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EFFECT OF FINANCIAL STATEMENTS INTERPRETATION KNOWLEDGE ON QUALITY RETAIL INVESTMENT DECISIONS AMONG BROKERAGE FIRMS TRADING AT THE NAIROBI SECURITIES EXCHANGE IN NAIROBI COUNTY

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Effect of Financial Statements Interpretation Knowledge on Quality Retail Investment Decisions among Brokerage Firms Trading at the Nairobi Securities Exchange in Nairobi County

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Abstract:

Purpose of Study: This study examined the effect of financial statements interpretation knowledge on the quality of retail investment decisions among brokerage firms trading at the Nairobi Securities Exchange in Nairobi County. It sought to determine whether enhanced financial statement interpretation skills significantly improve the quality of investment decisions made by retail-facing brokerage professionals.

Methodology: The study adopted an ex-post facto research design involving 20 licensed brokerage firms with a population of 714 employees. A stratified random sample of 257 respondents was selected. Data were collected using structured questionnaires and analyzed using descriptive statistics and binary logistic regression in SPSS version 25.

Findings: Out of 257 questionnaires distributed, 203 were returned, representing a 79.0% response rate. Respondents demonstrated moderate-to-high financial statement interpretation skills, with the highest competency in calculating financial ratios and comparatively lower competence in balance sheet analysis. Binary logistic regression revealed that financial statement interpretation had a positive and statistically significant effect on the quality of retail investment decisions ($B = 2.454$, $p < 0.001$). The odds ratio of 11.638 indicated that respondents with higher financial statement interpretation skills were substantially more likely to make quality investment decisions, confirming financial literacy as a critical predictor of sound retail investment behaviour.

Conclusion: The study concludes that financial statement interpretation significantly enhances the quality of retail investment decisions among brokerage firms at the Nairobi Securities Exchange. Strengthening financial statement literacy through investor education and professional training can improve investment outcomes, reduce speculative decision-making, and promote informed participation in Kenya's capital markets.

Keywords: *Financial Statements Interpretation; Quality Retail Investment Decisions; Nairobi Securities Exchange; Brokerage Firms*

1. INTRODUCTION

The interpretation of financial information provided to the public by companies has to be right for investors to make a correct investment decision. Retail investors capable of understanding financial statements are better equipped to evaluate a firm's viability, avoid speculative investments, and make informed choices regarding securities to invest in that align with their financial objectives (Aristei & Gallo, 2021). Investors, when they do not have this knowledge, tend to make investment decisions based on rumors, market sentiment and price speculations rather than fundamentals provided in the financial statements.

At the NSE, brokerage firms and their retail investor clients continue to make poor investment choices, which has caused concern on the depth of financial statement literacy among the members. Provision of trading platforms and investment products has grown; however, understanding of retail investors in decoding the financial disclosure that underlies good security selection, has been comparatively under-researched in the Kenyan brokerage space (Bucher-Koenen et al., 2023). This gap inspired the present study whose objective was to establish the effect of knowledge in interpretation of financial statements on quality retail investment decisions among retail brokerage firms at Nairobi Stock Exchange.

The hypothesis that guided this study was as follows:
H0: *Financial statements interpretation does not have a significant effect on quality retail investment decisions among brokerage firms trading at the Nairobi Securities Exchange in Nairobi County.*

2. LITERATURE REVIEW

Theoretical Review

Modern Portfolio Theory (MPT), developed by Markowitz in 1952, posits that rational investors assess the contribution of each security to the total portfolio risk and return rather than evaluating securities in isolation (Mba et al., 2022). Mean-variance optimization requires investors to extract information from company financial records on expected return and volatility, which relies on strong analytical skills. Investors who cannot read financial statements are therefore poorly placed to construct efficient, diversified portfolios.

Kahneman and Tversky's Prospect Theory states that investors make investment decisions based on their psychological point of reference and that investor losses are treated differently than investor gains. In terms of financial statement literacy, Ladrón de Guevara Cortés et al. (2023) illustrate that the reflection effect (where investors are less likely to take risk when faced with paper losses) is significantly reduced in investors with higher financial statement analytical literacy. This is an indication that financial statement literacy is a moderating effect on behavioral biases in investment decision-making.

