# THE EFFECT OF INVESTMENT DECISIONS ON FIRMS' PROFITABILITY (EMPIRICAL STUDY ON LISTED COMPANIES)

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## ABSTRACT

The association between investment decisions and the profitability of companies listed on the New York Stock Exchange is investigated in this study. The paper demonstrates a correlation between investment decisions, as indicated by asset growth, financial leverage, liquidity and business profitability. In the first section of the paper, comprehensive information and importance of them is given about variables used in the research. After that previous studies related to the topic are deeply analyzed and conclusions from those are indicated for further reference. In the last section the paper econometric models are used to determine the relationship between variables. In the data analysis part statistical findings pertaining to financial leverage and profitability are displayed. The findings of this study have important policy implications for firms. The study discovered that performance improved with higher investment decision, and financial leverage. In order to maximize profitability, the study advises corporate managers to allow for new opportunities in order to be more innovative, which will lead to new investments and higher financial leverage - in particular. In order to boost performance as indicated by return on equity, management of listed companies is advised to pursue a conservative financing strategy.

**Keywords:** investment, financial leverage, liquidity, performance, business profitability

**JEL Classification: G11, G31, G32**

## INTRODUCTION

Research will analyze how investment decisions influence the performance of the firms listed on exchange. The primary goal of investing is to generate a profit or return. In the modern world, businesses accomplish this through creating a new product, researching a new market, or starting a new business. Making investing decisions is a part of it. Investment choices are crucial for the company since they often determine its worth through affecting profitability and risk.

A company's investment choices are typically referred to as its capital budgeting or capital expenditure choices. A decision made by the company to invest its current resources most effectively in long-term assets in anticipation of a projected stream of benefits over a number of years is referred to as a capital budgeting decision. An efficient allocation of capital and an appropriate capital structure are critical decisions for any business organization. A bad investment choice could cause a company to incur losses and eventually close. The choice is significant not only for the requirement to optimize investor and owner equity returns, but also for the effect it will have on how well the organization can respond to its competitive environment.

Companies must have enough capital available to expand their operational activities in the battle to meet market demand. Companies can simply increase their operational operations through wise investments, which will have an effect on boosting corporate earnings. Profitability itself is the primary goal of the establishment of a company in order to maintain the sustainability of its business in the future; this is because profitability shows whether the company has good prospects in the future or not (Wijaya and Sedana, 2015). According to signaling theory, good investment activity, and high-profit income can provide a positive signal about the growth of the company in the future, so that it can increase stock prices which are used as a reflection of company value (Achmad and Amanah, 2014; Amarudin, Adam, Hamdan and Hanafi, 2019). The reason for this is that when market confidence grows and investors allocate more money to the company without hesitation, the company's stock price will rise as a result. This idea is supported by Fama and Eugene (1978) by the statement that the value of the company is solely determined by the investment decisions of the company's management. Since they are one of the key factors that affect business success or failure, as well as firm value in the end, the significance of investment decisions and the decision-making process on financial performance of organizations cannot be deemphasized.

The aim of the research is to answer the following research question: What is the Effect of Investment Decision on the performance of firms listed on an exchange? The findings of this study will help businesses and managers develop effective methods for investing in stocks, bonds, and other debt or equity instruments so they can take full advantage of the expanding investment market. In turn, this will provide them a competitive advantage. On of the main purposes of this study is to make a contribution to the study of investment decisions of listed companies. Firms can make more intelligent investment judgments if they are aware of corporate investment decisions and how they relate to business profitability. Investment analysts will also benefit from this study.

This research will also contribute to knowledge in the academic community, in research institutions, in educational institutions, and among individuals, enabling people to make informed personal investments of any size. Academically, this study aims to provide a greater understanding of the many sorts of investment decisions and their effects, as well as recommending more questions and points for further research. When conducting investigation this study has limitation only to use certain limited indicators as variables in which case effect of other unused variables can stay out of sight of mine as researcher because of which even it is less chance I can come to wrong conclusion which I think is not the case here despite.

