

Effect of Forex Volatility on the Pricing Decision Making Of Listed Manufacturing Firms in Nigeria

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Abstract

Decision making is an important aspect of management tasks in the face of uncertainty, this determines whether a company will be able to adequately manage its resources and generate profit. Such decisions can also influence the consumers which is seen in the constant complaints on the rise of product price in the Nigerian market which many blame on the volatility of foreign exchange. This study's objective is to check the level at which if any the effect of forex volatility on the pricing decision making of listed manufacturing firms in Nigeria. This study was carried out with the use of both primary data which consist of online questionnaires sent to cost management departments of the listed manufacturing firms and secondary data of 56 weekly moving average of foreign exchange from CBN bulletin. The study adopted the Structural Equation Modelling (PLS-SEM) is employed to analyse the data generated with the aid of Smart PLS 3.3 software package. The outcome of the study revealed that forex volatility only has a significant and positive effect on management prediction of customer perceived behaviour. This shows that management take important cognisance to the reaction of customers to foreign exchange rate when setting the price of their goods and service.

Keywords: *Forex volatility, Price, Pricing decision making, cost of production, profit margin customer perceived behaviour*

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I. Introduction

Volatility explains the measurement of the rate of changes and frequency of such changes. There are many instances when exchange rate volatility occurs some of which includes business dealings between parties from two different countries or the process of foreign direct investments.

Foreign exchange volatility describes the erratic movement in the price at which domestic currency is exchanged for foreign currency i.e., the appreciation or depreciation of the domestic currency in respect to foreign currency (Jacob et al., 2021). Foreign exchange volatility or Forex Volatility (FEV) can also be said to explain fluctuations in an economy's exchange rate, this affects the profitability of foreign exchange transactions and ultimately affecting firms' performance. The persistent high volatility in Nigeria commodity market (Okechukwu et al 2019) can be traced to volatility in forex prices which is driven by interest rate fluctuations, balance of payments and government intervention.

Movement in terms of volatility in Nigeria's Foreign exchange is evident, for example, in 1998, Nigeria experienced a significant rise in exchange rate volatility this could be partially attributed to the re-emergence of the country back into democracy (World bank, 2022). This caused a significant shift from the fixed exchange rate to the flexible exchange rate. Under the flexible exchange rate, the apex bank attempted to devalue the naira, thereby stabilizing exchange rates movement, this affected both nominal and real exchange rates leading to a sporadic rise between 2000 and 2006. This rise peaked around 2007 before a decline. From 2010 to 2020 the volatility of the rate can be said to be quite unpredictable.

The unpredictability of forex in Nigeria at the macro trickles down to the micro level ie firm specific level as the issue of at what price should producers set their products becomes apparent. Pricing as defined by (Byjus, 2021) is the process of fixing the value that a manufacturer will receive in the exchange of services and goods. Pricing decision is the managerial choices business makes when setting price for their products and services. This procedure is considered a company's management strategy as it affects its relationship with customers, its competitiveness and ultimately its profitability. Pricing decisions can be simple or complex depending on the management strategy to be adopted however the notable starting point for any manager when

assigning price is the cost attributable to the goods as the aim of setting a price is to achieve a predetermine profit margin (ROI).

The crux of the problem can be said to be traced to the introduction of the SAP (structural adjustment programme) in 1986, Nigeria has experienced massive fluctuations in its foreign exchange movement. This can be attributed to the foreign exchange policies that followed the introduction of SAP, Devaluations and shrinking of the Nigerian naira (Olatunde & Jacob, 2019). This has led to an increase in the cost of production, inflation and general loss of value in the nation's currency which invariably affects the economic landscape of the Nigerian manufacturing industry. The Manufacturing industry in Nigeria relies on more than 80% of its raw materials from import channels (Chinedu Uzochukwu & Uchenna Emmanuel, 2014). The weakness of the local currency as a result of the volatility in the foreign exchange will impact cost of production, setting a required predetermined margin (ROI) hence affecting the prices set on goods and services which could affect the perceived value of the product by the final consumer. It must be noted that hedging facilities are available to these manufacturing companies however, in the face of clear weaknesses of the Nigerian financial hemisphere and lack of robustness in the money market when compared with our foreign counterparts it is argued by some scholars to the extent at which hedging facilities are available to managers in the Nigerian manufacturing ecosystem (Dornubar & Victoria, 2021). This results in a problem for consumers as manufacturers tend to set their prices to offset the consequences of volatility in the exchange rate thus causing an undesirable increase in cost of goods in the Nigerian market and further increasing the hard ship of an already stretched out populace.

