

# Influence of Investment and Financing Decision on Profitability of Airlines in Kenya

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## Abstract:

In Kenya, the airline sector contribution to the GDP has been fluctuating over the years; the year 2013 at 0.4%, the year 2014 at 0.3%, the year 2017 at 0.4% and the year 2018 at 0.5%. Even though airlines serve many purposes and benefit the society at large in different ways, Profitability is a key factor for the survival and growth of airlines. However, profitability in the airline industry has been shown to be at very low levels and equity owners are not generally rewarded adequately for risking their capital. The profitability in airline sector has been inconsistent such that in 2017 it declined by 0.3%, in 2018 and 2019 it declined further by 1.1% and 1.4%. The general objective of the study was to examine the influence of financial management decision on profitability of local Airlines in Kenya. The specific objective was to examine the influence of investment decision and financing decision on profitability of Airlines operating in Kenya. This research adopted descriptive survey research design targeting 10 major established Airlines operating in Kenya. Secondary data was collected using secondary data collection sheet. Descriptive and inferential statistics was analyzed using STATA 15. Descriptive entailed means and standard deviation was used. Inferential statistics such as regression and correlation analyses was used to determine both the nature and the strength of the relationship between the dependent and independent variables. The findings revealed that investment decision ( $\beta_1=0.012$ ) and financing decision ( $\beta_1=0.000$ ) have significant positive effect on profitability of airlines companies operating in Kenya. The study recommends for the implementation of well thought investment decisions based on customer desires, market requirement, expert opinion and business environment.

**Key Word:** Financing Decision, Investment Decision, Financial Management Decisions, Profitability, Airlines Companies

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## I. Introduction

The airline industry contributes greatly to the global and national economy by transporting people and cargo and creating jobs and economic activity (IATA 2014). It also provides worldwide access to time sensitive products from medicines and fresh produce to emergency aid. According to the IATA annual report (2019) nearly three billion people and 47 million metric tons of cargo were transported safely by air in 2012. This activity has supported about 57 million jobs and \$2.2 trillion in economic activity which is about 3.5% of global GDP. More than half the world's tourists travel by air and aviation underpins iconic major global events such as the Olympic Games. Aviation enriches lives by -bringing families and friends together, bridging cultures, and spreading ideas (IATA 2019).

In terms of both demand and capacity, the airline industry has been one of the world's fastest expanding businesses in recent years. Over the last century, commercial aviation has been recognized as an essential component of economic success, promoting commerce and encouraging the development of tourist destinations (Lee 2019). A USD 2.7 trillion economic contribution from the aviation sector (direct, indirect, induced, and tourist associated) to global GDP was estimated by Krumer, Friesen & Shelton (2019) to be made by the global aviation industry. Furthermore, the aviation sector is one of the most significant contributors to the country's economy, and its contribution has been growing in recent years on an international scale.

However, profitability in this vital sector of the industry is at very low levels. According to the IATA, airlines have failed to receive sufficient investor returns before and during the study period. The average annual return on capital of world airlines has been lower than the weighted average cost of capital (IATA, 2019). The industry is affected by various factors such as cut throat competition, fuel price volatility, economic recessions, political changes and conflicts, financial pressure from various stakeholders, technological advancements, epidemics, and terrorism. This is mainly due to the global nature of the industry and its international connectivity which makes it vulnerable to local, regional or international events (Brauer and Dunne, 2018). In

addition, the industry is a highly regulated industry due to its catastrophic risks and economic importance. On the other hand, increasing competition among airlines and increasing costs of operation necessitate improved efficiency in airline operations to generate profit. Accordingly, airline managers are using various business strategies to stay profitable and continue operations despite the challenges. As a result periodic and continuous monitoring and assessment of determinants of profitability with the ultimate aim of taking proactive and timely measures to maintain profitability and prevent huge financial losses is a mandatory requirement (Schefczyk, 2015).

Further, despite the expansion of both demand and capacity, the industry has always been financially difficult, with narrow profit margins and a high degree of vulnerability to fluctuations in fuel costs, foreign currency, interest rates, and other factors (Stamolampros & Korfiatis 2019). Several factors, such as the competition from capital-intensive and technology-driven rivals, the volatility of fuel prices, and infrastructure investments, have resulted in the need for airlines to respond quickly in order to survive in the industry. The airline industry has become more competitive as a result of these factors. Due to the fact that the airline industry is a resource-intensive industry, it is important for it to keep up with technological advances by periodically upgrading its equipment and facilities in order to maintain its competitive position in the industry and become more competitive despite the fact that capital investments have a long gestation period (See & Abdul Rashid, 2016).

The airline industry in Kenya has been described by operational wastefulness and poor financial performance (Muthoni & Murathe, 2018) and according to Mutema (2016), in the State of the Kenya Airline Industry article, the challenges being faced include diminishing market potential, high fuel prices, safety records, need for skilled human resources, internal liberalization and high taxes. According to IATA reports (2019), in the State of the Airline industry currently, the Kenyan sky is dominated by the European and Middle East carriers. The stiff rivalry has led to restructuring in the local commercial airlines and also cancelation of some flights in a bid to cut cost and remain competitive.

Further, the airline industry has found itself in a very competitive market characterized by globalization and increased consumer demand for quality services and increased value for their money. A case at hand is the poor performance of Kenya airways which posted a 26 billion loss in the fiscal year 2015/2016 (NSE, 2016). The airline industry in Africa is also over-taxed and over-charged making it difficult to establish lower ticket prices and constricting the awareness of its huge traffic growth potential (Kahavya, 2015).

