African Journal of Commercial Studies (ISSN: 2958-2326)
Volume 1, Number 2, 2022 | pp 1 – 7

Financial Performance and Investment Decision Making in Kenya

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Abstract:
Investors can gain insight into an organization's future by examining its financial performance, which shows whether its operations and profits are on track to increase as well as the outlook for its stock. Financial performance is a snapshot of an organization's economic health and the management's performance. Investors can gain insight into an organization's future by examining its financial performance, which shows whether its operations and profits are on track to increase as well as the outlook for its stock. Financial performance is a snapshot of an organization's economic health and the management's performance. This paper examines the interactions between profitability and liquidity in terms of financial performance and investment options. Based on the study's findings, management must evaluate profitability, solvency, and liquidity in order to fulfill goals like maximizing shareholders' value.

Keywords: Financial Performance, Liquidity, Profitability, Financial Decision Making

ARK: ark:/69431/AJoCS.v1i2.1 **DOI:** 10.59413/ajocs/v1.i2.1

1. Introduction

The financial performance of a company provides investors with information about its overall health, a snapshot of its economic situation, and the management's performance. It also offers insight into the future, i.e., whether its operations and profits are expected to increase as well as the outlook for its stock (Sabri, Reza, & Wijekoon, 2020). Estimation of financial performance is one of the most salient investment decision-making assessment tools for any individual or organization, both in the public and private sector (Landi & Sciarelli, 2018). It is a subjective measure of how well a firm can use assets from its primary mode of business to generate revenue.

An organization's financial performance tells investors about its general well-being; it's a snapshot of its economic health and the job the management is doing, providing insight into the future, that is, whether its operations and profits are on track to grow and the outlook for its stock (Sabri, Reza, & Wijekoon, 2020). Organizational performance is measured using both financial and market methods, including return on investment, market share, sales profit line, market share growth, sales growth, and overall competitiveness (Alshehhi, Nobanee, & Khare, 2018).

An individual or organization that puts money into financial schemes or property with the expectation of achieving a profit is referred to as an "investor." For investors to settle on their venture choices on whether to put their cash in a specific firm, they most importantly need to access the financial health of an organization, surveying how first the organization's resources or securities can be changed over into cash without losing their market value, and evaluating the capacity of an organization to meet long-term obligations and financial obligations. It is basically evident that an organization can draw in new investors and hold on to old ones only by maintaining solid financial performance over the years (Hickman & Silva., 2018).

2. Agency theory

According to Oberauer and Lewandowsky (2019), a theory is an argument of ideas intended to explain a phenomenon. For the purpose of this study, a few theories have been argued to clarify what the financial performance of an organization means to the investment decisions of investors. Agency theory was developed by Jesen and Meckling in 1976. They suggested a theory of how the governance of a company is based on the conflict of interest between the company's owners (shareholders), its managers, and major providers of debt finance (Guluma, 2021). An agency relationship is composed of two parties, that is, the principal and the agent. The principal expects the agent to act in their best interest as they execute certain transactions and make major decisions on behalf of the principals. According to Chaney (2019), an agency relationship is an agreement between two parties where an investor (the principal) connects with someone else (the agent) to play a certain administrative role for their benefit, which includes the assignment of some decision-making authority to that agent. Agency problems or conflict may arise in the case of differences in interests between the agent and the principal (Panda & Leepsa, 2017). Agency losses, on the other hand, affect this relationship, which therefore calls for the alignment of the two parties' interests since a difference in the same may cause bone of contention. According to Frydman and Hilt (2017), the issue of data deviation among the board and financial institutions and office clashes between controlling investors and minority investors and between the administration and investors have been demonstrated to fundamentally influence an organization's management choices. A prospective investor ought to comprehend the divergence of interest before they can put their cash in a company's securities (Rock, 2020).

3. Financial Performance

Liquidity

Liquidity refers to how quickly an investment can be sold without negatively impacting its price (Kontuš & Mihanović, 2019). The more liquid an investment is, the more quickly it can be sold, and the easier it is to sell it for fair value or current market value. In accounting and financial analysis, a company's "liquidity" is a measure of how easily it can meet its short-term obligations, for example, taxes and wages (Bordeianu & Radu, 2020). Working capital management is very central in business due to its contribution to the profit and the worth of the firm. Firms that manage working capital efficiently enjoy the benefit of long-term survival in business (Ngari & Kamau, 2021). Some of the liquidity ratios that investors can use to access the financial performance of a firm are the current ratio (CR), which is current assets minus current liabilities. In a case where current liabilities surpass current assets, the current ratio will be less than one, which demonstrates that the organization may have issues meeting its short-term liabilities. The other ratio is the "quick ratio," which is the ratio of only the most liquid assets, for instance, cash, stock, and account receivables, compared to current liabilities. This ratio will show how well current assets can cover current liabilities. The quick ratio utilizes just the most liquid current assets that can be converted into cash within a period of ninety days or less (Dar & Dar, 2017).