## Literature Review

A lot of research papers related to the concept of investment and its effects on profitability have been presented till now. For example, Fama and Eugene (1978) suggested that one of the things that might raise the value of a company is investment decisions. Over the past few decades, studies on the impact of investment choices on business value have generated a lot of discussion in both emerging market and non-emerging market nations. Research undertaken in the 1990s revealed a trend that investment choices can raise business value (Emanuele, Bigelli and Sandri, 1998; Santos, Dos, Peffers and Mauer, 1993). Additionally, study patterns from the 2000s showed that investment choices frequently inhibit improvements in business value (Brio, Del, Miguel and Pindado, 2003; Lin and Kulatilaka, 2007). A trend was discovered in the 2010s demonstrating how investment choices contributed to improvements in firm value (Efni and Yulia, 2017; Soumaya and Hechmi, 2015; Susanti, Neneng, Affandi and Herwany, 2019). We came into conclusion that investment choices can raise a firm's value in light of these observed tendencies. The idea that underpins investment choices is called signaling theory (Alghifari et al, 2022). According to this hypothesis, investment spending is a sign that a firm will grow in the future, which will affect profits and raise its value (Sun, Lin and Chen, 2017). According to Maulana (2016), choosing an investment is a long-term capital investment decision that intends to attain expected future business profit results. Cahyono and Sulistyawati (2017) demonstrated how investment choices can have a favorable impact on a company's value. The outcome demonstrates the company's capacity to maximize investment in an effort to produce earnings in accordance with the amount of funds committed. Rafika and Santoso (2018) discovered that a funding decision can affect the value of a company. In this study, the debt to equity ratio (DER), which measures the proportion of a company's overall debt—either current debt or long-term debt—to its own capital (equity), was utilized as a funding decision indicator. Due to the fact that debt can aid management in keeping a company operational, PBV will therefore rise as DER does. So investors believe that rising debt will improve company performance like many banks do.

According to research by Dewi and Wirajaya (2013) and Mahendra, Artini and Suarjaya, (2012), Return on Equity (ROE) can be used as a measuring instrument to quantify profitability. Utilizing resources that the company owns, profitability ratios are used to gauge a company's capacity to turn them into profit. The reason ROE can be used as an indicator for profitability is that a greater ROE implies that a company is using its own capital to create investment profits from the funds invested in the company more effectively (Sudana, 2015). According to Murniati and others (2019) when investment decisions rise, the level of profitability gained by shareholders will likewise increase because investment decisions have a positive and significant impact on profitability.

The basic investment decision is the decision to allocate funding sources. Company's liquidity, or an organization's capacity to generate cash that can cover both short-term and long-term demands, is a factor that influences the investment decisions made by an organization. Companies must retain liquidity to prevent disruptions in the smooth operation of their investment activities and to keep the trust of third parties (Hidayat, 2010). Sunariyah (2006) asserts that the development of the firm's investment may be gauged by the increase of the total asset of the relevant company from year to year. Emphasis on the effects of capital investment on business profitability has been made in lots of earlier research both in developed (Kim, 2001; Kumar and Li, 2013) and developing countries (Jiang, Chen and Huang, 2006).

## Methodology and Data

A descriptive research design will be used for the investigation. It was decided to utilize a descriptive research design since it enables the generalization of research findings. Besides inferential statistics, panel data regression analysis, and hypothesis testing will be employed in this study's data analysis in order to draw conclusions about the study's findings. The SPSS program will be used to process the data and test the hypotheses with a specified significance value (α) of 5%. The panel data approach is the proper regression technique to utilize in this study since the data will be panel data, which is a combination of time series data and cross-sectional data. In order to adress the target population the 3 periods of financial statements of 15 publicly traded companies that have some level of exposure to crypto, either through investments, partnerships, or side ventures and 15 top companies listed on the NYSE as of March 31, 2022. The database for the study is completely based on secondary data. Profitability, leverage, liquidity and asset growth ratios are the variables that will be used in the analysis. All of the study's variables' data came from published annual reports and financial statements of the NYSE-listed companies. The income statement, statement of financial position, statement of cash flows and notes to the accounts were among the data that were retrieved from the NYSE handbooks.