More so, competitive threats from multinational players across the globe are increasingly making domestic players such as KQ more conscious of their vulnerable state and incentivizing them to proactively engage in an effort to ensure their sustainability in these turbulent times. Despite the previous strategies implemented by KQ, that is portfolio decisions such as the Jambo Jet, route expansion, optimization, efficiency and expansion related and partnership agreements the airline has poorly performed financially with the latest being the financial year 2014 huge losses for the 'African Giant - The Pride of Africa,' amounting to 7.9 Billion attributed to harsh economic and geopolitical conditions (Mutema, 2016).

Therefore, many setbacks have resulted to the airline operators in Kenya adopting survival strategies such as use of advertising, on-time flight departures, comfortable seats, good customer service, better planned route strategies and reduced fares. However, despite implementing these strategies, the operators in Kenya have continued to record dismal financial performance in the recent years epitomized by globalization, liberalization and consolidation of the African markets Mutema, 2016). Various strategies have been pursued to gain competitive advantage, for instance, local Airlines in Kenya have embraced formation of strategic alliances with other organizations to be able to compete effectively in the global arena; local aviation industry re-shaping itself to cope with investing in new fleets, adopting more efficient processes, carefully managing capacity and consolidating. But despite these efforts, the industry's growth as measured by profitability still balances on a knife-edge, with profit margins that do not cover the cost of capital (IATA, 2020).

The Kenyan aviation industry has grown over the year with a total of 37 local airlines registered and operating in Kenya. The airlines engage in the domestic, regional, and international carriage of passengers, mail and cargo through air. Some of the airlines also provides ground handling services as third party logistics providers to other airline operators; aircraft maintenance and Components repairs to other operators; and handles the import and export of cargo. See appendix V for details

Kenyan airline industry is primarily dominated by one player, which is Kenya Airways. Other players are Five Forty, & Jet link which are small compared to Kenya Airways. Kenyan airline industry is regulated by The Kenya Airports Authority (KAA), which was established in 1991 under KAA ACT CAP, Chapter 395 of the Laws of Kenya, to provide facilitative infrastructure for aviation services and Kenya Civil Aviation Authority (KCAA) that was established by the Civil Aviation (Amendment) Act, 2002 to plan, develop, manage, regulate and operate a safe, economically sustainable and efficient civil aviation system. According to KAA the airline industry business both in cargo and passenger has been growing at a rate of more than 9% from 2005 to 2011 (Farah, Munga & Mbebe, 2018). The airline industry has found itself in a very competitive market

characterized by globalization and increased consumer demand for quality services and increased value for their money. Competition threats from multinational players across the globe are increasingly making domestic airlines more conscious of their vulnerable state and incentivizing them to proactively engage in an effort to ensure their sustainability in these turbulent times

### **Statement of the Problem**

In Kenya, the airline sector contribution to the GDP has been fluctuating over the years; the year 2013 at 0.4%, the year 2014 at 0.3%, the year 2017 at 0.4% and the year 2018 at 0.5% (KNBS, 2019). Even though airlines serve many purposes and benefit the society at large in different ways, Profitability is a key factor for the survival and growth of airlines. However, profitability in the airline industry has been shown to be at very low levels and equity owners are not generally rewarded adequately for risking their capital. The Airlines profitability is then affected by volatile fuel prices, terrorist attacks, economic recessions, and pandemics that affect passenger travel services (Kumar and Manuel, 2019). Further, heavy interest expense from high leverage/gearing is depleting the profit margin of airlines and exposing them to higher levels of financial risk and bankruptcy (Stepanayan, 2019). Globally, India-one of the third aviation market- its Interglobe Aviation that has been its best performer of the industry has experienced deep shrinkage in its net profit margin of 2019 from 9 to 0.5% (Merkert & Swidan, 2020). The profitability in airline sector has been inconsistent such that in 2017 it declined by 0.3%, in 2018 and 2019 it declined further by 1.1% and 1.4% (Kasomba & Omagwa, 2020). According to Ministry of Tourism and Wildlife Research Report (2020), in Airlines, an escalation in the Covid-19 crisis saw passenger volumes fall by 1.6 million and \$320 million in lost revenues forcing about 6 Airlines operating in Kenya to run into insolvency, thus closed down. Although Kenya Airways realized improved revenue growth in the year, profitability was constrained by the increased competition in the airline area of operations. This indicates a critical situation for the sustainable and safe operation of airlines in a very capital intensive and heavily regulated industry. On the other hand, the growing demand for air transport services demands more robust financial management practices for airlines to expand and continue to provide safe and dependable air transport services. Few researches locally exist to ascertain whether financial management practices influences airlines profitability. Therefore, lack of adequate empirical evidence on financial management adopted by local Airlines in Kenya that experience low profit margins motivated this study to examine influence of financial management practices (Investment decision and Financing decision) on profitability of Airlines operating in Kenya.

### **Objectives of the Study**

- i) To examine the influence of investment decision on profitability of Airlines operating in Kenya.
- ii) To examine the influence of financing decision on profitability of Airlines operating in Kenya.

### **Research Hypotheses**

**H<sub>01</sub>**: Investment decision does not significantly influence profitability of Airlines operating in Kenya

**H<sub>02</sub>**: Financing decision does not significantly influence profitability of Airlines operating in Kenya

## **II. Literature Review**

### **Theoretical Framework**

The study was guided by the following theories; The Risk and Return Trade off Theory and Pecking Order theory

#### **The Risk and Return Trade off Theory**

The Risk and Return Trade off Theory proposed by Sharpe (1964) hinges on investment decision which is an independent variable of the study. It states that higher risk is associated with greater probability of higher return and lower risk with a greater probability of smaller return. The concept of risk and return trade off assumes that there exists an efficient and no riskless profit that can be earned. According to Krantz and Zhnag (2013) if the investors anticipate that prices will be high then they would rush to purchase the particular security and owing to forces of demand and supply then prices would increase since there will be limited supply. Moreover, an investor will be motivated to purchase securities when prices are high on anticipation he will get fair return. In contrast when there is anticipation that the prices will decline then investors will be in a hurry to dispose their securities as such to mitigate against any anticipated loss in future.

