

FACTORS INFLUENCING INVESTMENT DECISIONS IN NAIROBI SECURITIES EXCHANGE: A CASE OF DYER & BLAIR INVESTMENT BANK LIMITED

Kamuti Josphat Mweu

Master's of Business Administration, Jomo Kenyatta University of Agriculture and Technology, Kenya

Dr. Jane Omwenga

Lecturer, Jomo Kenyatta University of Agriculture and Technology, Kenya

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ABSTRACT

Investment in stocks involves two types of markets; the primary and secondary markets. A primary market is a financial market in which new issues of securities are sold initially by the corporation while a secondary market is a financial market in which securities that have been previously issued can be .The Security exchange market is a secondary market in which already issued shares are bought and sold. Stock exchange market is important as it provides a ready market for those who want to buy and those who want to sell thus making financial instruments liquid. The market publishes useful information in statistical and summary form about various companies for guidance. It keeps an eye on the financial affairs of every company whose shares are bought and sold through it. In Kenya the only organized stock market is the Nairobi Security exchange (NSE.) This study looked at four variables including financial conditions of the listed companies and how it influences investment decision at Nairobi security exchange. Secondly, the study examined the influence of Investors disposable income on investment decisions. The study further examined effects of Market information as well as education level of investors on investment decision at Nairobi Security exchange. The findings of this study are intended to help investment firms and brokers in the stock exchange to understand the unique characteristics of the customers that affect their day to day transactions and also be in a position to plan for them accordingly. In addition, the Nairobi Securities Exchange shall benefit

greatly as they will understand the less explored markets and be able to provide resources for creating awareness on how different market niches can gain access to various securities traded in the stock exchange. Finally, the study shall explore the various aspects of the capital markets that will enrich business students with the understanding of the functioning of the stock market. Data was collected using self-administered questionnaires which were hand dropped at dyer & Blare investment Bank for filling. A total of 75 respondents were picked from a population of 150 which included both employees of the Bank and individual investors. Descriptive statistics was used where data was coded and then analyzed using charts and tables. The study found that effect of listed Firms financial statements conditions had a positive effect on investment decision making at NSE. There was a positive correlation between market information and investors' investment decision making. This has come as a result of NSE making market information online for easy accessibility by the investors. Availability of market information is playing a central role in investors' decision making at NSE. With the country ICT platform going a notch higher, investors can access the needed information on real time and this facilitates investment decision making. A big number of the respondents were for the opinion that most of investors at NSE have knowledge in security market. Some of them have the knowledge as a result of academic qualifications as well as having interest in learning about investment in securities. The

study recommends that listed companies at NSE should annually publish their financial statements publicly in order to attract more investors. Investors should give priority to investment at NSE instead of struggling to save for future which is not practically realistic. Market information works well for both existing and prominent investors. It is recommendable to the investment companies to be availing market

information to the public all the time. Individual companies listed at NSE should create more awareness to the market. This will enhance market growth of securities and derivatives as people with idle funds will find a good place to invest them.

Key Words: *Investment Decisions, Conditions of Financial Statements, Investors' Disposable Income, Market Information, Investors' financial knowledge*

INTRODUCTION

An investment decision involves a choice on how to commit funds now in anticipation of expected flow of benefits in the future. It is an exchange of current funds for future benefits. If an individual chooses to invest (and defer consumption) he will do so according to the utility theory by selecting a portfolio that maximizes his Returns. Reilly and Brown (2006) define investment as a commitment of funds for a period of time in order to derive a rate of return that will compensate the investor for the time during which the funds are invested, for the expected rate of inflation during the investment horizon and for the uncertainty involved. A person's investment decision is a trade-off between immediate consumption and deferred consumption so as to enjoy greater consumption in future. The great trade off in investing is between risk and return. Return is the income received on an investment plus any change in market price. An investor can receive returns from stocks when prices of stocks go up over time or when dividends are paid (Mishkin & Eakin, 2007). Risk is the variability of returns from those that are expected. Utility is maximized when an investor gets highest expected return for any given variance or minimum variance for a given expected return.