Fama (1970) developed the Efficient Market Hypothesis (EMH). The semi-strong form of the EMH suggests that security prices already reflect all publicly available information including the information in financial statements. In an efficient market, investors who are unable to interpret publicly available financial information have no information advantage because prices already incorporate the same disclosures (Nyakurukwa & Seetharam, 2023). Investors who are able to meaningfully interpret financial statements, in contrast, are better able to identify truly undervalued or overvalued securities.

Empirical Review

Aristei and Gallo (2021) employed nationally representative data from a Survey on Financial Literacy and Competence conducted by the Bank of Italy. These researchers used instrumental variable regression on a sample of 2000 individuals aged 18 and above to test for a causal effect between a financial literacy index and a quality index for investment decisions. The findings noted that investors with more objective financial knowledge were more likely to interact with the stock markets, make informed decisions on asset allocation, and avoid fraudulent schemes. On the other hand, those with lower knowledge were more likely to participate in the stock markets in an uninformed manner and take uninformed risk. The study does not consider financial knowledge as one of the factors affecting the quality of the investment decision; instead, it isolates it from the financial knowledge as a key distinct driver of quality decision. However, its Italian context hinder the comparison with the information asymmetry present on the NSE.

To test investors', use of financial tools for sound investment decisions, Olayinka (2022) conducted a descriptive survey of Nigerian financial analysts. The researcher targeted accountants and investors to determine the roles of ratio analysis, comparative statements, and common-size statements for the evaluation of corporate financial performance. A major finding was that investors using these tools on a regular basis were able to make sound investment decisions compared to counterparts. The finding helps to validate expectations that financial statement analysis plays a pivotal role in ensuring quality retail investment decisions in the NSE. This is more so with the fact that Nigeria and Kenya markets have structural similarities, such as the nature of information asymmetry and limited retail participation.

Gekonde et al. (2024) employed quantitative research design, regression analysis technique and a sample of equity fund managers from NSE listed companies in Kenya to study investor behavior of NSE-listed companies in Kenya. The skills to read, decode and use financial statements was among the most reliable of the information processing literacies to predict sound investment decisions. The less analytically-illiterate fund managers were more likely to make speculative/momentum-type investment decisions. The study was carried out in the same NSE brokerage environment as the present study; therefore, the results of the study are directly applicable to Nairobi retail investors.

Rana (2024) employed structural equation modelling to analyze the impact of financial literacy on the investment choices of retail investors in the Nepalese stock market. The study included aspects of financial statement interpretation, financial risk assessment and knowledge of the stock market. Higher levels of money managers' money statement literacy were associated with superior ability to evaluate a firm's performance and make investment decisions consistent with their investment objectives. More so, lower money statement literacy was related to more reactive investment decisions and greater sensitivity to market noise. The findings support the argument that enhancing financial statement interpretation skills of NSE brokerage clients will lead to better investment decision making.

The reviewed studies show that there exists a positive association between financial statements interpretation and the quality of investment decisions in the developed and Sub-Saharan African countries. However, none specifically addressed the magnitude of the relationship between financial statements interpretation and investment decision quality for retail facing brokerage staff in Nairobi County; the present study seeks to fill that contextual gap.

3. METHODOLOGY

Research Design

The study utilized an ex-post facto research design. This research design is appropriate for examining the effect of a naturally occurring independent variable on a dependent variable minus researcher manipulation. It is also well suited to establishing cause-and-effect relationships among variables that already exist in the field. The design was used to find out the effect of interpretation of financial statements on quality retail investment decision among brokerage firms listed on Nairobi Stock Exchange.

Population and Sample

The study involved 20 brokerage firms licensed to operate retail investment business on NSE. The unit of observation comprised of 714 employees in four types of categories namely; investment analysts, risk officer, financial managers/financial accountants as presented in Table 1.

Table 1: Population Distribution

Category	Number
Investment analysts	156
Risk officers	167

Financial managers	178
Accountants	213
Total	**714**

Source: PWC (2025)

Stratified random sampling was used to select a sample of 257 respondents from a population of 714, with a sampling error of 0.05 and four strata. This is illustrated in Table 2.