This theory was evaluated to anchor the investment decision independent variable. The theory of trade-off indicates that executives just prefer debt (Etiennot et al., 2017). They balance debt costs and benefits to a proper leverage level, interest on debt is tax deductible (thus reduction of corporate tax liability) and interest expenditure on debt, thereby decreasing the efficient debt-to-equity price (Hou & Van Dijk, 2018). This theory is relevant to this study in that Airlines in Kenya can use trade off theory by factoring in investment decision in their financial management models and practices.

The theory is not void of criticism more so because of the assumptions in which the theory is based on. The major shortcoming of this theory is inability of developing economies capital markets to clearly categorize distressed and non-distressed companies due to limited information access (Mwangi, 2016). The theory is appropriate for the study since there is need for clear understanding of listed company's asset value since this would minimize possibilities of under or over valuation and ultimately optimize organization capacity to borrow.

**Pecking Order theory**

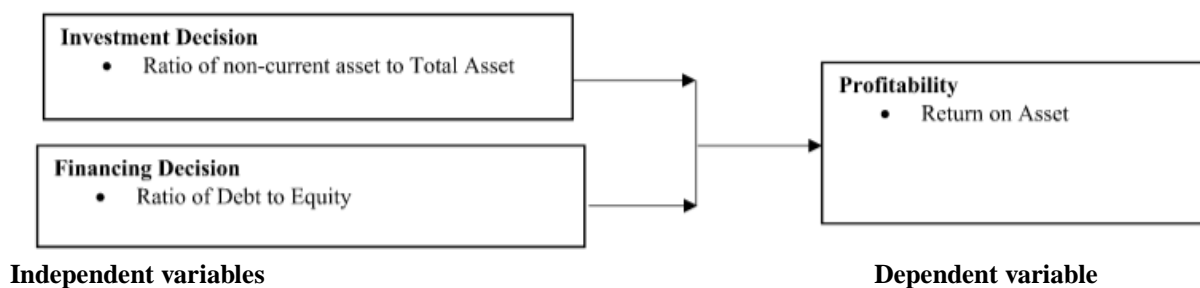
This theory is attributed to Myers (1984) and Myers and Majluf (1984). The theorists affirmed that businesses first opt to use their income to finance their investments due to information asymmetry. Companies issue debt first and share funding last, according to the theorist, when internal financing is not enough. The theory of pecking order indicates that companies have a specific capital preference order used to finance their companies. The preferences order represents the relative expenses of the different funding alternatives (Poschke, 2018). A comparable argument can be made between fresh debts holders and retained earnings. Furthermore, in relation to retained income, the greater the risk exposure associated with the data asymmetries for the different funding decisions, the higher the return on capital requested by each source (Vřatavu, 2015). Therefore, the business will prefer debt to received income financing, short-term debt to the long-term debt and debt to share finance.

However, there are also some limitations of Pecking Order Theory. The first limitation of the Pecking Order Theory is that it fails to incorporate the effect of taxes, cost of issuing new securities, agency cost, and financial distress of the investment opportunities. The second problem related to Pecking Order Theory is that it overlooks the problems associated with the decisions of financial managers to accumulate so much financial slack that they become protected to market discipline. It considers the impact of financial slack on the firm and the impact of availability of positive NPV's of projects. Due to these limitations, Pecking Order Theory is referred as complement rather than substitute of Static trade off theory

An alternative explanation for predicting organizational leverage is the pecking order theory (Calabrese, 2011). In contrast to this theory, enhanced profitability is anticipated to lead to a decrease in leverage, as a more lucrative company is better prepared to finance capital requirements with inner economic resources (Nderu, 2013). This theory is relevant to this study in the sense that it helps assess whether Airlines' received income financing, short-term debt to the long-term debt and debt to share finance and financing decision initiatives has an effect on their profitability.

**Conceptual Review**

This is a diagrammatic representation of the linear relationships between independent variables (Investment decision and financing decision) and the dependent variable (Profitability) as illustrated in figure 1.0.



**Figure 1.0: Conceptual Framework**

**Empirical Review**

**Influence of Investment decision on Profitability**

Alahyari (2014) sought to investigate the determinants of profitability for the Turkish airlines. Based on the panel data analysis, findings show that tangibility of assets, growth opportunities and liquidity ratios have significant impacts on the profitability of the firms. Tangibility of assets are negatively affecting the profitability of the firms in the airline industry, while growth opportunities are also inversely affect the profitability of airline companies in the sample. In addition, liquidity ratio is another factor which represents a negative and statistically significant relationship with the profitability of the firms. Kumar and Fernandez (2019) aimed to understand the determinants of capital structure policy of airline industry. This study documents positive relationship between leverage and profitability as predicted by the tradeoff theory. It also finds some evidence for signaling theory. Profitable firms signal higher cash flow generation capacity of the firm and uses higher

leverage. The negative relationship between leverage and growth confirms the prediction of tradeoff theory. Kalliokoski (2020) sought to determine can financial ratio analysis be used in the airline industry, do the rule of thumbs apply in the airline industry, and which company, Finnair or SAS, has better financial positions based on liquidity, profitability and activity ratios during the studied period of 2008-2018. It was also found, that financial ratio analysis can be used in comparing airline companies, but the existing rule of thumbs for ratios, are not applicable.

