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INVESTMENT IN STOCKS AND FINANCIAL PERFORMANCE OF INVESTMENT FIRMS LISTED AT THE NAIROBI SECURITIES EXCHANGE (NSE)

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Abstract

The financial performance of investment firms listed on the Nairobi Securities Exchange (NSE) is strongly influenced by their stock investment strategies. Poor allocation and exposure to volatility have led to declining profitability and weakened investor confidence. Approximately 60% of NSE-listed investment firms reported profit declines in the past five years, alongside a 12% reduction in foreign investment inflows. Guided by Modern Portfolio Theory (MPT), this study examined the effect of stock investments on the financial performance of NSE-listed firms, measured using Return on Equity (ROE). A descriptive research design and census approach were applied to all five investment firms listed between 2014 and 2023. Secondary data was collected from audited financial reports, NSE records, and Capital Markets Authority publications. Panel regression and diagnostic tests ensured statistical robustness. Results revealed that stock investments significantly and positively influence financial performance, though with notable exposure to volatility risks. The study concludes that well-managed equity portfolios enhance profitability and investor trust. Findings provide practical implications for firms, regulators, and policymakers seeking to strengthen investment practices in emerging markets.

Key Words: Investment in Stocks, Financial Performance, Investment Firm, Nairobi Securities Exchange

1. Introduction

The financial performance of investment firms listed on the Nairobi Securities Exchange (NSE) is essential for understanding their profitability, stability, and impact on investor confidence and the broader market (Wambui, 2019). Key performance indicators such as return on assets (ROA), return on equity (ROE), and profit margins are crucial for evaluating firm performance and financial health (Gitonga, 2020). Understanding financial performance aids stakeholders in making decisions regarding investment opportunities and risk management. Monitoring these indicators is vital for the growth and stability of the listed firms. According to Muriuki (2021), strong financial performance enhances investor confidence, hence attracting both domestic and foreign investments, which subsequently contributes to national economic growth. Conversely, poor financial performance can reduce investor interest, cause capital outflows, and destabilize the broader economy (Kariuki, 2019). Financial performance is thus a reflection of various investment decisions, Inadequate portfolio diversification, coupled with ineffective risk management strategies, undermines the stability and profitability of investment firms, making them more susceptible to market volatility and economic fluctuations (Mwangi & Muya, 2018).

Stocks, while offering the highest growth potential, are characterized by significant volatility. Equities can deliver high returns, but their performance is heavily influenced by market conditions and economic trends (Maina & Wambui, 2019). For investment firms listed on the NSE, stocks remain crucial for achieving high growth and capital gains. However, the NSE is particularly sensitive to regional economic changes, and the stock market's volatility significantly impacts firms' profitability (Kariuki, 2019). Effective stock portfolio management, such as diversification, is essential to mitigate risks associated with market volatility and secure positive financial outcomes (Mwangi & Muya, 2018). By diversifying across sectors and regions, firms can reduce exposure to specific risks.

2. Objective of the Study

To assess the effect of investments in stocks on the financial performance of investment firms listed at the Nairobi Securities Exchange.

3. Hypothesis of the Study

H_{01}: Investment in stocks have no significant effect on the financial performance of Nairobi Security Exchange listed firms.

4. Theoretical Review

This section will review key theories relevant to this study.

4.1 Modern Portfolio Theory

Modern Portfolio Theory (MPT): Introduced by Markowitz (1952), MPT underpins this study. The theory argues that investors can reduce unsystematic risk and optimize returns by diversifying stock holdings. The efficient frontier highlights optimal combinations of assets that balance risk and return. For NSE-listed firms, MPT provides a framework for structuring stock portfolios that enhance profitability while reducing exposure to volatility. Empirical studies reinforce MPT's relevance. Maina and Wambui (2019) found that firms with diversified stock investments achieved stronger financial resilience, while Kariuki (2021) reported that high stock concentration increased vulnerability to market swings. Similar findings in other emerging markets show that strategic equity management enhances long-term financial outcomes (Mutunga & Ochieng, 2020).

4.2 Empirical Review

This section involves reviewing and synthesizing findings from previous studies that focus on real-world evidence, as opposed to purely theoretical discussions.

4.2. 1 Investment in Stocks and Financial Performance

Maina and Wambui (2019) investigated the effect of stock investments on the financial performance of Kenyan companies listed on the NSE. The study used a descriptive research approach to analyze secondary financial data that was gathered over a period of five years. The study found that diverse portfolios performed better during times of economic stability but were worse during recessions. Businesses with diversified stock investments had higher returns and more financial resilience during periods of stable market conditions. The study however, focused on historical data which disregarded the dynamic nature of emerging countries, limited its ability to predict future market patterns.