The first step in making an investment decision is determining the required rate of return (Reilly & Brown, 2006). Most investments have expected cash flows and stated market price. One then estimates a value for the investment to determine whether the current market price is consistent with ones estimated intrinsic value. Models available for valuation of investments include the one period valuation model in which the present discounted value of the expected cash flows is determined using the required return (Mishkin & Eakin, 2007). Other models are the Gordon growth model and price earnings valuation model. After estimating a security's intrinsic value, the investor compares this estimated intrinsic value with the prevailing market price to decide whether do buy the security or not. Investment in stocks involves two types of markets; the primary and secondary markets. A primary market is a financial market in which new issues of securities are sold initially by the corporation while a secondary market is a financial market in which securities that have been previously issued can be resold (Mishkin & Eakin, 2007). The

stock exchange market is a secondary market in which already issued shares are bought and sold. Stock exchange market is important as it provides a ready market for those who want to buy and those who want to sell thus making financial instruments liquid.

STATEMENT OF THE PROBLEM

In classical economic theory, it is assumed that investors are rational and competent. The theory assumes that investors have the same preference, perfect knowledge of all alternatives and an understanding of the consequences of their decisions. Markets are assumed to be efficient. Neither technical nor fundamental analysis would enable an investor to achieve returns greater than those that could be obtained by holding a randomly selected portfolio of individuals stock with comparable risk (Malkiel, 2003). Psychologists from the branches of cognitive and experimental psychology have made the argument that the basic assumptions of classical decision making theory are incorrect since individuals often act in a less than fully rational manner. In particular, the seminal work by Kahneman and Tversky (1979) advocated the prospect theory which assumes departures from rationality. The theory assumes that people are loss averse in which they are more concerned with losses than gains and as a result, a person will assign more significance to avoiding losses than achieving again.

Studies carried out in Greece (Merikas, Merikas, Vozikis & Prasad, 2003) focused on economic factors and individual investor behavior and dealt specifically with experienced investors while in Pakistan (Kaleem, Wajid & Hessain, 2009) the focus was the factors affecting financial advisors perception in portfolio management. Al Tamini (2004) in the United Arab Emirates (UAE) and Sultana (2010) India, studied factors influencing individual investor behaviour in UAE and India respectively. A number of theories have been proposed to explain why and how individuals make decisions when investing, saving and even borrowing money. Schmidt (2010) explains that it is important to understand the investment participation decision of investors, what motivates them, even before considering the selection criterion and ability. Economic considerations exert influence on individual's keen to make capital gains or receive dividend payments from the investment they make. In the investment market an investor faced with options to invest in will logically choose the investment that guarantees protection of wealth, and comparatively provides higher returns in the market (Cole & Shastry, 2009).

The Rationality and Efficient Market Hypothesis (EMH) predominated theory and practice in the financial markets starting 1960's to 1980's. Fama (1970) explains that in an efficient market stocks will always trade at their fair market value in the securities exchange reflecting all available information, making it almost impossible for investors to purchase undervalued shares or sell shares at inflated prices. In reality individuals do not think rationally, are instead led by emotions, subjective thinking, and at times by the herd mentality (Shah & Oppenheimer, 2008).

The EMH has steadily become deficient to explain market behavior, subsequently leading to a shift in thinking, with the understanding that the market consists of human beings whose behavior cannot be understood solely through mathematical or economic studies (Ozerolet al., 2011). In making decisions to invest individuals behaviors will therefore be driven by personal frames, including availability of financial information to guide their selection decision. Behavioral theorists" postulate that investment decisions are to some extent influenced by personal prejudices and perceptions that fall short of the criteria of rationality as proposed in the EMH. The contemporary capital markets are therefore being analyzed from a new perspective of behavioral finance, a theoretical model applying the principles of psychology and sociology to finance (Pompion, 2008).