Kiiru, Kirori and Omurwa (2019) examined financial management and performance of the listed firms in the commercial and services segment using Kenya Airways as a case study. Findings showed that the investment decision on had a positive and statistically financial performance of Kenya Airways was positive and statistically insignificant. Kemuma (2014) sought to establish the Effect of Investment Decision on the performance of firms listed in the Nairobi Securities Exchange. Results revealed good, significant and positive correlations between ROA and all the predictor variables, that is., Investment Decision, Financial Leverage and Liquidity. Maiyo (2013) sought to investigate the impact of investment decisions on performance of companies quoted at the Nairobi Securities Exchange. The study found out that there was a positive relationship between the invested amounts and performance (profitability) of the listed companies. This is to mean that with increased decisions on investments the companies would perform better. Setiyorini and Kartika (2018) aims to examine the effect of profitability and investment decisions on corporate value. Return On Assets (ROA) is used as profitability proxy, Total Asset Growth (TAG) as investment decision proxy, and Price Book Value (PBV) as a proxy of company value. The results of this study partially show that profitability (ROA) and investment decisions (TAG) have a positive and significant impact on firm value (PBV). Simultaneously, the two independent variables influence the firm's value variable (PBV), but firm value is not only influenced by social-internal factors, corporate value is also influenced by external social such as interest rate, inflation rate, currency exchange rate and socio-political situation.

#### ***Influence of Financing Decision on Profitability***

Jiayi(2016) studied the relationships between systematic risk, financial indicators and the financial crisis from the perspective of international airlines. The findings of 28 international airlines over the period of 1997 to 2002 and 2007 to 2012 indicate that (1) airline systematic risk is negatively related to profitability and positively related to size, and these relationships hold over time periods, (2) the negative relationship between airline systematic risk and operational efficiency exists while it changes the sign over recent time periods, (3) airline systematic risk positively responds to financial leverage while its significance is influenced by samples used, (4) the positive relationship between airline systematic risk and liquidity is only significant over the first period, (5) no findings suggest airline systematic risk is related to growth. Moreover, the relationship between airline systematic risk and the financial crisis is not straight-forward because of lacking clear-cut judgment of the financial crisis year for airlines.

Tomoiagă (2014) investigated the impact of capital structure on firm value for airlines from the entire world. The sample included 111 companies listed on stock exchange for 2014. The results show that airlines have similar behavior in terms of capital structure, except for some companies grouped into different classes. Firm size has been found as negative determinant of capital structure, while tangibility, have been found as positive determinant of capital structure. The other factors have been detected to have no impact on the airlines' value. Kasomba and Omagwa (2020) assessed the effect of financial structure on financial performance of domestic commercial airlines in Kenya. The study found that lease financing, share financing, debt financing and retained earnings explained 86.6% and 65.9% of the variance in Net profit margin and ROA respectively of domestic commercial airlines.

Guzhva and Pagiavlas (2013) examined airline performances focusing on the capital structure expressed as liabilities/assets ratio for current- and long-term liabilities. It is found that most airlines do not follow the traditional finance management practice of lowering liabilities during lean times and increasing them during economic upturns. Only Southwest Airlines illustrates finance management of this type, with positive effects on its performance. In addition, it is found that among all airlines, levels of current liabilities are properly adjusted for movements of interest rates. However, this practice is not extended to long-terms liabilities, where only Southwest manifested proper adjustments. Finally, return on assets has a negative influence on current liabilities for other airlines, suggesting a risky practice of increasing liabilities when asset profitability is reduced and symmetrically, not taking advantage of market opportunities by increasing liabilities when operations are profitable

Demessie (2020) sought to examine the effect of capital structure on performance of the Ethiopian Airlines for the period 1994- 2018. The regression result show that short term and long term debt to asset had statistically insignificant and positive relationship with performance of Ethiopian Airlines (measured by ROA) at 5 % significance level, whereas total debt to asset had statistically insignificant negative impact on performance of Ethiopian Airlines. On the other hand, asset tangibility had statistically significant and negative

relationship with performance of Ethiopian Airlines. Finally the finding shows that a negative and insignificant relationship with firms size and performance of Ethiopian Airlines. Generally, the findings revealed that capital structure has statistically insignificant impact on performance of Ethiopian Airlines. Ginanjar, Hasnawati and Fiska (2021) aimed to determine the influence of financing decision, dividend policy on firm value. The findings revealed that investment Decision (PER) has a positive and significant effect on firm value, supports the Signaling Theory which explains the relationship between investment decision and firm value. Financing Decision (DER) has no effect on firm value, according to Trade Off Theory which explains that at a certain level of debt, tax savings (tax shields) from additional debt will be equal to the cost of financial distress. The results of the suitability test model show that financing decision (DER) influence firm value.

### **Research Gaps**

Financial performance in the Airline Industry has attracted a myriad of researches merely focusing on marketing, consumer relationship management, with little regard to financial management. For instance, existing literature shows a number of researchers have focused on use of asset management decision in financial lending institutions (Ngure (2017), with little focus in the Airline industry. More so few researches (Hayes, (2018), Muratila (2018), IATA, (2019), have focused on the relationship between the financial management and profitability of airlines in Kenya but majorly relied on primary data and not secondary data which is more reliable in financial analysis. To also help rescue financial performance of Airlines operating in economic crisis, Wawira, (2016) and Riaz (2017) suggested use of general revenue management mechanisms without considering asset management decision or Investment decision frameworks that can help Airlines cut on operation costs and enhance their profitability. Further, various strategies have been pursued to save the local Airlines dismal financial performance; for instance, local Airlines in Kenya have embraced formation of strategic alliances with other organizations to be able to compete effectively in the global arena; local aviation industry re-shaping itself to cope with investing in new fleets, adopting more efficient processes, carefully managing capacity and consolidating. But despite these efforts, the industry's growth as measured by profitability still balances on a knife-edge, with profit margins that do not cover the cost of capital (IATA, 2020), thus the need to examine influence of financial management (Investment decision, financial, Liquidity decision, asset management decision and Financing decision) on profitability of Airlines operating in Kenya.

