged from lows of 5% to highs of over 30% of GDP yearly without significant effects on growth rates (Abina & Mogbeyiteren, 2021; Akinboade & Kinfack, 2022). Thus, Onwiodiokit & Otolurin (2021) show that Nigeria cannot accumulate enough capital consistently to guarantee sustained economic growth rates. This failure is attributed to poor and weak institutions.

New institutional economics explain “ease of doing business” through regulation quality or efficiency in

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allowing entrepreneurs to set up and run businesses. For example, when investors face high taxes with cumbersome processes for obtaining credits, registering businesses, paying taxes, repatriating profits, and so on, this would fuel the cost of doing business, thereby affecting returns on investment. Ease of doing business also affects the incentives of entrepreneurs at home and abroad to invest. When it is easy to set up businesses, obtain credit from banks, license, register, and pay relatively low lending rates, the cost of transactions is low, uncertainty is reduced, and returns on investments are higher. As a result, investors are incentivised to increase capital formation, thereby increasing output and income (North, 1990; Acemoglu & Robinson, 2012; World Bank, 2020).

The persistent shortfall in capital formation has sparked several debates on regulatory policies and concerns about their capacity to promote capital formation, especially in Nigeria. Since regulators implemented regulatory reforms to improve Nigeria's ease of doing business over the past decade, critics argue that capital formation has not significantly improved. For example, some reforms aimed at making it easy to register businesses and access finance have not addressed fundamental issues confronting investors and have experienced limited success (Sike, Ibrahim & Maitala, 2021). High-interest rates charged by banks on loans,

inflation, unstable policies, multiple taxation, corruption, and inadequate power supply infrastructure are problems facing businesses trying to raise equity or debt to finance investments (Eze et al., 2022).

One major debate is whether Nigeria has done enough or should deregulate further to promote capital formation. Supporters of further deregulation argue that Nigeria has not done enough to make it easy to do business. According to Okeke et al. (2021), reforms that have been implemented thus far, including amendments to Companies and Allied Matters Act (CAMA), and introduction of National Single Window for trade facilitation, will gradually increase capital formation by reducing bureaucratic bottlenecks involved in registering businesses and promote transparency. They posit that Nigeria should be commended for implementing policies that have improved its ranking on the World Bank's Ease of Doing Business. Critics of this argument, such as Structural Reform Advocates, Industry Experts and Entrepreneurs, as well as Economists and Business Analysts however, submit that Nigeria may have done enough regulatory reform but is focusing on the wrong things. They added that nothing significant has changed with these reforms as they affect ease of doing business but fail to tackle the structural problems associated with capital formation in Nigeria. Corruption levels, poor policy consistency, and enforcement in Nigeria are still high, according to Alimi et al. (2023). They argue that passing new laws that make it easy for investors to carry out businesses does not help if they are weak and not enforced consistently.

Furthermore, deregulation critics also argue that regulation changes are making life easy only for registering businesses. Nigeria is yet to address fundamental macroeconomic variables affecting investment decisions. For instance, despite improvements in the business climate, electricity remains unstable, road networks are still terrible, and inflation is high. Adeleye et al. (2023) insist that no amount of regulation change will promote capital formation until these fundamental problems are fixed. In Nigeria, banks cannot provide long-term capital at affordable lending rates. Therefore, others argue that regulatory reform that makes it easy to do business will have limited effects on increasing capital formation.

In contrast to the previous argument, some scholars opine that regulatory reforms have contributed to improving capital formation in Nigeria and will continue to do so if aligned with the right policies. They argue that regulatory reforms promoting Nigeria's ease of doing business are needed although not sufficient conditions for increasing capital formation. For instance, by pushing forward with regulatory reforms that align with its African Continental Free Trade Area (AfCFTA), commitment and regional integration schemes, capital flows into the country may increase as doing business in Nigeria becomes relatively more accessible than its African counterparts (Akinboade & Kinfack, 2022; Eze et al., 2022). Therefore, it can be

said that there is no definite answer to whether regulatory reforms promoting ease of doing business help improve capital formation in Nigeria.

The remaining sections of the study are; section two which reviews existing literature on capital formation and regulatory reforms, section three describes the methodology employed in this study, while section four discusses and interprets the results. Section five concludes with recommendations for policymakers.