Recent literature in empirical finance is surveyed in its relation to underlying behavioural principles which come primarily from psychology, sociology and anthropology, Shiller (2002). The behavioural principles are: prospect theory, regret and cognitive dissonance, anchoring, mental compartments, overconfidence, over and under reaction, representativeness heuristic, the disjunction effect, gambling behaviour and speculation, perceived irrelevance of history, magical thinking, quasi-magical thinking, attention anomalies, the availability heuristic, culture and social contagion, and global culture. Moreover, prospect theory does not suggest that in this case riskless real interest rates need be particularly high. In a study of the behaviour and performance of individual investors in Japan by Kim and Nofsinger (2003), specific investor behaviours such as overconfidence, feedback trading and the disposition effect were identified. The study found that Japanese individual investors owed stocks with high risk, large book-to-market (BM) ratios, high trading volume, and earn low returns. Given the hypothesized positive risk/return relationship and the documented success of value firms, they were curious that investors could hold higher systematic risk firms and value firms and yet still underperform. Further, in their full sample period, they also found that individual investors made poor trading choices i.e., individuals sold (bought) stocks that did well (poorly), and that they bought and sold past winners. Their findings were consistent the predictions of overconfidence models.

More and more attention has been paid to institutional investors while less attention has been given to small scale or individual investors. Almost all previous studies have occurred in developed countries of Europe and America. Those that have taken place in Kenya such as Waweru, Munyoki and Uliana (1998), Wera (2006) and Mbaluka (2008) have all paid attention to the behavioural factors influencing investor decisions. None of the previous studies address the factors influencing investment decision in equity at Nairobi security exchange through Dyer and Blair investment Bank.

GENERAL OBJECTIVE

The main objective of the study was to determine the factors influencing investment Decisions at the Nairobi Securities Exchange.

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SPECIFIC OBJECTIVES

1. To determine how conditions of financial statements of companies influence investment decisions at Nairobi security exchange.
2. To analyse the effect of investors' disposable income on investment decision at Nairobi security exchange
3. To assess how market information influences investment decision at Nairobi Security Exchange
4. To establish how Investors' financial knowledge influences investment decision at Nairobi Security Exchange

THEORETICAL REVIEW

The study was guided by investment theories, portfolio theory and the Efficient Market Hypothesis.

Investment Theories

The expected utility model of Neumann and Morgenstern (1953) is the foundation of the modern investment theories. Financial decisions to invest are guided by the risk-return trade-off. The decision-makers' choice will depend upon his risk preference. A rational investor would maximize his utility and is therefore expected to accept an investment that would yield the maximum return. The most widely applied in finance is the expected utility model of choice under risk (DeBondt, 1998). Its rationale is based on the axioms underlying expected utility maximization.

Portfolio Theory

The portfolio theory is based on the expected utility model of Neumann and Morgenstern (1953). According to the theory, the great trade off in investing is between risk and return. Markowitz (1952), Roy (1958), and Tobin (1958) advocate the wisdom of holding a Diversified portfolio. Their mean variance analysis is concerned with how an investor should allocate his wealth among various assets available in the market given that he is a one period utility maximize. An efficient portfolio is one that has maximum expected return for a given variance or minimum variance for a given expected return. By selecting assets with low correlation of returns, it is feasible to reduce overall risk of the portfolio.

This occurs because as the returns of one asset go down, they will be offset by the returns of another asset going up. This is more likely to happen with securities from firms in different industries especially if those industries move differently against macroeconomic business cycles. Markowitz (1952) offers a good explanation of the phenomena of portfolio through diversification. Sharpe (1964), Lintner (1965) and Mossin (1966) making a number of

assumptions have extended the Markowitz mean variance framework to develop a relation for expected return. Given that investors are risk averse, it seems intuitively sensible that high risk stocks should have high expected returns. The work of Sharpe, Lintner and Mossin has resulted in the capital asset pricing model (CAPM). The CAPM model provides a simplified device by comparing each security's return with a single yardstick, the return on the market portfolio.

This device is the beta (β) coefficient, thus the CAPM is a single factor model depending only upon the security market. The model is founded on the assumption that the market is efficient and investors' measure returns and risk by means and variances. Consequently, it is possible for a range of investments in both individual stocks and portfolios to be plotted in terms of mean-variance characteristics. Given that investors prefer higher expected returns and lower risk, portfolios which are efficient should dominate those that are inefficient. The competing model of CAPM is a three factor model of (Fama and French, 1992).