There are several similar studies that have been conducted by other researchers, but there are differences of opinion between the results obtained. Research conducted by Putri et al., (2018), Darmayanti et al., (2018) states that financial management have a positive and significant effect on firm value. On the other hand, research conducted by Saputri et al. (2016) states that financial management such investment decisions have no effect on firm value. Research conducted by Putri, Isnurhadi & Yuliani (2018) show that financing decision, investment decision, and asset management decision have a positive and significant effect on firm value. However, this is contrary to the research conducted by Widyakto (2015) which states that debt policy has no effect on firm value. Fauzi & Suhadak (2015) examined that asset management decision has a positive effect on firm value. This result is inversely proportional to research conducted by Anita & Yulianto (2016) which states that asset management decision has no effect on firm value. From several research gaps of previous research results, this research aims to reveal whether there is an effect of investment decision, financing decision, liquidity decision and asset management decision on firm profitability.

### **III. Material And Methods**

This research adopted explanatory survey research design. The explanatory survey design was used to determine an association between the conceptualized independent and dependent variables as shown in the study's conceptual model. For this study, the target population was the 10 major local Airlines operating in Kenya for both cargo and human transport. The sampling frame in this study consisted of 10 Local Airlines operating in Kenya. A census of all the 10 major local airline companies registered by Kenya Civil Aviation Authority was studied. Secondary data was collected from individual company's financial reports which were accessed from Kenya Civil Aviation Authority. A secondary data collection tool was used. Data was collected for the five year period ending 31st Dec 2020 (2016-2020). The data collected was used to compute ratios for individual study variables. Data analysis included both descriptive and inferential statistics where model specification estimation and rationale of variables were done. Descriptive statistics included measure of central tendency; mean and measure of variability; standard deviation, maximum and minimum. These descriptive statistics was used to develop indices and measures to summarize the collected data (Kothari, 2007). The study used inferential statistics which are regression analysis and correlation analysis to test null hypotheses. These statistical tests were at 5% significance level. Secondary data was transformed into natural logarithm. The level of significance of 5% was used as a benchmark. If the P value is less than 0.05 at 5% significance level, reject the null hypotheses and accept the alternative and vice versa. Standard linear regression model was used to

measure the influence of Investment decision and equity on profitability. This included fixed and random effects regression model as well as linear regression models. All analyses were done using STATA 15.

#### IV. Result and Discussion

##### Descriptive Analysis

The objective of the descriptive analysis was to describe the properties of the data and to identify any unusual observations that may cause problems during inferential analysis. Thus, initial exploration of the data using simple descriptive tools was provided to describe and summarize the data generated for the study. The descriptive statistics of interest included mean, standard deviation, minimum and maximum as presented in table 1.

**Table 1: Descriptive Statistics**

Stats	Profitability	Financing Decision	Investment Decision
Minimum	-0.2112363	0.005732	0.015998
Maximum	0.1771819	18.60387	8.34059
Mean	0.0528253	4.428139	0.8745395
Standard Deviation	0.1066827	9.979243	1.444094
Skewness	1.515306	1.064301	1.426193
Kurtosis	3.42833	3.89091	3.39749
Jarque-Bera	1.731	2.58	5.018
Probability	.1123	.1826	.0813

From Table 1, profitability was measured using ratio of net income to total assets. Return on asset ranged from -0.211 to 0.177 with a mean of 0.0528 and standard deviation of 0.1066. The distribution mean standard error was 0.015 with a coefficient of variance of 2.4911. Financing decision was measured using ratio of debt to equity. As shown in Table 4.4, financing decision ranged from 0.0057 to 18.603 with a mean of 4.428 and standard deviation of 9.979. The distribution mean standard error was 1.4112 with a coefficient of variance of 2.253. Investment decision was measured using ratio of total revenue to total fixed assets. As shown in Table 4.3, asset management decision ranged from 0.0121 to 13.465 with a mean of 1.933 and standard deviation of 3.298. The distribution mean standard error was 0.4666 with a coefficient of variance of 1.706. Further, all variables have Skewness less than 2. This implies that are normally distributed and the data was adequate and met the assumption of normality. This observation was also supported by kurtosis values which were less than 6. The study also used a more robust technique known as Jarque-Bera (JB) to further ascertain the normality. The study failed to reject the null hypothesis since the probability value for Jarque-Bera was greater than 5% for study variables.

##### Inferential Analysis

Inferential analysis entailed correlation and regression analysis. The purpose also conducted stationarity test using Augmented Dickey-Fuller and choice of model using Hausman test.

##### Unit Root (Stationarity Test)

The study carried out a unit root test to ensure that there was no presence of unit roots (the panel data are stationary). Unit root test were conducted to ensure that the series were stationary and check the problem of having a spurious regression. A variable can only be said to be stationary when it has no unit root. The study used augmented Dickey-Fuller which is based on propositions

- Ho: All panels contain unit roots
- Ha: At least one panel is stationary

The results are as shown in Table 2.