The phenomenon of foreign exchange volatility and pricing decision as it affects the setting of prices of goods/services in the manufacturing sector has not been studied. There are more works of literature on foreign exchange rate volatility as it affects or impacts various macroeconomic components like Export volume (Saqib & Sana, 2012), Manufacturing growth sector (Abdulwahab Sulaiman et al., 2019) and International Trade (Ikechi & Anthony, 2020). This paper endeavour to look at exchange rate volatility from the perspective of management accountants and ask fundamental questions as to what extent does the movement in the foreign exchange contribute to the decision-making factor of how managers of listed manufacturing companies in Nigeria set and construct their pricing regime for their goods.

Objective of the study

The main objective of this paper is to examine the impact of Forex volatility on the Pricing decision making of listed manufacturing firms in Nigeria. To achieve the main objectives of the paper the specific objectives are to:

- I. examine the effect forex volatility on movement in the cost of production decision in listed manufacturing companies in Nigeria
- II. assess the impact of forex volatility on the determination of the required rate of return decision of listed manufacturing companies in Nigeria
- III. Evaluate the effect of forex volatility on customer perceived value of products of listed manufacturing companies in Nigeria

Statement of Hypotheses

The following hypotheses will be tested in this study

H₁: There is no significant effect of forex volatility on the determination of the cost of production of listed manufacturing firms in Nigeria

H₂: Forex volatility has no significant effect on the determination of the required rate of return of listed manufacturing firms in Nigeria

H₃: There is no significant effect of Forex volatility on the prediction of customers perceived value of products of listed manufacturing firms in Nigeria.

II. Literature Review

Exchange rate is the major medium by which international economic activities are carried out. Most if not all economies in the world today operate an open economy, which allows for interaction with other economies. These interaction results in the flow both in and out of goods and services with exchange rate being the soul connector and channel through which their economies carryout transactions and business in those goods and service. Therefore, exchange rate can be defined as the medium and price by which domestic currency is exchanged for another country's currency for the purpose of movement of goods and services from one country to another. There is a need to appreciate the connection between movement in exchange rate and the price of goods and service as it helps to determine the economic viability of a particular sector, in this case the manufacturing sector of Nigeria.

Foreign exchange or Exchange rate volatility refers to the rate at which the value of a currency changes from one period to the next; this usually indicates an appreciation or depreciation in the value (real and nominal) of the domestic currency to its foreign traded counterpart. Nigeria's adoption of a flexible exchange rate regime

in the 1990s and early 2000s has increased foreign currency exposure on the economy hence there is more volatility in the foreign exchange market. Exchange rate volatility shows an imbalance in the Forex market; this is usually determined by numerous economic factors some of which are inflation, interest rate and government policies. The erratic nature of the foreign exchange makes pricing decisions for companies difficult as there is no consistent trend for pricing decision. For instance, the rise in US Dollar and Euro against other currencies makes it hard to determine how much profit or loss will be incurred and hence, influences their pricing decisions. The higher costs of hedging means that companies have been forced to raise prices as a result profit are lower due to impact of FX Volatility on price inflation.