2. Literature Review

Capital formation has gained importance in the current discourse surrounding regulatory reforms that affect ease of doing business. Regulatory reforms have been shown by many authors to have varying degrees of influence on investment decisions that ultimately affect capital formation. Furthermore, capital accumulation has been an established factor of production that leads to economic growth in classical growth theories like that of Solow (1956). This reality remains true even in developing economies like Nigeria, where weak institutions and unfavourable regulatory environments constrain capital accumulation irrespective of savings, investments, and other conventional factors (Akinlo, 2004; Iyoha, 2009). More recent studies have expanded this idea by focusing on improving regulatory environments through ease of doing business reform policies.

Measuring regulatory processes that affect entrepreneurship and investment have been standardised with the ease of doing business score created by the World Bank group. Djankov et al. (2002) opined that complicated regulatory reforms burden businesses and stifle investments while predictable and less stringent regulations encourage investment and lead to capital formation. Furthermore, inclusive economic institutions guarantee property rights and protect individuals from unclear regulations that increase transactions costs thereby encouraging capital accumulation and growth (Acemoglu and Robinson, 2012). In Nigeria, however, the influence of ease of doing business regulatory reforms on capital formation remains controversial. In recent times, the Nigerian government has implemented regulatory reforms in its bid to improve business regulations as captured in world bank's doing business report. These regulatory reforms have been documented to have improved FDI flows into the Nigerian economy and improved growth outcomes in Nigeria (Adegboye & Iweriebor, 2018; Enejoh et al., 2020). However, these reforms have had little to no influence on capital formation in Nigeria. Although reforms were able to achieve meaningful improvement in Nigeria's ease of doing business ranking as argued by Akinlo & Egbetunde (2010), regulatory bottlenecks, corruption, and poor enforcement of regulations remain prevalent. Foreign investments continue to be concentrated in speculative markets while growth in domestic investments has been hampered by monetary

policies and credit constrains leaving capital formation unstable and unpredictable.

Institutional reforms are often left out in capital formation studies that focus on macroeconomic factors such as savings rates, inflation, and interest rates (Iyoha & Ekanem, 2002; Bakare, 2011). However, recent works have shown that weak institutions are what determine how these macroeconomic factors influence capital formation in Nigeria. Authors such as Abina and Mogbeyiteren (2021) and Akinboade and Kinfack (2022) have shown how poor regulatory enforcement and weak institutions stifle capital accumulation in Nigeria regardless of flexible regulatory reforms that improve Nigeria's ease of doing business ranking. Foreign direct investments have been shown by many authors to influence capital formation. Yet authors like Sike, Ibrahim, and Maitala (2021) argue that Nigeria's inability to absorb these investments translates to unused capital that fails to affect capital formation in Nigeria. Local investors have also enjoyed certain benefits from improved regulations yet face headwinds from inflation, high lending rates, and credit when trying to access capital affecting capital accumulation negatively (Eze et al., 2022).

Existing literature has failed to empirically establish how Nigeria's regulatory reforms captured in its ease of doing business ranking. Although individual factors that make up ease of doing business such as quality of regulations and effects of foreign investments have been studied, a study that focuses on how Nigeria's ranking of ease of doing business has affected investment and capital formation has not been conducted. While certain studies show that these factors improved under Nigeria's current government, a comprehensive study of how these reforms affected capital formation has not been done. Hence, this study evaluates the impact of regulatory reforms on capital formation in Nigeria, focusing on improvements in the business environment, with a guiding research question of; how do regulatory reforms in Nigeria impact capital formation and contribute to improvements in the country's ease of doing business ranking?

3. Methodology

Building on the North, 1990, capital formation is modeled as a function of the ease of doing business and selected control variables commonly identified in the literature. The study use time series data from 1991 to 2024 to ascertain the relationship between the variables of interest. The Central Bank of Nigeria (CBN) and the World Development Indicators (WDI) provided the data. The relationship between dependent and independent variables is examined using the Autoregressive Distributed Lag (ARDL) approach. Thus, theoretically;

$$EP = I_{\alpha} - \beta TC + \gamma PR \quad (1)$$

α, β, γ are weights reflecting the relative importance of each factor

Institutions (I) improve performance by shaping incentives.

Transaction costs (TC) reduce performance when they are high.