**Table 2: Unit Root Tests without Difference (Augmented Dickey-Fuller (ADF))**

	Statistics	P-Value	Significant
Investment Decision	28.7445	0.000	**
Financing Decision	11.5394	0.0419	*
Profitability	16.1728	0.000	**

\* sig at 5% level, \*\* sig at 1% level

Table 2 shows the summary results for Stationarity test. A p-value of more than 0.05 indicates the presence of unit roots (H0) while a p-value of less than 0.05 was an indication that there was no presence of unit roots for augmented Dickey-Fuller tests. The results indicated that there was absence of unit root for all the study variables.

**Hausman Test (Choice of Model)**

A Hausman test was carried out to determine whether to use the fixed effect or random effect model to address objectives of this study. The appropriate approach of choosing between fixed and random effect model is running a Hausman specification test to determine the more efficient model (Borenstein, Hedges, Higgins, & Rothstein, 2010). Under the test, the null hypothesis is that there is no significant correlation between the individual effects and the independent variables. A rejection of the null hypothesis confirms the argument in favor of the fixed effect against the random effect model. The results are as shown in Table 3.

**Table 3: Hausman Test**

	(b) Fixed	(B) Random	(b-B) Difference	sqrt(diag(V_b-V_B)) S.E.
Investment Decision	0.073313	0.071438	0.001875	0.005402
Financing Decision	0.051256	0.031819	0.019437	0.016824

b = consistent under Ho and Ha; obtained from xtreg  
 B = inconsistent under Ha, efficient under Ho; obtained from xtreg  
 Test: Ho: difference in coefficients not systematic  
 $\chi^2(4) = (b-B)[(V_b-V_B)^{-1}](b-B) = 17.5$   
 Prob>chi2 = 0.0062

If the p-value is small (less than 0.05), reject the null hypothesis. Results in the table 3 indicated a prob>chi2 value of 0.0062 which is less than critical P value at 0.05 level of significance which implies that the null hypothesis that a fixed Effect model is the best was rejected. The study hence used a fixed effect regression model.

**Correlation Analysis**

Correlation analysis provides a value that shows whether changes in the dependent variable are caused by changes in the independent variable. Table 4.0 shows the outcomes of the study.

**Table 4.0: Pearson Correlation Analysis**

	ROA	investment decision
		1
Investment decision		0.6885** 0.0002
Financing Decision		0.3343* 0.0461
		0.0051** 0.9935

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

\*\*. Correlation is significant at the 0.01 level (2-tailed).

As indicated in Table 4.0, there is significant positive relationship between Investment decision and financial performance as indicated by .6885, p=0.000. This implies that increase in Investment decision would results to increase in profitability of local Airlines in Kenya. The findings conform to Farinha and Prego (2013) discoveries that investment decisions have strongly positive association with the rate of firms' investment and profitability. The findings also conform to the finding of Mutinda, Gathungu, Kibe and Wambua (2020) that investment decisions had significant impact on financial performance. Similarly, the correlation coefficient for financing decision was 0.3343, P=0.0461, suggesting that there is significant positive relationship between financing decision and profitability (ROA). Increase in financing decision would results to increase in profitability (ROA). The findings are in line with the discoveries of Njiru and Mwikamba (2020) that financing decisions have significant effect on financial performance. The results are not in agreement with a research conducted by Abor (2008) who discovered that financing decisions has a considerably negative effect on profitability. It therefore means that an increase in debt is associated with a reduction in performance. Ibrahim (2019) disclosed that debt is a general decision, having weak or no effect on the results of the company

**Linear Regression**

Regression analysis was done to determine the influence of independent variables on the dependent variable. These analysis yielded R which is the coefficient of correlation and R square which is the coefficient of determination. The results are as follows:

**Influence of Investment Decision on Profitability of Airlines Operating in Kenya**

The study sought to examine the influence of investment decisions on profitability of Airlines of companies in Kenya. The first null hypothesis denoted,  $H_{01}$ : Investment decision does not significantly influence profitability of Airlines operating in Kenya. Having gone by the fixed effect model basing on the Haussmann LM test, the results of the fixed effect model are presented in Table 5.0.



**Table 5.0: Regression Fixed Effect of Investment Decision on Profitability of Airlines Operating in Kenya**

Fixed-effects (within) regression		Number of obs =	50
Group variable: Airline Companies		Number of groups =	10
R-sq:		Obs per group:	
within =	0.1073	min =	5
between =	0.8407	avg =	5
overall =	0.474	max =	5
		F(1,39) =	8.99
corr(u_i, Xb) = 0.4757		Prob > chi2 =	0.0042

ROA	Coef.	Std. Err.	T	P>t	[95% Conf. Interval]
Investment Decisions	0.01127	0.003758	3.00	0.004	0.00881 0.18373
_cons	0.06117	0.010806	5.66	0.000	0.02286 0.08948
sigma_u	0.081822				
sigma_e	0.06569				
Rho	0.608065	(fraction of variance due to u_i)			

The analysis shows that the panels were strongly balanced for this bivariate analysis as shown by the number of observations per group. There were a total of 50 observations used in this analysis considering 10 groups of entities implying strongly balance panels. The minimum, maximum and average numbers of observations per groups were all equal to 5. The R<sup>2</sup> is generally a measure of the variation of the dependent variable profitability that is explained by the variation of the predictors in the model. The result obtained from fixed effect model indicated that investment decision accounted for 47.4% (Overall R square=0.474) of the variation in profitability of Airlines of companies in Kenya. The ANOVA statistics measure the general significance of the model. The F-statistic to the model shows is 8.99 which is greater than 0 implying that the estimated parameters in the model are at least not equal to zero. This infers that investment decision has an influence on profitability of Airlines of companies in Kenya. The estimated coefficient of investment decision is significantly not equal to zero ( $\beta=0.01127$ ,  $t=3.000$ ,  $p\text{-value}= 0.004$ ). The P-value is less than 0.05 which implies that the estimated coefficient is significant at 5% significance level. The estimated coefficient of investment decision here implies that a unit increase in investment decision would cause the levels of profitability to decrease by 0.011 units. The p-value of the constant is less than 0.05 which shows a significant constant term. The regression model is as shown below