## Analytical model

The models logit, probit, discriminant analysis, and regression models can all be used to analyze quantitative data. When the dependent variable is binary, the models of logit, probit, and discriminant analysis are appropriate. B. Muthen and L. Muthen, (2007) advised using a regression model for this type of investigation because the dependent variable is continuous. Return on Equity was used to clearly evaluate the performance of the company (Y).

$$Y = \alpha + \beta 1x1 + \beta 2X2 + \beta\ 3X3 + \varepsilon$$

Where,

Y = Profitability as measured by Return on Equity of the company

X1 = Change in assets as measured by Asset Growth ratio

X2 = Financial Leverage of the company as measured by the debt to equity ratio

X3= Liquidity as measured by Current ratio of the company.

$\alpha$ = The Intercept or constant

$\beta 1 \ldots \beta 3$ = the regression coefficients of the independent variables.

$\varepsilon$ = Error term

## Empirical Study and Discussion

### Descriptive statistics

The study determined that it was first necessary to assess the performance of the firms via investment decision variables under consideration, i.e., liquidity as measured by the company's current assets to current liabilities ratio, financial leverage as measured by the debt to equity ratio and change in assets as measured by asset growth ratio. As shown in Table 1, their mean, standard deviation, lowest and maximum values were calculated.

**Table 1: Descriptive statistics**

| | N | Minimum | Maximum | Mean | Std. Deviation |
|---|---|---|---|---|---|
| Financial Leverage | 90 | -10.7257 | 12.2129 | .912233 | 3.0754154 |
| Liquidity | 90 | .5894 | 12.1263 | 1.667093 | 1.4703806 |
| Asset growth | 90 | -.8358 | 4.4417 | .171222 | .5591951 |
| Valid N (listwise) | 90 | | | | |

Source: Results of the analysis of SPSS 16.0

Change in assets as indicated by the asset growth ratio had a mean of 0.17, minimum value of -0.84 and maximum value of 4.44 with standard deviation of 0.56 meaning that study includes both low and high investments made companies with average of relatively low asset growth companies. Liquidity as indicated by current ratio had a mean of 1.68 with minimum value of 0.59 and maximum value of 12.13 which shows that sample includes mostly companies with good liquidity condition while the standard deviation shows that the data is well distributed via having both higher and lower liquid firms. In general, the relatively high ratios show that most businesses had a wide margin of safety. Debt to equity ratios as an indicator of financial leverage had a mean of 0.91 with minimum value of -10.73 and maximum value of 12.21 showing the existince of highly geared companies even with equity deficit meaning that sample consists of companies having been provided by mostly debt financing.

## Inferential statistics

The advance analysis started by firstly defining whether data for analysis is normally distributed or not by use of normality test for the purpose of the definition of further tests that is going to be used during the research. Then the degree of relationship between the various variables was found using correlation analysis. Spearman Correlation test was used to determine whether there is a significant difference between investment decision and the performance of firms listed on the New York Stock Exchange, while the regression analysis was used to determine the impact of the investment decision variables on firms' profitability.

## Normality test

**Table 2: Tests of normality**

| | Kolmogorov-Smirnov[a] | | | Shapiro-Wilk | | |
|---|---|---|---|---|---|---|
| | Statistic | df | Sig. | Statistic | df | Sig. |
| Financial Leverage | .277 | 90 | .000 | .777 | 90 | .000 |
| Liquidity | .261 | 90 | .000 | .512 | 90 | .000 |
| Asset Growth | .267 | 90 | .000 | .529 | 90 | .000 |
| Profitability | .217 | 90 | .000 | .751 | 90 | .000 |
| a. Lilliefors Significance Correction | | | | | | |

Source: Results of the analysis of SPSS 16.0

The abovementioned table shows the result of my normality test. As per consideration of my confidence interval of 5% none of the variables of my research are normally distributed. That is why I am going to apply non-parametric tests to my variables in further steps.

**Spearman correlation test**

The study evaluated whether the investment choice proxies (asset growth, financial leverage, and liquidity) would improve firm profitability in this part by measuring the strength of correlation between the investment decision variables and firm profitability. The correlation coefficients for each variable taken into consideration in this investigation are shown in Table 3.

**Table 3: Spearman's correlation coefficients matrix**

| | Financial Leverage | Liquidity | Asset Growth | Profitability |
|---|---|---|---|---|
| Financial Leverage | 1.000 | -.197 | .036 | .246* |
| Liquidity | -.197 | 1.000 | .190 | .106 |
| Asset Growth | .036 | .190 | 1.000 | .056 |
| Profitability | .246* | .106 | .056 | 1.000 |

*Correlation is significant at the 0.05 level (2-tailed).