Profitability

Profitability is the degree to which a business yields profits or financial gain (Bikker & Vervliet, 2018). They are used to measure the performance of the management. Profitability is the major objective of every business (Alarussi & Alhaderi, 2018). Therefore, estimating current and past profitability and projecting future profitability is vital to investors. A business that earns huge profits compensates its shareholders with huge profits from investment. Financial metrics used by analysts and investors to measure and evaluate the ability of a company to generate income are known as profitability ratios (Rashid, 2018). Profitability ratios are categorized into two categories: margin ratios and return ratios. Margin ratios represent the company's ability to convert sales into profits at various degrees of measurement; they include operating profit margin and net profit margin (Rahman, 2017). Return ratios represent the company's ability to generate returns for its shareholders. This is the profitability ratio that is most accurate in our case, and it includes return on equity (ROE), which is calculated by dividing profit for the year by share capital and adding reserves to the result. and return on capital employed (ROCE), which can be arrived at by dividing operating profit by share capital, adding reserves, and non-current liabilities, and multiplying the result by a hundred. The return on capital employed helps in capturing the monetary returns on equity and debt (Tirumalsety & Gurtoo, 2021). Thus, it is used by investors as a criterion for establishing an investment portfolio and designing investment strategies.

4. Financial decision making

For every individual or organization, sound financial decision-making is a vital key towards attaining financial freedom or success (Al Breiki & Nobanee, 2019). Financial decisions include investment decisions and dividend decisions. In the investment process, one needs to be able to make thoughtful decisions on how and when to invest.

Financial literacy is important in enhancing the prudent decision-making capabilities of an individual (Riitsalu & Murakas, 2019). Previous research has suggested that improvements in education in financial management positively correlate with decision-making on critical investment decisions. Dividend decisions, on the other hand, relate to the distribution of profits earned by an organization. Factors such as earnings affect dividend decisions since returns to investors are paid out of present and past income. Every financial decision has an impact on the financier, and the effects can either be positive, i.e., profits, or negative, i.e., constant losses (Pelster & Hofmann, 2018). Before allocating resources to a specific decision, businesses must conduct an initial cost-benefit analysis of all of their working capital management options (Ngari & Kamau, 2022).

5. Conclusion

When the liquidity is on average low, the general financial performance of the organization becomes automatically poor; therefore, extreme liquidity management should be put in place in order to boost the financial performance of the organization. Corporate entities should however create a balance between extreme liquidity policies and profitability. Having seen how the financial performance of an organization is of great importance to investors, it is advisable that management carry out a routine checkup of the organization to verify its performance in relation to solvency, liquidity, profitability, and asset base. In order to achieve targets such as maximizing shareholders' wealth, management must take into consideration risks including liquidity risks, solvency risks, and profitability risks.

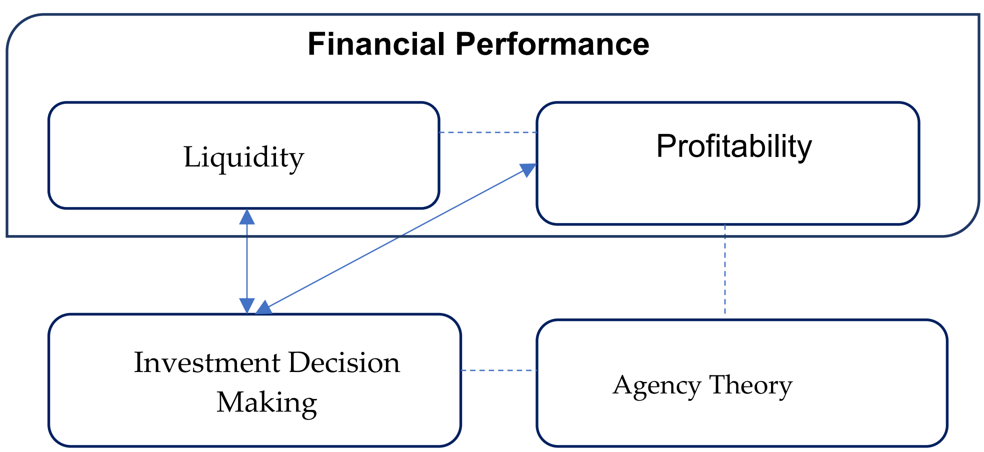

Figure 1: Linkages between Financial Performance and Investment decision making

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