Currency devaluation has been proven to be one of the factors behind volatility in the foreign exchange market of an economy (Adenekan et al., 2019). Devaluation as a term is defined as the deliberate act of downward modification in the official exchange rate which reduces the value of a currency. In Nigeria currency devaluation can be traced first to 1986 during the SAP (Structural adjustment Programme) period (Adubi & Okunmadewa, 1999). The idea of devaluation was to improve export volume and reduce import volume as the price differential between Naira and other currency will cause an increase in demand for Nigeria exports. However, economic factors such as Nigeria's Mono economy and lack of policies to drive internal production and export as seen Nigeria to become over dependent on import as a result the idea behind devaluation as lead to an increase in inflation for goods and services (Chinedu Uzochukwu & Uchenna Emmanuel, 2014).

Price can be defined as the relationship between quantity demanded and the cost of producing a given quantity that fixes it at a determined point in time. Price is thus, formed from total cost incurred over an agreed time. Pricing is the process by which price is determined. Pricing strategy, on the other hand, frames the pricing policies of a firm to achieve its overall objectives through appropriate measures at allotted time intervals during production or sale of product/service to customer. Pricing strategy is also the consideration of all internal and external factors affecting prices of products/services produced by the firm.

Pricing strategy to be adopted by a firm depends on the business strategy, type of market which the business entity is trying to operate in and time span either long term or short term. But it is key to note that managers develop pricing strategy for long term market effect. In the Nigerian manufacturing arena, the prevailing strategy are Revenue-oriented pricing and operations-oriented pricing as catering for demand and covering cost are of high priority for manufacturing firms in Nigeria.

Revenue oriented pricing is a form of price setting that involves using the price to generate revenue or profit. This type of pricing strategy can be used in times when there is high demand for products and hence increase in business volume. It is used to obtain maximum output with minimum cost while Operation-oriented pricing, businesses use prices at which they make sales to maximize sales revenues. Operations-oriented pricing seeks to align the firm's total costs (measured by its total revenues) with the firm's average revenue per unit of output sold. To execute any of the strategies highlighted appropriate technique need to be adopted and manufacturers tend to adopt either absorption costing technique or Marginal costing techniques.

According to Zeithaml (1988) consumer perceived value can be regarded as "consumer's overall assessment of the utility of a product (or service) based on perceptions of what is received and what is given. The simplest form of consumer perceived behaviour can be said to be the ratio or trade-off between quality and price of goods and service. The concept is used to understand consumer behaviour towards the functional characteristics of a products however this concept for the sake of this paper is taken from the producers perspective as it is important for producers to predict the possible perceived value of the customer in order to factor it in when making decision on the type and price of goods to be produced as you need to understand the target consumer and their needs in order to make value and price based decision on production/ manufacturing. With it cannot be overemphasised the importance of Consumer perceived value is to managers when setting price as there is need to understand the consumer trade off nature between dimensions of perceived value (Social, emotional, functional, epistemic and conditional value) and Price.

The concept of enterprise theory (Theory of firm) attempts to develop a method by which an organization creates a pool of solutions from alternatives to achieve its goals by maximizing profits and reducing costs. It is a decision-making process in which all factors affecting cost and profit are systematically reviewed to create the most appropriate combination of cost and profit factors to achieve optimal profitability. The theory is relevant to this study because it allows managers to predict or see trends in managers as they make decisions about how to price products and services in market conditions. In the process of pricing a product or service, managers must consider the company's short- and long-term goals, which automatically determine the purpose of the pricing.

The behavioural theory of the firm by (Cyert & March, 1963) provides a different perspective on the guiding principles of firms. It is stated that the company will not seek to maximize results but will strive to satisfy the different groups and stakeholders that make up the totality of the firm as they are varying objectives of which the firm needs to satisfy at different point in time.

The theory of consumer works in tandem with the theory of firm. This is because theory of firm tries to predict how decisions will be used to determine the price and amount at which goods and services are expelled

from the firm while the consumer theory looks at consumer reaction to those goods that are being expelled as a measure of the level of satisfaction the consumer believes it will receive from a particular good or service. This satisfaction is defined as the perceived value of goods and service.