Kariuki (2021) assessed how stock market volatility affected the financial performance of businesses listed on the Nairobi Securities Exchange (NSE) in Kenya. The study used a quantitative approach to analyze secondary data from a ten-year period. Businesses that relied heavily on stock investments were shown to be more vulnerable to market swings, which could lead to unpredictable financial outcomes. The study emphasized the need of strategic planning and advanced risk management techniques in lowering these risks. However, because it overlooked significant macroeconomic factors like inflation and interest rates, the study's forecasting accuracy was constrained. However, it was made evident that ongoing market monitoring and adaptable investing strategies are necessary for long-term stability.

Mutunga and Ochieng (2020) conducted a study on the impact of global stocks on Kenyan investment firms' performance. The study used quantitative methodology. Data was collected using secondary methods from financial reports over five years. Researchers applied regression analysis to determine the relationship between global stock investments and financial outcomes. The study found that international stocks improved returns and diversification but were negatively impacted by currency fluctuations and geopolitical risks. The study recommended using financial instruments like derivatives to hedge risks and advised firms to stay informed about global economic trends. The study's reliance on secondary data limited its scope by excluding qualitative factors such as managerial expertise and market strategies.

Wanjiru (2018) investigated how blue-chip stocks could boost Ugandan investment firms' profitability. Employing a quantitative research design, the study examined secondary data from financial statements spanning five years. The study evaluated the connection between financial performance of the investment firms and blue-chip stock allocations using regression analysis. It was discovered that blue-chip stocks improved businesses' financial resilience during recessions by offering stability and steady returns. The scarcity of these equities in local markets presented a problem, preventing businesses from realizing their full potential.

Mwangi and Muya (2018) conducted a comprehensive study on the effect of growth stocks on the financial performance of South African investment firms. The study used quantities approach and regression analysis to examine financial data over a ten-year period. The analysis found that growth stocks have the most short-term volatility but the best long-term returns, making it challenging for companies to maintain consistent financial performance. It emphasized how important it is to balance growth and income-producing stocks to maintain overall financial stability. Critics to this study argued that it relied on historical data, which may not accurately capture the dynamic nature of financial markets.

4.3 Conceptual framework

5. Methodology

This chapter covers research design, population of the study, sample and sampling techniques, data collection instruments, collection procedures, data processing and analysis.

5.1 Research Design

This study adopted a descriptive research design, suitable for examining the relationship between stock investment levels and financial performance among investment firms listed on the Nairobi Securities Exchange (NSE). The design enables both quantitative analysis and interpretive insight, aligning with the study's dual goals of empirical validation and strategic relevance.

5.2 Population of the Study

The population for this study consisted of all the five investment firms that were listed on the Nairobi Securities Exchange (NSE) between 2014 and 2023.

5.4 Data Collection Instruments

This study utilized secondary data which was collected using a secondary data collection sheet. Data was sourced from financial statements, annual reports, and relevant economic reviews of firms listed on the Nairobi Securities Exchange (NSE). Additional sources included company financial reports from the NSE and Capital Markets Authority (CMA), published research papers and dissertations, government reports and policy documents related to investment performance, and stock market data from the NSE website.

5.3 Census Technique

This study used a census technique to gather information from all investment businesses listed on the Nairobi Securities Exchange (NSE). Given the small number of NSE-listed companies, a census is both realistic and doable. It allows for a complete review of financial performance patterns across the industry, improving analysis accuracy and increasing the validity of the study's findings. Furthermore, this approach avoids sampling bias, guaranteeing that the findings are representative of the entire population.

5.5 Data Processing and Analysis

After data collection, the study used a structured method to process data and analysis. The first steps in data processing was data cleaning and validation, during which errors, missing numbers, and inconsistencies will be found and fixed. After cleaning, the data was normalized and grouped for effective analysis. To enhance accuracy and clarity, SPSS and Microsoft Excel were used for statistical computations, data visualization, and trend analysis. Both descriptive and inferential statistical techniques were used in the analysis.

The following regression model was applied.

$\mathbf{Y = \alpha + \beta_1 X_{1it} + \varepsilon_{it}}$ **……Equation 1**

Where:

Y represents financial performance

α represents the intercept

β_1 represents regression coefficient of independent variable

X_1 represents Investment in bonds

it represents firm i in time t

ε represents Error term

5.6 Research Findings and Discussion

This section presents the findings from data analysis and interpretation to investigate the relationship between portfolio and financial performance of Investment firms listed at Nairobi Securities Exchange.

6. Descriptive Statistics

Descriptive statistics were used to summarize the regression panel data and identify underlying patterns. These statistics comprised dispersion measures like standard deviation, minimum and maximum values, central tendency indicators like the mean, and distributional metrics like skewness and kurtosis. Table 6.1 depicts the descriptive statistics results

Table 6.1: Descriptive Statistics results

Variable	Minimum	Maximum	Mean	Std. Dev	Skewness	Kurtosis
Investment in Stocks	0.3396	0.3946	0.3470	0.0171	-0.1020	1.7240
Investment in Real Estate	0.2258	0.2323	0.2272	0.0024	0.0510	2.3657
Cash Equivalents	0.1462	0.1483	0.1467	0.0006	0.0392	2.2336
Investment in Bonds	0.2709	0.2911	0.2781	0.0041	-0.1884	2.0526
N	**50**					