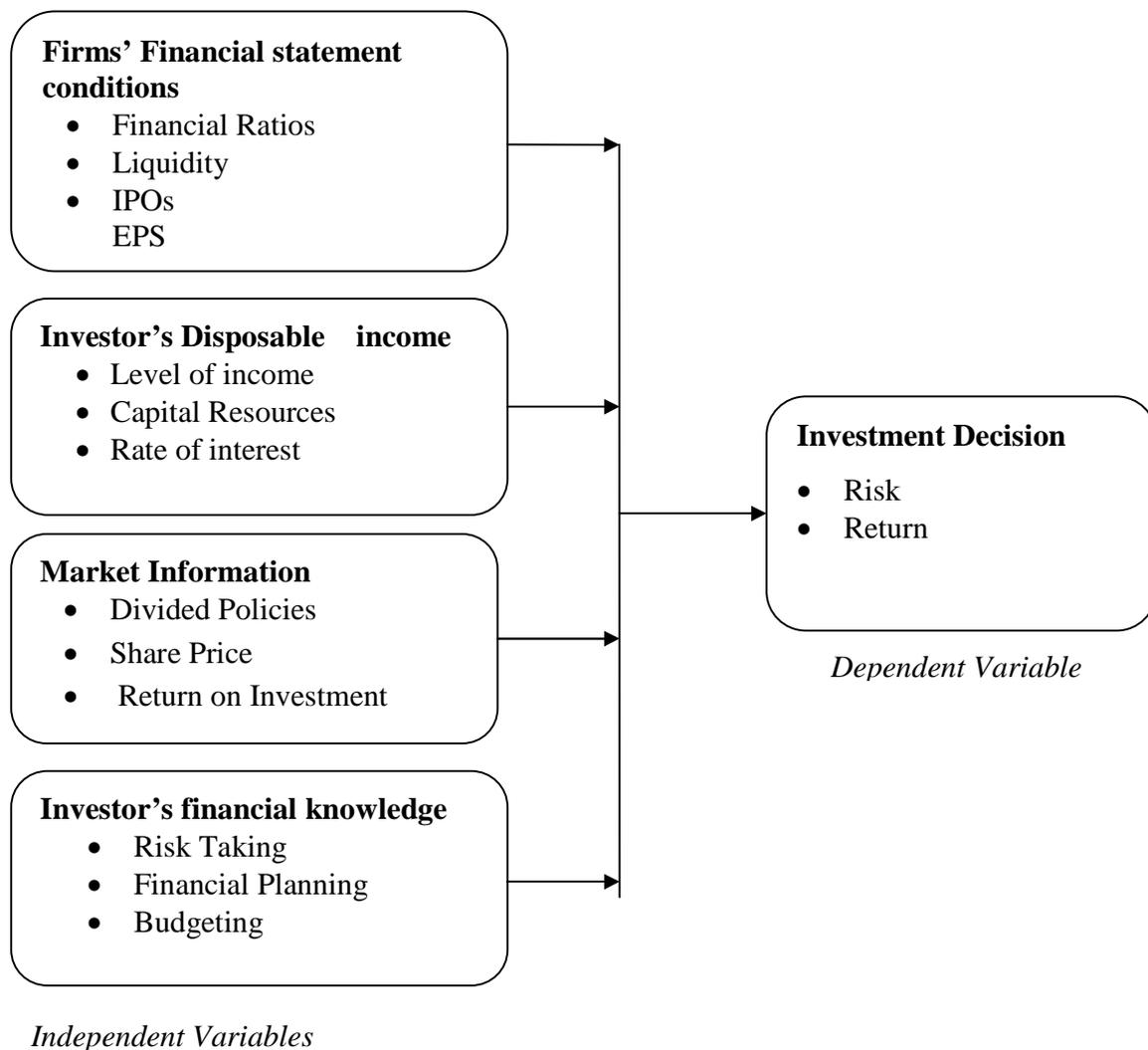
Both are linear regression based models used for the calculation of expected returns Ross (1976) has developed an alternative model, the arbitrage pricing theory (APT) in response to the criticisms of CAPM. Whereas CAPM is a single factor model relating a stock (or portfolio) to the market portfolio alone, APT is a multifactor model which effectively includes CAPM as a special case. In addition to the market portfolio APT makes use of advanced statistical technique known as factor analysis to identify other factors that affects the pricing of a security. Like CAPM, APT is founded on the assumption that capital markets are perfect and investors prefer more wealth to less wealth under uncertainty. APT suggests that returns on any given asset will be determined by a series of factors which are common to all assets and factors unique to the given asset. Market equilibrium will occur when will no longer yield better returns or lower risks arbitrage.