**Profitability = 0.06117+0.01127 Investment Decisions .....1.0**

The study therefore rejected the null hypothesis that investment decision does not influence profitability of Airlines of companies in Kenya and concluded that there is significant influence of investment decision on profitability. This implies that increase in investment decision would results to increase in profitability of Airlines of companies in Kenya. Findings are also in line with finding of Musau (2016) that investment decisions have statistically significant influence on SACCOs financial performance. The results do not agree with Triani and Tarmidi (2019) who sought to establish how decisions on investment decisions, dividend policies and funding affected the firm value in companies quoted on the Indonesia Securities market from 2013 to 2016 and concluded that investors did not react significantly to the corporate investment decisions and thus the value is not affected by investment decisions.

***Influence of Financing Decision on Profitability of Airlines Operating in Kenya***

The study sought to determine the effect of financing decisions on profitability of Airlines of companies in Kenya. The second null hypothesis denoted, **H<sub>02</sub>**: Financing decision does not significantly influence profitability of Airlines operating in Kenya. Having gone by the fixed effect model basing on the Haussmann LM test, the results of the fixed effect model are presented in Table 6.0.

**Table 6.0: Regression Fixed Effect of Financing Decisions on Profitability of Airlines Operating in Kenya**

Fixed-effects (within) regression		Number of obs =	65
Group variable: Airline Companies		Number of groups =	13
R-sq:		Obs per group:	
within =	0.3825	min =	5
between =	0.1154	avg =	5
overall =	0.1118	max =	5
		F(1,39) =	7.43
corr(u_i, Xb) = -0.1316		Prob > chi2 =	0.0031

Profitability	Coef.	Std. Err.	T	P>t	[95% Conf. Interval]
Financing Decision	0.11579	0.014173	8.169	0.003	-0.54576 0.314185

*Influence of Investment and Financing Decision on Profitability of Airlines in Kenya*

_cons	7.882514	0.082267	95.82	0.000	7.712724	8.052304
sigma_u	0.462898					
sigma_e	0.128141					
Rho	0.928823	(fraction of variance due to u_i)				

The analysis shows that the panels were strongly balanced for this bivariate analysis as shown by the number of observations per group. There were a total of 50 observations used in this analysis considering 10 groups of entities implying strongly balance panels. The minimum, maximum and average numbers of observations per groups were all equal to 5. The result obtained from fixed effect model indicated that financing decisions accounted for 11.18% (Overall R square=0.1118) of the variation in profitability of Airlines of companies in Kenya. The F-statistic to the model shows is 7.43 which is greater than 0 implying that the estimated parameters in the model are at least not equal to zero. This implies that financing decision has an influence on profitability of Airlines of companies in Kenya. However, the influence is significant (P=0.0031). The estimated coefficient of financing decisions is significantly not equal to zero ( $\beta=-0.11579$ ,  $t=-8.169$ ,  $p\text{-value}=0.003$ ). The P-value is less than 0.05 which implies that the estimated coefficient is significant at 5% significance level. The estimated coefficient of financing decisions here implies that a unit increase in financing decisions would initiate the levels of profitability to increase by 0.11579 units. The regression model is as shown below

**Profitability = 7.882514+0.11579 Financing Decision .....2.0**

The study therefore rejected the null hypothesis that financing decisions does not affect profitability of Airlines of companies in Kenya and concluded that there is an influence of financing decisions on profitability. This implies that increase in financing decisions would results to increase in profitability of Airlines of companies in Kenya. Abor (2018) established a significant relationship in South Africa between financing decisions and ROA. Similar findings were also discovered in their research on Brazilian businesses by Mesquita and Lara (2013). This research therefore hypothesizes that the connection between financing decisions and ROA and ROE (Return on Equity) is positive. However, the results does not confirm with Demessie (2020) who sought to examine the effect of financing decisions on performance of the Ethiopian Airlines for the period 1994- 2018. The regression result show that financing decisions had statistically insignificant and positive relationship with performance of Ethiopian Airlines (measured by ROA) at 5 % significance level.

**Hypotheses Testing**

The hypothesis was tested using p-value method. The acceptance/rejection criterion was that, if the p-value is greater than the significance level of 0.05, we fail to reject the Ho but if it’s less than 0.05 level of significance, the Ho is rejected. The first hypothesis to be tested was: -

**H01: Investment decision does not significantly influence profitability of Airlines operating in Kenya**

From the findings, investment decision had a regression co-efficient ( $\beta$ ) of 0.01127,  $p=0.004$  implying that a unit increase in investment decision across time and among airlines of companies would result in a significant increase of 0.01127units in profitability. Since the t value is greater than 1.96 and P value is less than 0, the first null hypothesis was rejected as investment decision does significantly influence profitability of Airlines of companies in Kenya. Investment decision assists in the survival as well as development of a company enterprise, which calls for the demand to funnel efforts of businesses towards understanding effective financing decision, which will certainly protect the shareholders interest. Investment decision includes investment with high risk is the risk seeker who invests more to more to expect more returns from the investment decisions. The results agree with Durnev, Morck, and Yeung (2004) who posit that investment decisions at the corporate level tend to be focused on enhancing the profitability where there is a greater concentration on firm-specific risk arbitrage. A firm’s Investment decisions on companies with high creditworthiness are very sensitive to the internal funds availability. On the contrary, less creditworthy firms tend to be less sensitive to availability of internal fund.

