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Influence of Equity Investments and Financial Performance of Business in Africa. A Critical Literature Review

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Abstract

Purpose: Investors can be categorized as either institutional or individual. The management is concerned with the formulation of investment decisions. These investments are key to attaining success thus ensuring increased firm valuation. The overall objective of this study was to assess examine influence of equity investments and financial performance of business in Africa.

Methodology: The paper used a desk study review methodology where relevant empirical literature was reviewed to identify main themes and to extract knowledge gaps.

Findings: The study concluded that equity investments have a weak link on explaining the profitability of investments business in Africa. The findings also affirmed that equity investments have a positive significant effect on liquidity. The results indicated that an increase in the equity holding within the firm will result in improvements in the current ratio within the firm.

Unique Contribution to Theory, Policy and Practice: The study recommends that the capital markets authority to rely on the findings of this study when developing benchmark guidelines on the minimum holding on various investment portfolios. This will ensure there are set regulatory requirements that will guide collective investment schemes in the management of their investors funds which can significantly improve the public confidence in the institutions and drive their financial performance.

Keywords: *Influence, Equity Investments, Financial Performance, Business, Africa.*

INTRODUCTION

Financial performance is a measurement of the ability of an organization to use limited resources resulting in profit generation and attainment of competitive advantage (Kimeu, 2015). It is a representation of the impact of adopted policies in monetary terms (Amin & Harry, 2003; Chepkorir, 2018). Financial institutions with sound financial performance promote investment and accelerate growth economically. Likewise, unsound financial institutions performance has a potential of causing adverse implications on growth of the economy (Madiwe, 2014).

According to Gauvreau, Ilies, and Stegerean (2011), organization productivity can be measured with the guidance of two dimensions; financial or non-financial measures. Recent years have seen financial enthusiasts, researchers, the general public and corporate managers increasingly gain interest in firm financial performance and factors affecting their performance (Omondi, 2013). This is because this information can be used as a signaling tool to its shareholders, current and potential investors and creditors who want to provide capital to the firm (Jaswani, 2008).

Financial performance measures the results of the policies and operations undertaken by a firm and expresses the results in fiscal terms (Erasmus, 2008). It does this by identifying the financial aspects of the policies and establishing the relationship between the income statements thus identifying the firm's strengths and weaknesses. Omondi (2013), notes that stakeholders use company reports and evaluate the possible return on equities as a means of measuring firm performance.

Financial performance provides information which is useful to managers when determining whether a firm will succeed in the future (Levine & Zervos, 2009). Jim (2014) mentioned firm performance in financial institutions can be measured in various ways such as the rate of growth in the value profits, employees, investment opportunities and assets among other growth indicators. Glova and Gavurova (2012) posit that net profit, profitability, return on assets, return on equity, and return on investments are the indicators of profitability.

Financial performance has been calculated using ratio analysis and assessed by analyzing trends to determine the future financial performance estimates. This ratio analysis involves different financial performance areas such as profitability, total asset value and liquidity. These performance calculating tools used are derived from the information available in the periodic financial reports (Babalola, 2013)

Ilo, Yinusa, and Elumah (2018) analyzed performance of Nigerian mutual funds obtaining data from 37 mutual funds in operation between 2012 and 2015. These companies used portfolios that were spread over six categories. The study aimed to evaluate fund managers' skills. The findings indicated that stock investment positively affected mutual fund performance. The study assessed Nigerian investments while this study focuses on Kenyan companies. Iraya and Wafula (2018) assessed how portfolio diversification impacted returns of balanced mutual funds in Kenya. Utilizing descriptive research design approach to analyze the weekly performance of 7 balanced

mutual funds in 2013, portfolio diversification was determined by analyzing the level of Unsystematic Risk in Performance. Findings showed that unsystematic risk was positively related to returns among balanced mutual funds. The study failed to specifically indicate how equity investment influences CIS returns.