The Efficient Market Hypothesis (EMH)

The last pillar of the modern portfolio theory is the efficient market hypothesis. The efficient market hypothesis is based on the notion that people behave rationally, maximize expected utility accurately and process all available information (Shiller, 1998). Fama (1965) defines an efficient market as a market for securities where given the available information, actual prices at every point in time represent very good estimates of intrinsic values. In this market, there are large numbers of rational profit maximizers actively competing with each other trying to predict future market values of individual securities and where important current information is freely available to all participants (Fama, 1965). When information arises, the news spreads very quickly and is incorporated into the prices of securities without delay. Neither technical analysis nor even fundamental analysis would enable an investor to achieve returns greater than could be obtained by holding a randomly selected portfolio of individual stocks with comparable risk.

EMH is associated with the idea of random walk which characterizes price series where all subsequent price changes represent random departures from previous prices. If the flow of information is unimpeded and information is immediately reflected in stock prices, then tomorrow's price change will reflect only tomorrow's news and will be independent of the price changes today. But news by definition is unpredictable and the resulting price changes must be unpredictable and random. (Malkiel, 2003) concludes that as a result, prices fully reflect all known information and even uninformed investors buying a diversified portfolio at a tableau of given prices given by the market will obtain a rate of return as generous as that achieved by experts.

CONCEPTUAL FRAMEWORK



EMPIRICAL REVIEW

Investment is the exchange of current funds for future benefits. The objective of any investor is maximize those benefits and to achieve that; his investment decision must be guided by certain factors that range from economic to some which are not so economic. Among the economic factors that have been found to influence investor decisions include, expected corporate earnings, condition of financial statement, firms' status in industry and the possibility of capital appreciation. Merikas et al (2003) undertook a survey of the factors influencing individual investor behaviour in the Greece stock exchange and the variables rated as most important are classic wealth maximization criteria such as expected corporate earnings, condition of the financial statement or firm status in industry. Sultan (2010) found out that the object of most investors was either capital appreciation or balance of capital appreciation or current income. Al-Tamimi (2004) also found expected corporate earnings, stock marketability, past performance of a firms stock, dividends paid condition of financial statement and expected dividend to be the most influencing factor among individual investor in United Arab Emirates stock market. Speculative factors such as get rich quick, recent price movement in the firm stock and affordable price significantly influence investors' decisions (Merikas et al, 2003 and Al- Tamimi, 2004). Kaleem (2009) has found that age, income, gender and education to have significant role in determining the investment style of investors.

Sultana (2010) shows that increase in age decreases the risk tolerance level and that male investors dominate investment in India. Sewell (2010) says that research has indicted that decision making patters in males and females are significantly different. Men are more prone to overconfidence than women and overconfident investors trade excessively. According to Prince (2003) men tend to be more confident, trade more frequently, rely less on brokers and believe that returns are more predictable, thus anticipate more returns than women. Hinz , McCathy and Tuner (2003) conducted a study in USA using data from federal Government Thrift savings plan. Their finds showed that women are less likely to hold risky assets and more likely to allocate assets towards fixed income alternatives.

Cultural factors such as religion have an influence on investment decisions. Although Al-Tamimi (2004) surprisingly found religion to have the least influence on UAE investors, Metwally (2007) notes that Muslim countries all over the world are in rage to implement Islamic principles in society so that the economy and their social lives flourish according to the teachings of Islam. According to him, presently most of the Islamic countries are investing in the interest carrying instrument and the zakat (compulsory charity) is not implemented according to the civil laws. The criterion for ethical investment is different for Muslims and non-Muslims. The ethical investor is least concerned about the return from the investment but focus on the quality of the product, business activity and the way they handle the business issues. The Muslim investor has certain criteria for the selection of the portfolio which are according to Islamic principles. Most of the investments in the Western Market and the Islamic countries are not ethical as most of the

companies engage in *riba* (interest) and most companies are dealing in *haram* (prohibited) products even if their main business are religiously legitimate.