Source: Results of the analysis of SPSS 16.0

Table 3 shows that at 0.05 confidence interval, there were good, significant and positive correlation between Proftability and Financial leverage (R = 0.246).

**Regression analysis**

The association between investment decisions and the profitability of companies listed on the New York Stock Exchange was investigated in the study using panel data regression analysis. In this regard, a straightforward definitional model was employed, as illustrated below:

$$ROE = \alpha + \beta1(\text{Asset Growth}) + \beta2(\text{Financial Leverage}) + \beta3(\text{Liquidity}) + \varepsilon$$

The coefficients of determination and the analysis of variance (ANOVA) were also obtained using the regression statistics. Unlike the latter, which was used to determine whether there is a significant mean difference between dependent and independent variables, the former was used to demonstrate the strength of the relationship. ANOVA was carried out at a 95% confidence level.

**Tabel 4: Model Goodness of fit**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .471[a] | .222 | .195 | .6481418 |

a. Predictors: (Constant), Liquidity, Asset Growth, Financial Leverage
b. Dependent Variable: ROE

Source: Results of the analysis of SPSS 16.0

Regression analysis was utilized in the study to determine the association between ROE and important investment decision elements such liquidity, financial leverage, and asset growth. A correlation value (R) of 0.47 was generated, showing a positive linear dependency of ROE on the factors of investment decision, including liquidity, financial leverage, and asset growth.

An adjusted R-squared of 0.195 further revealed that Asset Growth, Financial Leverage and Liquidity only explain 19.5 percent of the variations in ROE while 81.5 percent is explained by other factors not accounted for in the model.

**Table 5: Analysis of variance**

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 10.302 | 3 | 3.434 | 8.175 | .000[a] |
| | Residual | 36.128 | 86 | .420 | | |
| | Total | 46.430 | 89 | | | |
| a. Predictors: (Constant), Liquidity, Asset Growth, Financial Leverage | | | | | | |
| b. Dependent Variable: Profitability | | | | | | |

Source: Results of the analysis of SPSS 16.0

To determine the differences between the means of the dependent and independent variables and to demonstrate if a relationship exists between the two, the ANOVA statistics were used. The P-value of 0.000 indicates that ROE and Asset Growth, Financial Leverage, and Liquidity have a substantial joint association that is significant at the 5% level of significance, which also demonstrated the significance of the regression analysis performed at the 95% confidence level.

**Table 6: Coefficients of regression**

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|---|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | .215 | .110 | | 1.949 | .055 |
| | Asset Growth | -.153 | .123 | -.119 | -1.245 | .216 |
| | Financial Leverage | .107 | .022 | .458 | 4.795 | .000 |
| | Liquidity | .015 | .047 | .030 | .310 | .757 |
| a. Dependent Variable: Profitability | | | | | | |

Source: Results of the analysis of SPSS 16.0

The coefficients of determination in table 6 above reveal both a positive relationship between ROE and other predictor variable of Financial Leverage. When considering all, the established regression equation is equal to:

$$ROE = 0.215 - 0.153 (Asset\ Growth) + 0.107 (Financial\ Leverage) + 0.015 (Liquidity) + \varepsilon$$

One of these relationships was significant according to significant tests (T-tests and P-values), which led to the study to determine how investing decisions affected the performance of companies listed on the New York Stock Exchange. The regression results indicate that the space allocation value would be 0.215 when Asset Growth, Financial Leverage, and Liquidity have zero values. It is also proven that, while keeping other variables (asset growth and liquidity) unchanged, an increase in financial leverage would lead to a 0.107 rise in ROE. This statistic had a t-value of 4.795 with a P value of at .000 showing that the statistic is significant at 95% confidence level.

As seen from the table above significance of only the 2nd variable is less than 0.05, so I only considered this variable for further testing. The variable is ordinal, non – parametric, and also had more than 2 values, that is why I used Kruskal –Vallis test as further step in my research.