Kimani and Aduda (2016) studied effects of portfolio size on fiscal productivity of Kenyan investment firms, obtaining data from financial statements of 45 Kenyan investments firms over a five-year period with findings showing that the highest returns came from stocks portfolio, then bond and money market returns with real estate portfolios reporting the least profits. The study was based on investment firms while the current study examined how portfolio selection affects fiscal productivity of Kenyan CIS. Aroni, Namusonge and Sakwa (2014) examined how access to financial information influence the rate of investment in companies' shares. Retail investors were contacted for this survey. Primary data was gathered from 311 respondents randomly selected form 836 investors involved at the NSE at March, 2013. After application of descriptive and linear regressions, results indicated that financial information had significant and positive influence on investment decisions. The above studies however are focused on how investment decision is arrived at but fail to examine how investment in equities affected the financial performance.

Gunathilaka (2014) investigated the equity investment decision process of Sri Lankan retail investment firms through the analysis of data from 168 respondents. The study noted a strong relation between perceived firm value and equity choice decisions. Transparency in reporting, and self-image/firm-image maintenance significantly impact stock selection. The risk and historical prices had a moderate impact on the decisions made. Obamuyi (2013) examined drivers of investment decisions in Nigerian capital markets. Five main factors were derived; previous share performance, projected security capital bonus, projected firm earnings, the dividend policy and the get rich quick mentality. The opinion of family members, religious affiliation, brand loyalty and possibility of losses in other investments did not have a significant impact on investment decisions.

Qureshi and Hunjra (2012) assessed factors that equity fund managers consider before making decisions regarding financial investment. Data was obtained from 327 equity fund managers of investment firms, banks, insurance firms and other investment schemes. The study demonstrated risk aversion, use of financial tools, heuristics, and investment decision making positively and significantly impact firm-level corporate governance. Equity fund managers are reported to be highly risk averse and use heuristics and other financial tools to guide their investment decisions. The study however considered the investment decisions but failed to examine how investment in equity affected firm returns. Additionally, the study investigated financial firms, while the current study focuses on Kenyan collective investment schemes. Kagunda (2011) evaluated asset allocation policies and how they affect fiscal productivity of Kenyan firms. The study concluded that the way fund managers allocated assets in equity-based funds was positively related to better fiscal productivity of the funds. The study however did not take into account non-equity-based

funds.It is against this background that the study intended to examine influence of equity investments and financial performance of business in Africa. A critical literature review.

Statement of the Problem

Data from the Capital Markets Authority (2018) indicates between 2017 and 2018, funds held by Equity investment bank unit scheme fell by 57.48%, British American Unit trust scheme dropped by 16.97%, Old mutual unit Trust scheme dropped by 7.03%. The only unit schemes to record a growth in their funds were CIC unit scheme to stand at 26.92%, ICEA Lion 10.46% and CBA unit trust 7.29% of the total funds under management. Despite the dip in the financial performance of the above CIS there is inconclusive evidence indicating how investment portfolio contributed to the drop in the financial performance of CIS making this study key in filling this knowledge gap.

Literature documents that most fund managers utilized equity composition so as to foster fund performance and enhance their capacity to pull new investors (OECD, 2013). Kasanga (2011) and Osano (2013) found that investment fund performance is greatly affected by the investment strategies and the equity allocation. With increasing public sensitization on the investment opportunities as well as promotion of the capital markets to the middle and lower-income individuals (Capital Markets Authority, 2018); an examination of the financial performance of CIS in the country as an alternate investment destination was essential in strengthening the investments flows as well as offer investors alternative channels of investing their fund. It is against this background that the study intended to examine influence of equity investments and financial performance of business in Africa.

Objective of the Study

The overall objective of this study was to examine influence of equity investments and financial performance of business in Africa.

Significance of the Study

This study will be important to shareholders of the collective investments schemes in Kenya by directing their choice and selection of investment styles and the best performing institutions. The results were key in enhancing the knowledge of potential and existing investors within the securities exchange. The findings will also be of immense contribution to the management practices in regards to policy making and are expected to enhance the decision making of investment schemes on the best equity investment portfolios to hold in order to enhance the shareholder returns.