A minimum stock of 0.3396 (33.96%) suggests that the firm with the lowest stocks exposure invested significantly in stocks. In contrast, the maximum allocation of 0.3940 (39.46%) implies that certain organizations adopted a little more aggressive attitude. With a mean of 0.347 (34.7%), this indicates that stocks formed the largest share of portfolios. A low standard deviation of 0.0171 indicates less unpredictability, implying that enterprises maintain a consistent strategy to stock investment across time. The negative skewness of -0.1020 indicates that a small number of firms allocated significantly less than the mean. The slight negative skewness (-0.102) implies that a few firms invested less than the average, but the distribution was generally balanced. The kurtosis value of 1.724, which is lower than 3, indicates a flat distribution, meaning there were fewer extreme investment shifts and that no firms significantly deviated from the average.

6.1 Correlation Analysis

Pearson correlation analysis was performed to examine the direction and strength of the linear relationships between stock and financial performance (ROE). The results are presented in Table 6.2

Table 6.2 : Pearson Correlation Matrix

	ROE	Stocks
ROE	1	
Sig. (2-tailed)	—	
N	50	
Stocks	.594	1
Sig. (2-tailed)	.000	—
N	50	50
N	50	50

The correlation analysis revealed statistically significant positive relationships between return on equity and all four investment portfolio components examined in the study. Investment in Stocks recorded a correlation coefficient of 0.594 with a p-value of 0.000, which is less than 0.01, indicating a strong and statistically significant relationship with financial performance. This means that as investment in stocks increases, there is a strong tendency for return on equity to rise as well. The strength of this relationship suggests that equities are a key driver of profitability among investment firms listed on the NSE.

6.2 Regression Analysis for Effect of Investment in Stocks on Return on Equity

To evaluate the relationship between investment in stocks and financial performance, panel regression analysis was conducted. The analysis aimed to determine whether investment in stocks significantly influences return on equity (ROE). The findings are shown in Table 6.3

Table 6.3: Regression Results for Investment in Stocks on ROE

ROE-Stocks	Coef.	St. Err.	T-value	P-value
Investment in stocks	0.462	0.089	5.230	0.000
Constant	0.102	0.025	4.080	0.000
R-squared	0.353			
F-test	27.356			
Prob > F	0.000			
Number of observations	50			

The regression results show that investment in stocks has a positive and statistically significant effect on ROE. A coefficient of 0.462 indicates that a one-unit increase in stock investment leads to a 46.2% increase in ROE. The p-value of 0.000 confirms that the effect is statistically significant at the 0.01 level. Given the statistically significant coefficient and low p-value, the null hypothesis (that stock investment has no significant effects on financial performance is rejected at the 0.01 significance level. The R-squared of 0.353 suggests that stock investments explain 35.3% of the variation in ROE. This finding is supported by Mutua (2016), who investigated portfolio diversification among investment firms in Kenya and found that equity investments had a strong positive influence on firm performance due to capital appreciation and dividend income.

7. Summary of the Findings

The findings align with Modern Portfolio Theory, affirming that diversified and strategically managed equity portfolios enhance firm-level returns. Investment firms that actively rebalance and optimize their stock holdings demonstrate superior financial outcomes, validating the role of

portfolio management as a core driver of profitability. From a governance perspective, the results highlight the need for board-level oversight of investment strategy. Firms with clear asset allocation policies and performance benchmarks tend to outperform, suggesting that strategic clarity and execution discipline are critical. In the Kenyan context, these insights are particularly relevant given the NSE's evolving regulatory framework and the push for institutional transparency. Investment firms that leverage data-driven equity strategies not only improve shareholder value but also contribute to market stability and investor confidence.

8. Conclusion of the Study

This study examined the relationship between stock investment strategies and financial performance among investment firms listed on the Nairobi Securities Exchange (NSE). The findings revealed a strong, statistically significant correlation between equity investment intensity and Return on Equity (ROE). Anchored in Modern Portfolio Theory and supported by empirical evidence, the results affirm that strategic equity allocation is not merely a financial tactic but a core driver of institutional performance. Investment firms that actively manage their stock portfolios balance risk, timing and diversification consistently outperform their peers. In the Kenyan context, where capital markets are maturing and regulatory oversight is tightening, these insights carry weight. They underscore the need for data-driven investment governance, robust portfolio analytics, and executive-level accountability in asset management.

9.Recommendations of the study

The study recommends that NSE-listed firms put a greater focus on investment in stocks. The findings demonstrated that investing in equities had a statistically significant and favorable effect on financial performance, particularly the Return on Equity (ROE). Stocks have the potential for capital gains and dividend income, which can contribute significantly to firm profitability. It is therefore advised that Firms should therefore strengthen their equity analysis and adopt dynamic stock selection strategies that align with both market trends and firm risk tolerance. Diversifying stock holdings across industries and geographies can help reduce market-specific risks and increase long-term return potential.

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