Table 2: Sample Distribution

Category	Number	Ratio	Size
Investment analysts	156	0.218	56
Risk officers	167	0.234	60
Financial managers	178	0.249	64
Accountants	213	0.298	77
Total	**714**	**1**	**257**

Source: Author (2026)

Data Analysis

The Statistical Package for Social Sciences (SPSS) version 25 was used for the quantitative data analysis. To summarize the respondents' financial statements interpretation ability, descriptive statistics in the form of means and standard deviations were used. Next, inferential analysis in the form of binary logistic regression was applied at a critical value of 0.05 with the dependent variable quality retail investment decisions coded as low or high. The individual effect of the financial statements interpretation on quality retail investment decisions was validated through a bivariate logistic regression model below:

$$Log\ Y\ (P/1\text{-}P) = \beta_0+\beta_1X_1 + \beta_2X_2+ \beta_3X_3 +\beta_4X_4$$

Where P refer to probability of a high-quality investment decision, (1-P) signifying probability of a low-quality investment decision and $\beta0$ to $\beta4$ logistic coefficients representing the financial statements interpretation as one of the four financial literacy dimensions in the study.

4. RESULTS

The table below encompasses the descriptive statistics of financial statements interpretation construct.

Table 3: Descriptive Analysis on Financial Statements Interpretation

	N	Minimum	Maximum	Mean	Std. Deviation
I am able to interpret information presented in a company's income statement.	203	1	5	3.62	1.044
I understand how to read and analyze a company's balance sheet.	203	1	5	3.60	1.123
I can evaluate a company's overall performance using its financial statements.	203	1	5	3.61	1.035
I am able to calculate and interpret basic financial ratios (e.g., profitability, liquidity).	203	1	5	3.83	.996
I use financial statement information when making investment decisions.	203	1	5	3.70	.987

On average, the respondents indicated that they have a moderate to high level of competency interpreting financial statements. The ability to calculate and interpret basic financial ratios (such as profitability, liquidity) (M = 3.83, SD = 0.996) and the use of information from the financial statements in investment decisions (M = 3.70, SD = 0.987) were also the highest mean. Interpretation of an income statement and evaluation of overall company performance based on financial statements were also rated moderately (M = 3.62, SD = 1.044) and (M = 3.61, SD = 1.035), respectively, and balance sheet was found to be the lowest with a mean score of 3.60, SD = 1.123, indicating higher variation in the respondents' balance sheet analysis skills. Financial Statements Interpretation and Quality Retail Investment Decisions (Bivariate Model). A bivariate logistic regression was performed to determine if there was an effect on quality retail investment decisions when interpreting financial statements. The outcomes of the tests are shown in table 6.

Table 4: Bivariate Logistic Regression on Financial Statements Interpretation

Model Summary			
Step	**-2 Log likelihood**	**Cox & Snell R Square**	**Nagelkerke R Square**
1	190.867[a]	.219	.315
a. Estimation terminated at iteration number 5 because parameter estimates changed by less than .001.			

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	B	S.E.	Wald	df	P-values	Odds
Financial Statements Interpretation						
Low financial statements interpretation (RC)	-	-	-	-	-	0
High financial statements interpretation	2.454	0.393	38.936	1	0.000	11.638
Constant	-0.112	0.212	0.281	1	0.596	0.894

Note: Model Summary: -2 Log Likelihood = 190.867; Cox & Snell R Square = .219; Nagelkerke R Square = .315.

Both the nature of the contribution and the meaning of financial statements interpretation to the predictions of good investment decisions in retail sector are summarized in the model. The value of the -2 Log Likelihood was 190.867, the Cox and Snell R Square was 0.219 and the Nagelkerke R Square was 0.315. This indicates that, between 21.9% and 31.5% of the variation in the quality of the retail investment decision is accounted for by financial statements interpretation. The variables in the equation indicated that financial statements interpretation had an effect on quality retail investment decisions that were positive and statistically significant: B = 2.454, Wald = 38.936 and $p < .001$, which means Exp(B) = 11.638. This means that the higher the respondents' ability to interpret financial statements the more likely they were to make a quality retail investment choice. The odds ratio indicates that the improvement in financial statements interpretation significantly contributed to a quality investment decision making.