Strong property rights (PR) enhance performance by encouraging investment and innovation.

$$\begin{aligned} \Delta gfcf_t = & \delta_0 + \sum_{i=1}^n \delta_{1i} \Delta gfcf_{t-i} + \sum_{i=0}^n \delta_{2i} \Delta eodb_{t-i} + \sum_{i=0}^n \delta_{3i} \Delta gexp_{t-i} + \\ & \sum_{i=0}^n \delta_{4i} intr_{t-i} + \sum_{i=0}^n \delta_{5i} infr_{t-i} + \sum_{i=0}^n \delta_{6i} fdi_{t-i} + \\ & \gamma_1 gfcf_{t-1} + \gamma_2 eodb_{t-1} + \gamma_3 gexp_{t-1} + \gamma_4 intr_{t-1} + \\ & \gamma_5 infr_{t-1} + \gamma_6 fdi_{t-1} + \mu_t \end{aligned} \quad (2)$$

With respect to the variables mentioned above, δ_0 represents the intercept; $\delta_1 - \delta_6$ and $\gamma_1 - \gamma_6$ short-run and long-run elasticities respectively; μ_t represents error term; Δ denotes the difference operator; and n denotes the lag length.

3.1 Estimation Technique

Autoregressive Distributed Lag model (ARDL) was employed in the study. The technique of ARDL became essential for the study because it can simultaneously establish short run and long run relationship at a time. More so, ARDL is superior to Johansen co-integration based on mixed stationarity level that is; I(0) and I(1) but must not be I(2).

3.2 Unit Root Test

Prior to testing for cointegration, the time series properties of the variables need to be examined. The study made use of Augmented Dickey-Fuller (ADF) test for unit root regression test which was estimated.

$$\Delta Y_t = \alpha_0 + \beta Y_{t-1} + \varphi_1 Y_{t-1} + \varphi_2 Y_{t-1} + \varphi_3 Y_{t-1} + \varphi_4 Y_{t-1} + \varphi_k Y_{t-k} + \varepsilon_t \quad (3)$$

where Δ is the difference operator, Y_t the series to being tested, k is the number of lagged differences and ε_t is error term. The standard Augmented Dickey-Fuller (1979) test for a unit of null hypothesis $H_0: \delta = 0$ against the one side alternative, $H_1: \delta < 0$ in the regression). Under the null hypothesis Y_t has a stochastic trend; under the alternative hypothesis Y_t is stationary. The ADF statistic is the OLS t-statistic testing t-statistic $\delta = 0$. The lag length k can be estimated using the BIC or AIC (Stock & Watson, 2003). The rule of thumb stated that the series must be mixed with I(0) and I(1) and significant at either 1%, 5% and 10%. ARDL estimated the long run relationship in the model. To do this, Autoregressive-distributed lag (ARDL) model was employed (Pesaran et al., 2001). The rule of thumb was that should the F-statistic exceeds the upper critical bounds value, then the H_0 (null hypothesis) is rejected; should the F-statistic falls between the bounds, it is inconclusive and should the F-statistic falls below the lower critical bounds value, it is no co-integration. When long-run relationship exists, the F-test indicates which variable should be normalised.

Table 1: Measurement and Definitions of Variables

Variable	Measurement	Justification	Source
Capital Formation (gfcf)	Gross Fixed Capital Formation (% of GDP)	Captures investment in physical assets such as infrastructure, machinery, and equipment; widely used proxy for capital accumulation	WDI, 2024
Ease of Doing Business (eodb)	Ease of Doing Business Index / Rank (inverse-adjusted)	Measures regulatory efficiency and institutional quality affecting investment decisions	World Bank (Doing Business), 2024
Government Expenditure (gexp)	Total government expenditure (% of GDP)	Public investment and spending influence private investment decisions	WDI, 2024
Interest Rate (intr)	Real lending interest rate (%)	Cost of capital; higher rates may discourage investment	CBN, 2024
Inflation Rate (infr)	Consumer Price Index (annual %)	Measures macroeconomic instability affecting investment confidence	WDI, 2024
Foreign Direct Investment (fdi)	Net FDI inflows (% of GDP)	Reflects foreign capital contribution to domestic investment and capital formation	WDI, 2024

Source: Authors' Compilation 2026

Table 2: Descriptive Statistics

Variable	Mean	Median	Max	Min	Std. Dev.	Skewness	Kurtosis
gfcf	5.157	5.355	6.077	3.707	0.687	-0.593	2.215
fdi	0.706	13.007	72.836	5.388	15.869	2.071	6.496
infr	-0.755	-0.36	1.87	-5.19	1.706	-0.996	3.358
eodb	2.658	2.815	3.36	1.381	0.534	-0.973	3.038
intr	37.737	39.279	53.278	20.723	10.252	-0.08	1.742
gexp	22.937	20.568	90.028	0.239	21.108	1.061	4.218