Subjective factors such as perceived ethics of the firm, feelings of a firms products and services community involvement and employee relation together with neutral information such as coverage in the press and statements from politicians contribute to relative neglect of the consideration of significant traditional variables (Merikas et al, 2003). Epstein (1994) examined demand for social information by individual investors. The results indicate the usefulness of annual reports to corporate shareholders. The results also indicate a strong demand for information about product safety and quality and about the company's environmental activities. Furthermore, a majority of the shareholders surveyed also want the company to report on corporate ethics, employee relations and community involvement. Advocacy factors such as brokerage house recommendation, family member opinion friends and coworkers recommendation and opinion of firm's majority shareholders do have some influence on investment decisions (Merikas et al, 2003) although in some studies (Sultana, 2010 and Al-Tamimi, 2004) they were found to have the least influence.

Behavioural factors such as herd behavior, regret aversion over confidence, mental accounting, representativeness and anchoring were found to account for investors investment decisions. Wagacha (2001) outlined that with the passage of the Capital Markets Authority Amendment Act (2000), which recognizes specific investment vehicles and especially mutual funds and unit trusts, then more opportunities for diversification by both institutional and retail investors would emerge in Kenya. Kamanda (2001) evaluated the equity portfolios held by Kenyan insurance companies over the period January 1998 to December 1999 and observed that majority of the insurance companies' maintained poorly diversified portfolios and the market portfolio outperformed the insurance industry portfolio. Kamanda also observed that the market rate of return for the Nairobi Stock Exchange was less than the risk free rate during the study period. This study seeks to establish the relationship between conditions of financial statements of firms, Investors' disposable income, market information and investors' knowledge and how they influence investment decisions at Nairobi security exchange.

RESEARCH METHODOLOGY

This study adopted a descriptive survey research design. The design is used to obtain information concerning the current status of a phenomenon with respect to variables or conditions in a situation. A descriptive design involves planning, organizing, collection and analysis of data so as to provide information being sought. This design provides in-depth responses which result in better and elaborate understanding of the phenomena under study. The target population was 150 people comprising of the management staff and individual investors. , random sampling techniques were used. The target population of 150 people was categorized into management staff and individual investors. Out of reach category in the target population, a

sample of 50% was taken. Meaning out of each target category, every subject with an even registration number was considered. The Researcher used stratified random sampling method where the population was grouped in stratus according to the categories they fall.

Self-administered questionnaires and interviews were employed. The use of questionnaires allows the usage of structured /closed –ended, unstructured/open-ended and contingency questions. The researcher constructed close-ended and open-ended questionnaires, which was administered to the target. The researcher used questionnaire because potentially information can be collected from a large portion of a group. This potential is not often realized, as returns from questionnaires are usually low. The researcher distributed the questionnaires and collected them immediately after the exercise to ensure efficiency in collection of the data. Data was tabulated and statistically analyzed using both descriptive and inferential statistics. Descriptive statistics involved percentages, frequencies and means. The purpose of descriptive statistics was to enable the researcher to meaningfully describe the findings. Multiple regression model was adopted for inferential statistics. Data was presented in Tables, bar graphs. The study used SPSS (Statistical Package for the Social Sciences) program to aid the analysis. The study used multiple regression analysis, it involves finding the best straight-line relationship to explain how the variation in an outcome (or dependent) variable, Y, depends on the variation in a predictor (or independent or explanatory) variable, X. The regression equation will be:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon$$

Whereby; Y = Investment decision, X1 = conditions of financial statements, X2 = investors' disposable income, X3 = market information and X4 = Investors' financial knowledge. Further, β_0 = the regression intercept, β_1 , β_2 , β_3 & β_4 = Regression Coefficients and ε = Error term normally distributed about a mean of 0 and for purposes of computation ε is assumed to be 0.

FINDINGS AND DISCUSSIONS

The findings of the study are based on 75 responses which represent 100% response rate. These include 59 investors (comprising 78% of the population) while 16 respondents representing 21% were staff of Dyer & Blare investment Bank.