5. DISCUSSION

The results indicate that basic financial ratios were the most confident application, while balance sheet analysis was the least confident level of financial statement literacy among NSE brokerage staff. This is mainly because the latter's financial statement literacy was in varying degrees. This relates to the findings of Olayinka (2022) and Kamau et al. (2025), which reveal that ratio analysis, comparative statements and common-size statements help investors to analyze the value of a company. On the other hand, limited application of those tools mainly lead to suboptimal or poor investment decisions.

The effect of financial statements interpretation on positive quality retail investment decision is statistically significant. This aligns with Aristei and Gallo (2021) results, which showed positive link between objective financial knowledge and investors' behavior, in terms of overall participation in the stock markets, correct asset allocation and avoidance of fraud schemes. Additionally, it corroborates the study by Gekonde et al. (2024) that identified information processing literacy (reading financial statements and interpreting financial statements) as one of the key factors that influences sound investment decisions among participants of the NSE. It is also in tandem with Rana (2024) and Doğaner et al. (2024), who linked good financial statement

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interpretation skill with rational and goal-driven investment decisions among retail investors in the emerging market.

The study finds a significant effect after accounting for the effect of risk and return knowledge. The findings further validate the theoretical assumption in Modern portfolio theory that the return and risk information that can be gained from financial records is related to mean-variance optimization function. A significant effect was found following the adjustment for risk and return knowledge, along with trading literacy and knowledge about the stock market. This support the theoretical assertion from Modern portfolio theory that return and risk information gathered from financial records is linked to the function of mean-variance optimization. It also validates the semi-strong version of the Efficient Market Hypothesis, introduced by Fama in 1970, which states that only investors who can meaningfully process publicly available financial information can take advantage of mispricing. It also supports with Ladrón de Guevara Cortés et al (2023), who determined that investors who are more analytic-literate are less affected by the reflection effect of the Prospect Theory when it comes to the selection of mispriced securities.

6. CONCLUSION

The study concludes that the interpretation of financial statements has positive and significant influence on the quality of investment decisions in retail segment of the NSE in Nairobi County among the brokerage firms. Overall, respondents exhibited sound financial ratios skills while showing relatively low level of competency in balance sheet analysis and in overall performance evaluation. This reflects a significant lack of sufficient competency among members of retail facing brokerage staff on the financial statement literacy. The results provide evidence that the ability to read and interpret financial statements is an independent, practical investment decision-making competence and not just an accounting technical skill.

7. RECOMMENDATIONS

Client and staff training in reading income statements, balance sheets, cash flow statements and financial ratios should be reinforced. This is especially in reading the balance sheet and in overall performance evaluation, where the competence was low, by brokerage firms and investment advisors. Brokerage houses should also consider producing simplified guides on how to use financial indicators of listed firms to gauge their financial health, and to reduce investor reliance on rumor and short-term price movements. The Capital Markets Authority and the Nairobi Securities Exchange should include financial statement analysis as a core component of a coordinated national investor financial literacy framework. Universities and professional training institutions should incorporate financial statement interpretation into business, finance and entrepreneurship curricula to better prepare future retail investors.

8. CONTRIBUTION TO THEORY, PRACTICE AND POLICY

Theoretically, the study builds upon Modern Portfolio Theory (MPT), Prospect theory and the Efficient Market Hypothesis (EMH). This is mainly by showing that the skill of financial statements interpretation is a measurable skill affecting the quality of an investment decision and not a purely theoretical construct, in the context of a Kenyan Brokerage environment. The results provide a practical basis for brokers and investment advisors to make financial statement analysis a priority in client education and orientation programs. Regarding policy, the study provides empirical foundations to the Capital Markets Authority, Nairobi Securities Exchange (NSE) and Ministry of Education to integrate financial statement interpretation into the investor education program. It also inspires capital markets educational curricula for more informed and resilient retail investor's participation at the Nairobi Securities Exchange (NSE).

9. COMPETING INTERESTS

There are no competing interests in this research publication.

10. AUTHORS' CONTRIBUTIONS

Edward Kinya Ndichu designed the study, collected and analyzed data and drafted the manuscript. Paul Kirigia and James Nzili supervised the study, critically reviewed the manuscript and approved the final manuscript for publication.

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