Source: Authors' Computation 2026

Table 3: Correlation Matrix

Variable	gfcf	fdi	infr	eodb	intr	gexp
gfcf	1					
fdi	-0.4840	1				
infr	-0.4492	0.0335	1			
eodb	-0.5290	0.4105	0.2258	1		
intr	-0.7048	0.1545	0.4701	0.5599	1	
gexp	0.7022	-0.3871	-0.3228	-0.6563	-0.7463	1

Source: Authors' Computation 2026

4. Results and Discussions

The descriptive statistics show that capital formation has a high mean and wide standard deviation, meaning that substantial disparity in capital formation while government expenditure exhibits variability, which indicate unreliable fiscal spending patterns. Ease of doing business has a relatively low standard deviation indicating gradual institutional changes over time. Interest rate shows notable volatility suggesting frequent monetary policy adjustments while foreign direct

investment has a relatively low mean with high variability emphasising unstable inflows.

Table 3 shows a no potential multicollinearity problems since the coefficients of the independent variable are ≤ 70 .

Table 4: Augmented Dickey-Fuller Test (Unit Root test)

Variable	Level (Const)	First Diff. (Const)	Order
gcfc	-3.796*** (0.003)	-4.635*** (0.031)	I(1)
eodb	-1.355 (0.604)	-5.593*** (0.000)	I(1)
fdi	-1.798 (0.391)	-5.612*** (0.000)	I(1)
infr	-2.210 (0.203)	-4.759*** (0.000)	I(0)
intr	-2.267 (0.183)	-6.928*** (0.000)	I(1)
gexp	-2.193 (0.209)	-6.570*** (0.000)	I(1)

Notes: *** p<0.01, ** p<0.05.

Source: Authors Computation 2026

Table 5: Bounds Test

Test Statistic	Value	Critical Values I(0)	Critical Values I(1)	Decision
F-statistic	5.44	2.62 (0.05)	3.79 (0.05)	Co-integration

Source: Authors Computation 2026

Table 6: ARDL Long Run

Variable	Coefficient	Std. Error	t-Statistic	P-value
gexp	0.2124	0.0915	2.32**	0.021
eodb	3.8427	1.5423	2.49**	0.014
intr	-0.0318	0.0196	-1.62*	0.106
infr	0.0246	0.0108	2.28**	0.023
fdi	-0.1874	0.1012	-1.85*	0.064
gexp	0.2124	0.0915	2.32**	0.021

Notes: *** p<0.01, ** p<0.05. p<0.10*

Source: Authors Computation 2026

The results of the Augmented Dickey-Fuller (ADF) unit root test (Table 4) indicate that the variables exhibit integration at varying orders, the mixed order of integration justifies the use of the ARDL approach, which accommodates variables integrated at I(0) and I(1).

The ARDL bounds test (Table 5) reports F-statistic of 5.44, which is greater than the upper critical bound at the 5% level, hence, leads to the rejection of the null hypothesis of no long-run relationship.

Estimates of long-run results as shown in Table 6 indicate that ease of doing business positively influences capital formation and is statistically significant. The result is both theoretically and empirically sound. Theoretically, drawing from the new institutional economics school of thought (North, 1990; Acemoglu & Robinson, 2012), when the cost of doing business

(regulatory efficiency) is reduced, incentives for investment improve through stronger protection of property rights and lower transactions cost leading to more capital accumulation. The result is in tandem with the view of Djankov et al. (2002) which posits that reduction in regulatory complexity and enhanced predictability brings about more entrepreneurial effort and investment.

The study is empirically consistent with the findings of recent studies such as Akinboade and Kinfaek (2022) and Eze et al. (2022) where regulatory improvements positively influence investment decisions and capital formation in emerging economies including Nigeria. It also confirms theoretical standpoint that institutional reforms will continue to play fundamental role in reversing Nigeria's growth- bust capital formation paradox (Abina & Mogbeyiteren, 2021).

