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RETAINED EARNINGS AND FINANCIAL PERFORMANCE OF LISTED MANUFACTURING AND ALLIED FIRMS IN KENYA

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ABSTRACT

This study assessed the influence of retained earnings on financial performance of listed manufacturing and allied firms in Kenya. The study covered a period between 2016 and 2023. The descriptive survey design was utilized in this research. The target population included 10 manufacturing firms listed on the NSE from 2016 to 2022 while respondents comprised all 248-line managers within the target population. Data collection method utilized was both secondary and primary. The study found out that retained earnings has a highly significant influence on financial performance, with a correlation coefficient of 0.885 and an adjusted R squared of 0.653, suggesting that retained earnings decisions are critical for optimizing profitability in listed manufacturing and allied firms in Kenya. Retained earnings serve as a valuable internal financing source, supporting growth and innovation while enhancing financial stability.

Keywords: retained earnings, financial performance, listed manufacturing and allied firms

1.0 BACKGROUND OF THE STUDY

The concept of retained earnings is underpinned on Modigliani and Miller (1958) seminal theory which set the stage for future scholars in acknowledging the inherent imperfections in the real-world markets. This perspective was later affirmed by Natalie (2023) who argued that in an efficient perfect market the capital structure of a firm does not affect the value. Subsequent studies have built on their work and newer theories emerging to correct the weaknesses of the earlier theories. Pecking order and Trade-off theories have emerged to elucidate firms' choices regarding optimal use of equity and debt (Al-Najjar & Taylor, 2018). For example, Pecking order theory proposed that firms should consider generating internal sources of finance first and consider external financing as the last option mainly due to information asymmetry between top management and external investors. The trade-off theory presents an alternative to the Pecking order theory in explaining the role of retained earnings in attaining an optimal capital structure. The theory postulates that retained earnings act as a buffer enabling a company to retain a debt ratio which is likely to minimize the likelihood of financial distress during unexpected downturns or when there is scarcity of external finance or when it is too costly (Mulama, 2014). Such are theories that offer substantial insights towards complex dynamics of capital structure decisions, providing firms' in order to understand how

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they navigate trade-offs over debt and equity to maximize value and mitigate risk in an ever-evolving market landscape.

Retained earnings is a financing strategy where the management of a firm decide to apportion part of the generated profits in a particular financial year for re-investment purpose in the coming year. This implies that the amounts of dividends that should have been distributed to the shareholders is reduced to provide this facility. The effect of retaining earnings has generated agency conflict between shareholders and managers over time. A conflict of interest may also emanate when deciding the retention ratio because top managers may prefer retaining more than what is distributed as dividends to shareholders who may be in need of higher payout. This friction may persist due to uncertainty on ownership level and decision-making control. Additionally, high retention may imply that the foregone dividend by the shareholders may subject them to higher opportunity cost (Chasan, 2012). Regardless, if a firm fail to consider retained earnings for re-investment the growth in future earnings is likely to suffer. Again, investment of retained earnings in projects that have weak future cashflows could equally trigger growth retardation presenting a platform for taking on external debt or issuing new equity shares to fund growth. Various arguments have been brought forward to resolve this conflict with minimal success. To justify retained earning companies should endeavor to ensure that the re-invested funds generate above average return for the company in the future. This may reduce the agency conflict associated with dividend payout while at the same time minimize chances of financial distress in the long-run which could mark its death bed if weak turnaround strategies are not put in place.

1.1 Manufacturing and Allied sector in Kenya

Kenya's economic growth is linked to the performance of its manufacturing and allied sector, which ranks third sixth-largest contributor to GDP. The sector contributes approximately 7.6% to 7.7% of the GDP, a value that has been oscillating but remains a prime focus for economic growth with the current government desire of pushing it to 15% by the end of 2027 by increasing investment promotion, building industrial parks and export processing zones (State Department for Investment Promotion, 2025). The However, the sector grapples with a multitude of challenges that significantly impede its growth trajectory. These include persistent security concerns stemming from frequent terror attacks, accompanied by arbitrary charges levied by regulatory bodies. Moreover, the sector contends with insufficient governmental support, particularly in the procurement of local supplies and the establishment of coordinated relationships with agricultural sector. Weak negotiation strategies within regional trade frameworks exacerbate these challenges, compounded by the high costs associated with accessing credit facilities from financial institutions (Cheng, 2018).