The choice of the investment decisions will have a significant impact on profitability. The results validate the agency theory that agency costs threaten the ability of a firm to undertake viable investments. According to the agency theory, agency conflicts emanate from different sources resulting to under-investment. In this case, substantial size of the firm’s value is made up of future investment opportunities. The company can be endowed with high-risk bonds that can have incentives to reject positive (net present value) projects if the benefit from investing in the project accrues to the firm’s bondholders. Danielson, Heck and Shaffer (2008) opine that since the stock price of a firm can be manipulated in the short-term, incentives to increase the current stock price can destabilize both the investment and operating decisions. The results agree with Pandya (2016) in a study on the impact of financial leverage on market value added in India that debt equity ratio and debt ratios are found to be statistically significant in explaining variation in market value added of the sample companies. The results do not agree with Triani and Tarmidi (2019) who sought to establish how decisions on investment decisions, dividend policies and funding affected the profitability in companies quoted on the Indonesia

Securities market from 2013 to 2016 and concluded that investors did not react significantly to the corporate investment decisions and thus the value is not affected by investment decisions.

**H<sub>02</sub>: Financing decision does not significantly influence profitability of Airlines operating in Kenya**

Lastly, the results revealed that financing decisions had a regression co-efficient ( $\beta$ ) of 0.11579,  $p=0.003$  implying that when investment decision, asset management decision and liquidity decision are controlled, a unit increase in financing decisions across time and among airlines of companies in Kenya would result in significant increase of 0.11579 units in profitability. The  $t$  value is greater than 1.96 and  $P$  value is less than 0, therefore the second null hypothesis was rejected as financing decisions does significantly influence profitability of Airlines of companies in Kenya. The results validates the agency theory that managers are self-serving and at times can have goals that differ from those of the owners (shareholders), which, if not controlled or monitored, may entice them to indulge in actions that favor them at the expense of owners' wealth maximization. As control and dominance of the managerial team strengthens, the company experiences increased information asymmetry, making it harder for bondholders and shareholders to keep an eye on the managers' actions. Entrenchment motives may eventually make managers to use leverage beyond the elastic limit or the optimal point, so as to cement their control and minimize pressure from the external owners who are the shareholders. In a counter point of view, Fama & French (2002) postulates that entrenched managers may prefer minimal leverage to optimal leverage since they perceive it to have lower firm risk and thus protect their under diversified human capital resources (Huang, Boateng and Newman, 2016). This will definitely result to conflict with management and shareholders and bondholders.

Financing decisions concerned making use of financial debt as well as equity in financing companies' operations. Absence of a partnership between a firm's market value and its financing decisions does not in itself suggest that the financing decisions are immaterial to the company's safety and security holders. When the firm can provide high-risk financial obligation, it may have the ability to utilize its financing decisions to change riches from its shareholders to its supply- owners or vice versa. According to the chain of command concept firms prevent outside financing while they have interior financing available as well as stay clear of brand-new equity financing while they can engage in brand-new debt financing at reasonably reduced interest rates.

The results of the study agree with Ayuba, Bambale, Ibrahim and Sulaiman (2019) that financing decisions including use of short term and long term debt have positive significant effect on Tobin's  $Q$ . The results confirmed with those of Hatem (2017) which revealed that those firms that engage in financing decision are more profitable to those that adopt short term. Additionally, Al-Qudah (2017) established that financing decision has a progressive association with performance of an enterprise. However, the results do not agree with Memon, Khan, Shaikh, Shah, Zahid and MuhammdShaikh (2017) who established that financing decisions have no significant impact on firm's performance in Pakistan. Likewise, the results disagree with Kenya and Ombok (2018) who analyzed the effect or cause of leverage on value-added financial performance of NSE firms and analyzed using fixed effects multiple regression model and the outcome demonstrated that financial leverage has a negative significant impact on value-added financial performance.

## **V. Conclusion and Recommendation**

Based on the empirical evidence, a number of logical conclusions can be made as follows and presented in terms of study objectives. The study concluded that investment decision has significant positive effect on profitability. An increase in investment decision would results to significant increase in profitability. Therefore, investment decision has got significant positive influence on profitability. The study concluded that financing decision has no significant positive effect on profitability of Airlines of companies in Kenya. An increase in financing decision would results to significant increase in profitability. Hence, financing decision is a significant predictor of profitability of Airlines of companies in Kenya.

The study recommends for the implementation of well thought investment decisions based on customer desires, market requirement, expert opinion and business environment. Investment decisions should involve understanding the market, creating new business opportunities and investing in product and service quality improvement and cost reductions. So, it is vital to consider how investment decisions are perceived by the firm as it brings effort, creativity, and attitude towards firm products and services. Further, management need to continuously analyze the investment decisions and expenditures that they make and align them with the firm's objective for them to be effective accountable in their operations. The study also recommends that, the management of airline companies in Kenya to balance between financing a firm using short term debt and long-term debt. For firms looking for long-term financing can go for equity or preference shares and debentures. For short-term financing requirements such as working capital, listed firms can borrow funds in the form of bank loans, factor receivables and commercial paper. The choice often depends upon which source of funding is most easily accessible for the firm. Short-term debt is less expensive than lasting debt but is riskier because they need to be renewed occasionally. A firm may discover itself in a situation if they are incapable to renew their debt

usually as a result of some adverse information, actual or otherwise. Many failings of huge firms are sped up by unavailability of short-term financing. Nevertheless, long-term financial debts are more effective sources of debt financing amongst reputable company institution primarily by virtue of their asset base.

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