Table 7: ARDL Short Run

Variable	Coefficient	Std. Error	t-Statistic	P-value
$\Delta gexp$	-0.2305**	0.1069	-2.16	0.033
$\Delta eodb$	0.0235	0.2088	0.11	0.912
$\Delta intr$	0.0109*	0.0059	1.84	0.069
$\Delta infr$	-0.0048***	0.0017	-2.80	0.006
Δfdi	-0.0018	0.0162	-0.11	0.912
ECT(-1)	-0.5248	0.2310	-2.27	0.026
Constant	0.2511	0.3980	0.63	0.530

Notes: *** $p < 0.01$, ** $p < 0.05$, $p < 0.10$ *

Source: Authors computation 2026

Table 8: Diagnostic Tests

Diagnostic	
Breusch-Godfrey (serial correlation)	0.4656
White test	0.4192
Breusch-Pagan (heteroscedasticity)	0.4547
CUSUMSQ (stability)	Stable

Source: Authors Computation 2026

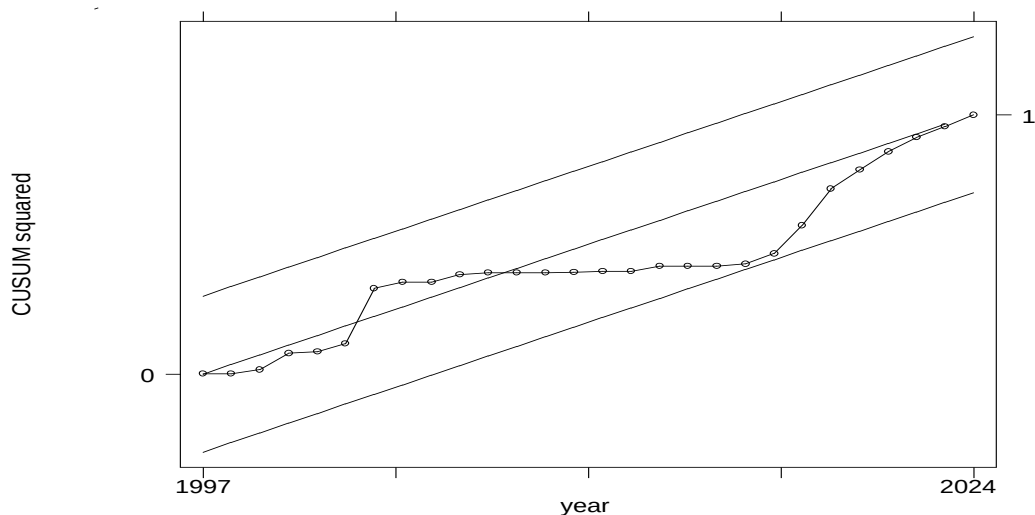


Figure 1: CUSUM Test

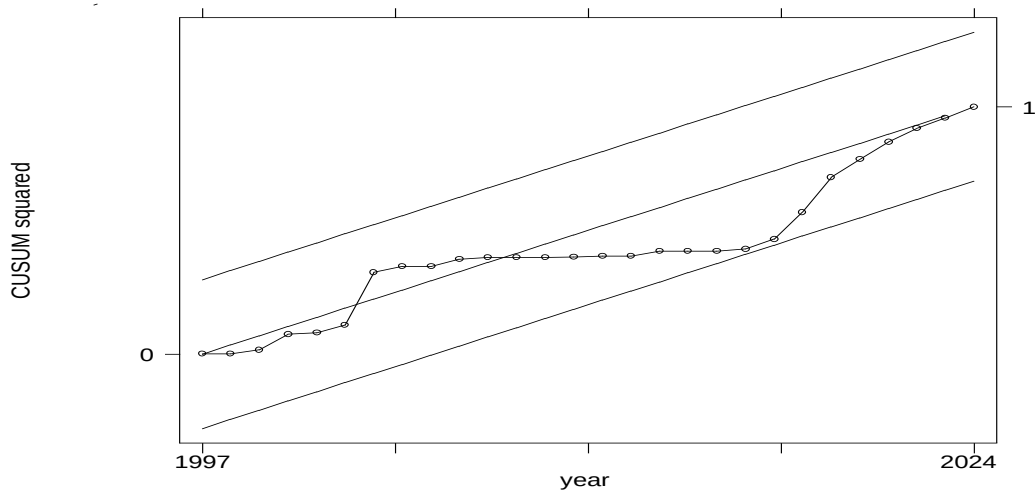


Figure 2: CUSUM Squared Test

Government expenditure and inflation significantly increase capital formation in the long run which is also empirically consistent. Theoretical and empirical literature on both variables shows that productive government expenditure crowds in private investment by improving the business environment for investors. However interest rate and foreign direct investment coefficient are only weakly significant which may imply structural failures in Nigeria's financial intermediation system and lack of absorptive capacity for foreign capital; a result consistent with recent studies (Eze et al. (2022), Adeleye et al. (2023)). Therefore, long-run results confirm the institutional argument found in extant literature.