Although there is lack of substantive empirical evidence for this study however, Saqib & Sana (2012) examined the influence of exchange rate volatility on trade volume (exports) and its effects on the real effective exchange rate in their paper "Exchange rate volatility and its effect on Pakistan's export volume" (REER). EXPORT, IMPORT, REER, Total RESERVE, CPI, FDI, GDP, GDP Deflator, and Term of Trade were the variables examined in this study. The analysis relied on secondary source data from the World Bank, which covered the years 1981 to 2010. The data was analysed using regression methods, specifically the multiple liner regression technique. The study found that the real effective exchange rate has an inverse relationship with Pakistan's export volume. It also demonstrated that imports have a direct association with export volume and have a beneficial impact on Pakistan's exports. They went on to say that the only way to reduce the balance of trade deficit is to increase exports rather than reduce imports because imports affect exports as well. However, the study only looked at macroeconomic variables, not how macro and micro variables interact to get a more holistic picture of the impact of exchange rate fluctuation on trade volume.

In their study "Effect of exchange rate on manufacturing sector growth in Nigeria," Abdulwahab Sulaiman et al., (2016) looked at the impact of exchange rate on the manufacturing sector's operation from 1986 to 2014. The authors used a time series experimental approach for their study since it blended theoretical explication with practical observation. The data was analyzed using the ordinary least square (OLS) regression approach, and a pre-estimation test revealed that the variables were stationery at first difference and that they all have a long run equilibrium. According to the findings, there is a strong link between Nigerian exchange rates (FOREX) and industry outputs. Their research went on to advise that changes in exchange rate management strategy and techniques should be allowed to take a reasonable amount of time to take impact, i.e. the lag time between policy implementation and effect should be taken into account. The report advised that the government support manufacturing activity by providing incentives and subsidies to local producers as well as increasing technological infrastructure development. However, the effect of the exchange rate on the pricing categorization of output by manufacturing company managers, which will affect the consumer of such outputs, is not considered in the study. Because exchange rate situations are always changing, factors that were relevant between 1984 and 2014 may no longer be relevant now.

Ikuemonisan et al (2018) In their work "Food price volatility effect of exchange rate volatility in Nigeria," looked at the volatility dynamics in food price index returns (FPIRETURNS), imported food price index returns (CIFCPIRETURNS), dollar price at bureau de change (BDCRETURNS), and inter-bank rate (EXRETURNS). The study used the exponential generalized autoregressive conditional heteroscedasticity (EGARCH) model, which allows the error term to be conditional heteroscedastic and the dynamics of generating the underlying heteroscedasticity to be asymmetric. This means that the model used in this study introduces parameters that can reveal how conditional variances respond to both positive and negative shocks of equal magnitude. The study found that leverage effect and high persistence were present in some of the chosen models, and that exchange rate volatility influences the volatility of food price index returns but is more noticeable on the swings of imported food price index returns. The research went on to advise that the government create an FX market stabilization strategy as a prelude to assuring the stability of the domestic food market, which is fairly fundamental because it fails to provide instances of such stabilization policies. The study solely looks at the impact of exchange rate volatility on food prices, leaving out other products such as consumer and industrial goods. In addition, the study only looked at a portion of the manufacturing industry.

Exchange rate volatility and disaggregated manufacturing exports: Evidence from an emerging country," Vo et al., (2019) looked at the connecting relationship between Vietnam's manufacturing sector and 10 of its subsidiaries that export goods to 26 of the country's primary export partners. The study covers the years 2000 to 2015 and relied on secondary data sources. The methodology revealed a three-stage model analysis that included the use of GARCH for volatility, panel dynamic ordinary least squares (DOLS) to obtain an asymptotically unbiased, normally distributed, and control the problem of endogeneity, and finally, the error correction model to investigate the impact of the exchange rate on export growth during the surveyed period. The study's findings indicated that while depreciating the Vietnamese currency looks to increase short-term manufacturing exports, the resulting exchange rate instability has a long-term detrimental impact on manufacturing exports. The study is detailed; however it does not go over all of the possible recommendations for the outcome. Also, there is a problem with not considering the causal relationship between exchange rate depreciation, volatility, and export performance, which would be revealed if the pricing mechanics of products exported were included.