The study’s results will contribute to literature on performance of the investments firms in Africa and more so contribute to the available knowledge on their contribution towards economic growth and individual investor income growth. Future scholars and academicians will also find this study useful as a reference material as well a source of valid information on influence of equity investments and financial performance of business in Africa. This therefore underpins the need for

this study that allowed for exploration of influence of equity investments and financial performance of business in Africa.

THEORETICAL REVIEW

The study will benefit from the efficient market hypothesis theory that was proposed by Fama (1970) and prospect theory that was proposed by fielbeck (2005).

Efficient Market Hypothesis

Advanced by Fama (1970), this theory holds that beating the market is impossible since the stock market's efficiency will always change the existing share prices and incorporate all the relevant market information. The theory holds that stocks will always trade at their fair values and investors will never trade in undervalued or overvalued stocks within the market. This makes outperforming the market through expert stock selection next to impossible and to achieve high returns, investors have to purchase riskier investments (Makovský, 2014).

Harvey (2004) indicates that the theory assumes an efficient stock market. Secondly the theory holds that a large number of investors will expertly analyses and select securities based on their returns. Thirdly the theory holds that new information being disseminated to the market is random and independent of the existing news. Lastly the theory holds that new information has immediate effects on stock prices and the price of a stock is representative of all the available information (James, 2009).

The theory is pertinent to the study for its influence in identifying the factors that push for the selection of certain investments in a portfolio. The theory's crux is that outperforming the stock market is impossible hence investor will actively select a riskier investment that will offer higher returns (Alrabadi, 2012). The theory was more so relevant since it helps in explaining stock market performance by examining the nexus between efficiency and the price of shares. This theory was integral in examining how equity investments selection in a portfolio affect the fiscal results of African investment businesses.

Prospect Theory

The modern prospect theory is based on the writings of Filbeck, Hatfield and Horvath (2005) who indicated that investors are influenced by subjective decision making and rational expectations when making investment decisions. Waweru, Munyoki and Uliana, (2010) indicates that the prospect theory on its own describes individuals' decision-making processes by incorporating the regret aversion, the loss aversion and mental accounting. Investors within an exchange market will avoid regret by avoiding trading in decreasing shares and sell the ones whose value is increasing. Additionally, investors will sell stocks early on when their value is still high to avoid regret when its value dips (Forgel & Berry, 2006; Lehenkari & Perttunen, 2004).

Barberis and Thaler, (2003) indicate that there is evidence that investors were less stressed about the prospect of making losses when they purchase sovereign bonds or government backed

securities since they tend to be more risk free than normal corporate bonds. Lehenkari and Perttunen (2004) echo the above sentiment and conclude that investors will always be loss averse hence the positive and negative returns can boost the investor portfolio selection choices. In regard to mental accounting most investors separate portfolios into various accounts allowing for efficient evaluation of the financial transactions (Ritter, 2003).

The above theory was central in assessing the risk aversion, loss aversion and the mental judgement that investors undergo in selecting different asset classes for their portfolio. The theory in principle guided to the study in examining how the building of an investment portfolio using; bonds, equities and money market is normatively and subjectively conducted by investors and how this affects the fund's financial returns.

Empirical Review

Tebaldi, Nguyen, and Zuluaga, (2018) examined factors determining the financial health of emerging markets. The study focused on 31-developing countries from 1994-2014. The study purpose was to examine the determinants of the spread on sovereign governments bonds and they impact in the economic sector with findings showing limited increase in bond spreads post the financial crisis which positively impacted economic growth. The study focused on effect of sovereign bond on national economic aspects whereas current research assessed bond investment. Mengich, Kibati and Ragama (2018) examined effect of investment in corporate bonds on productivity of Kenyan banks. Adopting an ex-post facto research design involving 42 commercial banks, secondary data was sourced from audited accounts reports covering 2008-2017. Findings indicated that corporate bonds trading significantly affect the banks returns on asset.