Regulatory quality do not have significant effect on capital formation in Nigeria in the short run (Table 7). This implies that if there is any improvement on Nigeria regulatory reforms; it will take some years before it will have effect on investors' decision. In other word it has long- run relationship with capital formation which is what we expect since capital formation will be affected by institutional changes. Based on short-run result; capital formation in Nigeria is highly explained by monetary policy variables; Government expenditure is negative and statistically significant at 5%. This implies that capital formation is rather crowded out by government spending in the short-run. This could be because government spending may have been directed to areas that does not directly affect capital formation in the short-run.

Inflation is negative and significant. This implies that there is short- run effect of capital formation as the country experiences adjustment towards its long-run equilibrium because of inflation rate. Interest rate is weakly significant. This show that capital formation in Nigeria is insensitive to change in interest rate in the short-run. This may be because of institutional factors that are taken as rigid in the economy FDI is not significant in explaining capital formation in short-run. This implies that capital inflow that are in the form of foreign direct investment do not have immediate effect on domestic capital formation. This may be because some of the profit that will be used in financing capital formation is being repatriated abroad.

The coefficient estimate on ECT(-1) is negative (-0.5248) and significant at the 5% level. Hence, we conclude that there is evidence of long-run equilibrium relationship between ease of doing business and capital formation in Nigeria. It further shows that approximately 52.5% of disequilibrium in capital formation is adjusted each year to achieve long-run equilibrium path.

The diagnostic tests validate the accuracy of the estimated model. The Breusch-Godfrey test indicates the absence of heteroscedasticity, suggesting that the error terms exhibit constant variance. The CUSUMSQ (Figs. 1 and 2) test additionally verifies the model's stability throughout the study period. These results

confirm the model's robustness and affirm the reliability of both short-run and long-run estimates

5. Conclusion and Recommendations

To establish regulatory impact on capital formation, this study employs the ease of doing business regulatory reform index in the ARDL approach. The regression results show a distinction between long-run and short-run results. The positive and significant coefficient for ease of doing business regressor indicates that long-run capital formation improves with increase in regulatory reforms on improving business environment. It can be concluded that productive government spending and improved business regulatory environment promote capital formation in Nigeria. A good regulatory environment means less red tape which improves institutions and these are found to promote investment and capital deepening in Nigeria. Physical capital accumulation still matters in investment as government spending on infrastructure remains a driver of investment in the long-run. However, weak and positive coefficients on interest rate and the negative coefficient of FDI confirms widespread distortions in financial sector that make interest rate adjustments weak channels for stimulating investment and limited capacity to absorb foreign capital in the domestic economy.

The ease of doing business regulatory reforms does not have a statistically significant short-run effect on capital formation which implies that changes in the regulatory environment do not trigger investment activities in the short-run. With a negative and significant error correction term, we can conclude that capital formation, interest rate, government spending, and FDI are cointegrated. It follows that there is a stable long-run equilibrium relationship among capital formation and its regressors. Furthermore, since the coefficient of error correction term is -0.5248 it can be interpreted that approximately 52.5% of the short-run deviation from long-run equilibrium is corrected annually.

It is recommended that government should continue to implement policies targeted at improving the business regulatory environment in Nigeria through more reforms to deepen credibility and sustenance. Furthermore, government spending should be channeled more on productive ventures such as infrastructure development, provision of power and improved transportation which supports capital formation and private investment in Nigeria. Attention should also be given to improving the rate of infrastructure development in Nigeria. Nigeria's central bank should consider reforms that will deepen access to credit as adjustment in interest rates may not have strong impact on investment. Lastly, efforts should be made to encourage foreign direct investment that has stronger linkage with domestic economy to take full advantage of knowledge and technology spillovers that will enhance capital accumulation in the country.

Hence, the study concludes that while capital formation is affected by fiscal and productive factors in the short-run, long-run movements in capital formation are influenced by institutional indicators such as quality of regulations in Nigeria.

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