The impact of currency rate volatility on Nigerian international commerce was explored by Ikechi & Anthony (2020) in their study "Exchange rate volatility and international trade in Nigeria." The researchers assumed that fluctuations in exchange rates have an impact on export and import volumes. The study relied on a secondary data set with a 1996–2018-time frame (22 years). OLS (Ordinary least square regression), which

revealed short run estimates, was one of the econometric tools utilized by the authors. Long run estimate was performed using a combination of Johansen cointegration test, VAR and granger causality, variance decomposition, Impulse test, and ARCH and GARCH procedures. The test yielded mixed findings for the factors under consideration. However, the authors' generalized findings revealed that there is evidence of volatility of the Real effective exchange rate (REER) depending on Nigeria's import and export trade movements. This highlighted that a slowdown in export growth could diminish foreign exchange revenues available to the Nigerian government for capital expenditure. Because financial shocks frequently increase exchange rate fluctuations, the authors suggested using monetary and fiscal interactions to reduce negative consequences. The impact of price volatility on internal consumers of items produced from both import and export was not considered in this study, which would have provided a better indication of how to effectively offset the effect and assure a more solid suggestion.

In Nigeria, Jacob et al. (2021) looked at the predictors of foreign currency rate volatility and non-oil export. The study employed secondary data from the CBN bulletin, and it covered the years 1982 to 2017. The descriptive statistics and co integration analysis methodologies used in the investigation served to shed light on the data set's properties. The unit root and stationarity among the variables specified as the determinant were tested using GARCH and ARCH models, which were supported using ADF and PPT to test the unit root and stationarity among the variables outlined as the determinant. The autoregressive distributive lag and bond test were used to determine long run cointegration between the independent and dependent variables. Nonoil export has a positive association with the foreign exchange rate, bank rate, inflation, and foreign exchange volume, according to the data. GDP, M2, and government spending, on the other hand, have negative coefficients and are statistically insignificant. The application of a rebound policy on the currency rate would help to stabilize the volatility effect, thereby encouraging non-oil exports.

III. Methodology

This study employed the use of both primary and secondary data. A primary data collection technique was adopted for the collection of the dependent variable (Pricing decision making) data using an online questionnaire. Face validity was ascertained through expert advice on the structure of the questionnaire which was followed by the online administration to a pilot respondent of 15 respondents to further test the validity of the questionnaire before it was finally administered to 56 respondents all representing selected manufacturing companies in Nigeria cutting across Industrial goods, consumer goods, agriculture goods and health care products.

Secondary data collection technique was used in sourcing the data of the independent variable. The source used was the CBN daily moving average foreign exchange rate figures for the dollar from CBN statistical bulletin, the weekly moving averages where collated and used to analyse against the primary data. The study adopts simple random technique. And Partial Least Square – Structural Equation Modelling (PLS-SEM) is employed to analyse the data generated with the aid of Smart PLS 3.3 software package.

The questionnaire is divided into “A and B”. The section “A” comprises of the respondents’ details which include Age, highest education, and gender while section B involves the necessary questions reflecting the variables of the study. The study has 2 major variables namely: Independent variable represented by foreign exchange volatility and the dependent variable which is subdivided into Cost of production, Required rate of return and customer perceived value of the product.

Cost of production decision

The study adopts 6 items to measure cost of production. This is done by employing 5-point Likert scale in ranking the items (i.e., interval scale), where 1 =Strongly disagree and 5= strongly agree comprising the scale with a minimum score of 1 and a maximum score of 5. The measures are shown in Table 1.