Wanyonyi (2018) studied how investment diversification affects financial results of NSE-listed agricultural firms, employing a descriptive research design and utilizing a census survey of the Kenyan listed agricultural firms. The research relied on panel data for the period 2010-2017. Findings indicated a positive association between bond investments, securities investment and profitability. The study was dependent on listed agricultural firms while this study examined Collective investing schemes firms in Kenya. The study presented a methodology gap as it utilized descriptive research design while our study will utilize a desktop review design.

Fanta and Makina (2017) studied equity, bonds, institutional debt and economic growth in South Africa. The study relied on finance-growth nexus in South Africa accounting for the role of bond markets, stock markets, and bank and non-bank financial intermediaries using a vector autoregressive technique. The study indicated that bank and non-bank institutions involved in the bond market play a major part in promoting South Africa's economic development. The current study however sought to examine influence of equity investments and financial performance of business in Africa. Abbasi and Malik (2017), however, note that the concept of foreign ownership of large domestic companies is controversial in developing countries.

Choi, Fedenia, Skiba, and Sokolyk (2017) examined how portfolio concentration impacts profitability of global institutional investment firms considering security holdings for 10,771 companies hailing from 72 countries. The study's focus was on the impact of concentrated investment strategies on return on investment. Findings showed that adopting concentrated investment strategies resulted in optimal returns within the sampled markets. The study however failed to indicate how specific instruments such as bond investments influenced the returns of the mutual funds.

Henke (2016) studied how social screening affects productivity of bond mutual funds. The study focused on financial viability of 103 socially responsible bond funds in United States and the Eurozone. Using a mixture of descriptive and inferential analysis techniques, results showed that between 2001 and 2014, the bond funds outperform by one-half of 1% per annum. The study however focused on the US and Eurozone. Specifically, the study focused on influence of equity investments and financial performance of business in Africa. The study presented a geographical gap as it was done in USA while our study will generalize African countries.

METHODOLOGY

The study adopted a desktop literature review method (desk study). This involved an in-depth review of studies related to influence of equity investments and financial performance of business in Africa. Three sorting stages were implemented on the subject under study in order to determine the viability of the subject for research. This is the first stage that comprised the initial identification of all articles that were based on influence of equity investments and financial performance of business in Africa. The search was done generally by searching the articles in the article title, abstract, keywords. A second search involved fully available publications on the subject on influence of equity investments and financial performance of business in Africa. The third step involved the selection of fully accessible publications. Reduction of the literature to only fully accessible publications yielded specificity and allowed the researcher to focus on the articles that related to influence of equity investments and financial performance of business in Africa which was split into top key words. After an in- depth search into the top key words (influence, equity investments, financial performance, business, Africa), the researcher arrived at 6 articles that were suitable for analysis. This were findings from:

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SUMMARY, CONCLUSION AND RECOMMENDATIONS

Conclusion

The study concluded that equity investments have a weak link on explaining the profitability of investments business in Africa. The findings also affirmed that equity investments have a positive significant effect on liquidity. The results indicated that an increase in the equity holding within the firm will result in improvements in the current ratio within the firm. The findings indicate that increased reliance on equity investments in businesses will result in less interest charges from other forms of investments thus improving the firm liquidity position.

Recommendations

The study results established there is a positive effect of equity investment on business performance. Supported by the results, recommendations were for the capital markets authority to rely on the findings of this study when developing benchmark guidelines on the minimum holding on various investment portfolios. This will ensure there are set regulatory requirements that will guide collective investment schemes in the management of their investors funds which can significantly improve the public confidence in the institutions and drive their financial performance. Further, the regulator can be able to develop new policies to guide the assets management within the collective investment schemes to ensure that public funds are well-protected and the firms achieve value in their financial performance.

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