The study found that effect of listed Firms financial statements conditions had a positive effect on investment decision making at NSE. 80% of the respondents opined that conditions of financial statement had a positive influence on investment decisions while 7% of the respondents were for the idea that financial statements conditions had negative influence on investment decisions. 13% of them indicated that the financial statement conditions didn't have any influence in investment decision. This shows that financial statements conditions had a positive influence on investment decision at NSE. The net worth of a given company and its valuation gave it attractiveness to the prominent investors. Disclosure of financial statements plays a

positive role of investors' decision in investing at NSE and financial statement is a rational tool to facilitate investment decision at NSE.

The study further found that there was a positive relationship between investors' disposable income and investment decision in security market. The investors who invest at NSE have good disposable income as indicated by the largest proportion (80%) of the respondents. The research found that investors could only plan for investment decisions at NSE when their disposable income was encouraging and in good condition to warrant that. 82% of the respondents reiterated that investors disposable income had a positive impact on investment decision. This implies that investors' disposable income has positive effect on individual's investment decision.

Further the study found that there was a positive correlation between market information and investors' investment decision making. From the study, 92% of the respondents indicated that market information plays a role in Investors decision making. This has come as a result of NSE making market information online for easy accessibility by the investors. The study also found that market information was excellent for investment decisions.

Lastly, the research found that knowledge in financial management and investment positively influenced investment decisions at NSE. Investors with adequate knowledge in financial management and investment could make fast investment decisions NSE faster than those without, knowledge of finance has a positive effect on investment decision at NSE and that knowledge on finance facilitates investment decision making at NSE.

Table 1: Regression Coefficients

Variables	Unstandardized Coefficients (β)	Coefficients Std. Error	Standardized Coefficients (β)	T	Sig.
(Constant)	2.837	.112		0.000	0.000
Conditions of financial statements	0.420	.120	0.224	1.867	0.023
Investors' disposable income	0.395	.106	.279	2.632	0.025
Market information	0.553	.146	0.330	2.260	0.014
Investors' financial knowledge	0.637	.075	0.235	3.133	0.006

From the regression analysis, the four independent variables (conditions of financial statements, investors' disposable income, market information and Investors' financial knowledge) explain 69.2% of investment decision at Nairobi Security Exchange. Further, taking all the four factors constant at zero, the possible value of Y would be 2.467. The results indicate that investors financial knowledge contributes the most to investment decisions, followed by market

information, then conditions of financial statements, while investors' disposable income contributes the least among the four factors studied.

CONCLUSIONS

The study concludes that firms' financial statements conditions are used adequately by investors at NSE. Any serious investor is doing a back ground check on the net worth of any listed company he is interested in investing in. Investors can only invest in NSE using the residuals after expenses and savings. Majority of the respondents were for the opinion that with the improved economy which has an effect in individuals' disposable income, Investors have can make quick decisions to invest at NSE.

The study further concludes that availability of market information is playing a central role in investors' decision making at NSE. With the country ICT platform going a notch higher, investors can access the needed information on real time and this facilitates investment decision making. From the findings, a big number of the respondents were for the opinion that most of investors at NSE have knowledge in security market. Some of them have the knowledge as a result of academic qualifications as well as having interest in learning about investment in securities.

RECOMMENDATIONS

This study recommends that since financial statements conditions affect the investment decisions, listed companies at NSE should annually publish their financial statements publicly in order to attract more investors. The financial statements will always work as an information tool that will enhance growth in both ways that is on the side of the Investor and on the side of the Firm.

With regard to investors' disposable Income the study recommends that investors should give priority to investment at NSE instead of struggling to safe for future which is not practically realistic. They should evaluate all the variables in the environment instead of considering only one variable. Investors do also need to diversify their investment in different companies by developing a portfolio of investments to minimize risks and maximize returns.

The study deduced that market information works well for both existing and prominent investors. It is recommendable to the investment companies to be availing market information to the public all the time. This will create investment appetite to the investors because they will always act from the point of knowledge.

On Investors' financial knowledge the study recommends that the individual companies listed at NSE should create more awareness to the market. This will enhance market growth of securities and derivatives as people with idle funds will find a good place to invest them.

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