Table 1: Distribution of questions to measure cost of production decision

CODE	ITEMS
CP1	Fluctuations in dollar will make raw materials to be expensive and vice versa.
CP2	Exchange rates affect import prices
CP3	A fall in Naira in the foreign market will cause labour rates to be high for professionals and vice versa
CP4	Dollar appreciation against Naira will affect overhead cost in production (Rent)
CP5	Fluctuations in Oil prices in international market makes production cost more expensive
CP6	CBN exchange rate policies affect product cost

Source: Field survey, 2022

Require rate of return Decision

The study adopts 5 items to measure require rate of return. This is done by employing 5-point Likert scale in ranking the items (i.e., interval scale), where 1 =Strongly disagree and 5= strongly agree comprising the scale with a minimum score of 1 and a maximum score of 5. The measures are shown in Table 2.

Table 2: Distribution of questions to measure require rate of return (Profit margin) decision

CODE	ITEMS
PM1	Changes in the exchange market will affect gross profit margin targeted
PM2	Dollar rise will make product sales to increase and vice versa
PM3	Foreign market conditions will affect revenue from products
PM4	Rise in dollar causes an increase in product inflation (Rent)
PM5	Dollar rate is a contributing factor when determining profit margin achieved.

Source: Field survey,2022

Customers perceived value of the product

The study adopts 5 items to measure require rate of return. This is done by employing 5-point Likert scale in ranking the items (i.e., interval scale), where 1 =Strongly disagree and 5= strongly agree comprising the scale with a minimum score of 1 and a maximum score of 5. The measures are shown in Table 3.

Table 2: Distribution of questions to measure prediction of customer perceived behaviour

CODE	ITEMS
CPB1	Product Price determines product quality
CPB2	Appraisal cost is important to product quality
CPB3	Customer’s complaint frequency determines product performance
CPB4	Higher inspection time will give better product quality
CPB5	Frequent quality audit increases consumer satisfaction

Source: Field survey,2022

Data Analysis

Descriptive analysis

Demographic outline of respondents

This part contains the demographic information of the respondents

Table 3

Gender	Freq.	Percent	Cum.
Male	20	35.71	35.71
Female	36	64.29	100.00
Total	56	100.00	

Source: Field survey, 2022

The gender distribution table reveals that 20 respondents representing 35.71% were male and 36 respondents representing 64.29% of the total respondents were females across the sampled manufacturing firms

Table 4

Age	Freq.	Percent	Cum.
29 to 34	4	7.14	7.14
34 to 39	25	44.64	51.79
39 to 44	8	14.29	66.07
44 to 49	7	12.50	78.57
50 and above	12	21.43	100.00

Total	56	100.00
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Source: Field survey, 2022

The Age distribution table reveals that 4 respondents representing 7.14% were within the age range of 29 to 34, 25 respondents representing 44.64% were within the age range of 34 to 39, 8 respondents representing 14.29% were within the age range of 39 to 44, 7 respondents representing 12.50% were within the age range of 45 to 49 and 12 respondents representing 21.43% were within the age range of 50 and above

Table 5

EDUCATIONAL QUALIFICATION			
ON	Freq.	Percent	Cum.
Bsc	27	48.21	48.21
Msc	3	5.36	53.57
MBA	14	25.00	78.57
PhD	12	21.43	100.00
Total	56	100.00	

Source: Field survey, 2022

The educational qualification distribution table shows that 27 respondents representing 48.21% of the population were BSc holders, 3 respondents representing 5.36% of the population were Msc holders, 14 respondents representing 25% held MBA qualifications and 12 respondents representing 21.43% held PhD qualifications.

Assessment of the structural model

The study structural model is given below. Thus, in order to assess significance of the path coefficients in the model, as well as bootstrapping based on 5000 samples (Henseler et al., 2009). Figure 1 depicts the PLS path structural model of this study.