**Kruskal Wallis test**

**Table 7: Kruskal Wallis test**

| | Profitability |
|---|---|
| Chi-Square | 29.163 |
| df | 13 |
| Asymp. Sig. | .006 |

a. Kruskal Wallis Test

b. Grouping Variable: Financial Leverage

Source: Results of the analysis of SPSS 16.0

As seen from the table above significance value is less than 0.05, so the main objective of my research paper of identification of effect of investment decisions on profitability of companies listed on New York Stock Exchange is confirmed.

**Interpretation of findings**

The results demonstrate a correlation between investment decisions, as indicated by asset growth, financial leverage, liquidity and business profitability. The inference is that a company becomes more profitable the more new investments it makes because of the new revenue sources and sources of income.

However, the association is fairly weak which can be attributable to other underlying factors like the initial investment expenses and the amount of time it takes to really get a profit from new investments.

Alltogether, these findings imply that businesses with more development potential generates more profit and cash. Similar findings were reported by Stella (2011), who suggested that, if successful, all large corporations and emerging SMEs eventually require additional investments in order to grow or innovate more. As Bekaert, Harvey, Lundblad and Siegel (2007) and Wurgler (2008) said investment decisions, particularly business expansions matter for profitability.

The data analysis displayed statistical findings pertaining to financial leverage and profitability. Calculating financial ratios of which debt to equity ratio was examined in this study is the method the most frequently employed to gauge financial leverage. The gearing ratio shows how much financing is provided by internally (owner funds) compared to external funds. As seen from the econometric model applied above there is positive relationship between financial leverage as an indicator of investments made and profitability. Because every firm needs money when it decides to make any investment and firms have two choices to generate fund either internally or externally. In general, nowadays companies use external financing which increases gearing ratio in order for making new different types of investments so they can repay both interest and principal amounts taken from the banks by means of profits generated at the same time from new investments. So, increase in financial leverage is an indicator of increase in profitabilty as also seen from my research result.

## CONCLUSION AND RECOMMENDATION

The research findings are summarized in this chapter. Furthermore, the conclusions' implications and potential areas for further study are discussed. According to the literature review, the study's findings are presented and contrasted with what other reserachers have claimed.

### Summary and conlusion

The results show that the size of new investments has a big impact on how profitable a company is. So, more innovative businesses are more likely to achieve higher profitability compared to less innovative ones when it comes to the introduction of new goods, services, branches, and technologies. Due to decreased interest amounts, financial leverage may improve profit after taxes. Ultimately, increased earnings may lead to better earnings per share or dividend payout ratios, which may raise the profitability of the company. Even if the marginal revenues from reduced interest expenses and tax shileds are kept for the company's expansion, it may ultimately maximize the company's worth and lead to the accomplishment of the wealth maximization goal that the real owners invest in.

## RESULTS AND RECOMMENDATIONS

The findings of this study have important policy implications for firms. First of all, the study discovered that performance improved with higher investment decision, and financial leverage. In order to maximize profitability, the study advises corporate managers to allow for new opportunities in order to be more innovative, which will lead to new investments, financial leverage - in particular, their debt-to-equity ratio and liquidity ratios and new investments. Secondly, in order to boost performance as indicated by return on equity, management of NYSE listed companies should pursue a conservative financing strategy. As a result, the management of the companies listed on the NYSE should focus on financing assets more frequently with long-term liabilities. This is because the study shows that, in contrast to the use of short-term financing, the use of greater long-term financing increases return on equity.

### Limitations of the study

Many difficulties were encountered over the course of the study. The study only covered a 3-year span, from 2020 to 2022, hence its conclusions are only valid for those three years. As a result, they may not be generalizable to other periods of time. It may not be possible to accurately depict the situation in the nation at all times based solely on the three years examined because changes over time are possible. The relationships in the study's model are further indicated as being merely from the perpectives of three variables; however, other attributes that can affect profitability have not been taken into account.

### Recommendations for further study

There is need to conduct a similar study over a longer time span. This is on the assumption that data collected over a longer period of time will yield outcomes that are superior to those of the results given in this study. The potential for greater objectivity that emerges from the sample period may be resolved over a longer length of time. It is also advised to conduct a causality analysis in order to identify the root reasons of the associations' observable between independent and dependent variables.

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