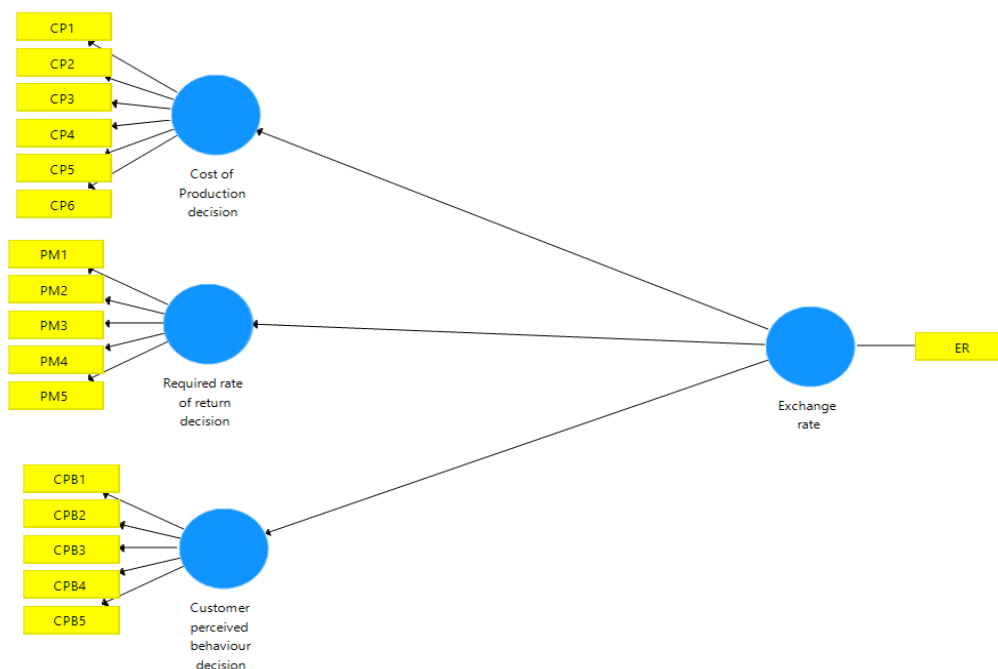


Figure 1: PLS Measurement model

Main analysis

Table of result of the structural model assessment

Hypothesis	Relationship	Standard Deviation (STDEV)	T Statistic	P Values	Findings
H1	Exchange rate -> Cost of production decision	0.444	0.892	0.373	Not Supported
H3	Exchange rate -> consumer per behavior	0.239	2.634	0.009	Supported
H2	Exchange rate -> require rate of return decision	0.308	0.813	0.417	Not Supported

The table above contains the result of the hypothesis tested showing the t-statistics and the P-value only. Exchange rate has no significant effect on cost of production decision and profit margin decision. Hence the null hypotheses will be accepted for both Hypotheses 1 and 2 which states that Exchange rate has no significant effect on cost of production decision and Exchange rate has no significant effect on required rate of return (Profit margin) decision. However, it further reveals that exchange rate significantly and positively effects consumer perceived behaviour by management at a p value of 0.009 which is less than the standard error of 0.05, thus the null hypothesis is rejected, instead the study accepts the alternate hypothesis which states that exchange rate has a significant impact on customers perceived behaviour expectation by management of listed manufacturing firms in Nigeria.

IV. Conclusion

The study establishes that Exchange rate is not a good determinant of cost of production decision and required rate of return decision making when it comes to pricing decision making of management in listed manufacturing firms in Nigeria, but exchange rate is a good determinant of customers perceived behaviour towards management pricing decision. This invariably suggests that management ability to predict customers behaviour to the news of increase or decrease in foreign exchange helps them efficiently set their prices to gain traction in the manufacturing market in Nigeria thus suggesting that manufacturing firms engage in high behavioural analysis of their customers before they set their prices taking advantage of both positive and negative reactions.

It is recommended that an agency should be set up to monitor the frequency to which price of goods produced by the manufacturing sector is changed thus protecting the consumers and reducing the level at which the weight of forex volatility is pushed to the consumers or customers .This can be done through the set up of regulatory bodies that will set price ceiling and floors.

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