Despite these obstacles, opportunities for growth abound, particularly evident with the recent establishment of market alliances and trade partnerships within the East African region under the newly formed East African Community Common Market (E.A.C.C.U). Kenya's manufacturing sector stands as the largest within this trading bloc, underscoring its pivotal role in regional trade dynamics (Cheng, 2018). Notably, the sector boasts ten firms listed on the Nairobi's Securities market, highlighting its prominence and potential for investment and expansion. However, addressing the prevailing challenges is essential to fully unlock the

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sector's capacity for sustained growth and competitiveness on both local and regional scales by exploring the influence of retained earnings in the capital structure of these firms.

This paper explored the relationship between retained earnings and performance of listed firms on the Nairobi's Securities market in the manufacturing and Allied Sector. By shedding light on this relationship, this specific study is aimed at informing top leadership and those involved in making strategic decisions on ways in which retained earnings may be prioritized when making investment projects to ensure enhanced financial performance and market efficiency among listed firms in Kenya's corporate sector.

1.2 Statement of the Problem

In Kenya, the manufacturing and Allied Sector contributes approximately 7.6% to the country's GDP ranking sixth-largest. This sector has the capacity to contribute more to the GDP than is the current situation. To thrive in a turbulent business environment, the support from the government in building a vibrant capital market is imminent. Therefore, it is expected that by enhancing utilization of retained capital the performance of this sector will improve significantly. The desire to link retained earnings with performance of manufacturing and allied firms is dire especially for firms seeking above average performance in terms of returns on capital and shareholder value maximization. However, scarcity of evidence exists on the relationship between retained earnings and performance of manufacturing and allied firms in Kenya. Additionally, this relationship remains blurred especially because majority of studies in this thematic area has been predominant in developed countries with few in developing countries. It is against this background that this study was done.

1.3 Objectives of the Study

This research assessed the influence of retained earnings on financial performance of listed manufacturing and allied firms in Kenya.

1.3.1 Hypotheses of the study

H01: There is no significant relationship between retained earnings and performance of

Manufacturing and Allied firms in Kenya

2.0 THEORETICAL FRAMEWORK

2.1 Pecking Order Theory

Underlying premise of this theory centers on prioritizing the primary source of financing to be retained earnings. At its core, the model proposes that entities do not adhere to a predetermined optimal capital structure. Instead, they adhere to a hierarchical approach to financing decisions. This hierarchy places funds which are internally generated as a preferred choice, marched closely by debt issuance, and only resorting to new equity financing once the firm has exhausted its debt capacity. This theoretical framework was initially conceptualized by Myers and Majluf in 1984. In accordance with this theory, companies deliberately favor and prioritize the utilization of internally generated funds over external sources of finance. When external

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financing is necessitated, firms tend to prefer long-term borrowing over equity issuance, with the latter being viewed as a last resort. This preference stems from the recognition of information asymmetries within the market. Consequently, business entities do not possess fixed equity-to-debt ratio due to these information disparities. Moreover, during dividend payments, firms often resort to borrowing to finance asset acquisition, thereby bolstering their financial position. In essence, the theory posits a dynamic approach to financing decisions, wherein firms adapt their strategies based on prevailing market conditions and internal dynamics. By prioritizing internally generated funds and utilizing debt financing, companies aim to leverage on financial flexibility and optimize their capital structure over time. This pragmatic approach shows the rationale behind firms' financing decisions, aligning them with the overarching goal of enhancing shareholder value and sustaining long-term growth.

The theory explains the strategic considerations that companies undertake when allocating capital resources for financing their operations (Cooper and Holmberg, 2017). It states that in scenarios where companies face information asymmetry with external fund providers, they prioritize reinvesting returns for financing investment opportunities above all other alternatives. This preference hierarchy favors short-term borrowing over issuing new equity, ultimately favoring debt over equity issuance altogether. Cooper and Holmberg highlight that when companies opt to fund expansion through retained earnings instead of issuing new securities, they mitigate asymmetric information challenges. This explains why equity issuance tends to be costlier as information disparities between internal and external stakeholders widen. Consequently, it is advisable for entities be faced with significant information asymmetry to go for debt issuance as a precaution towards avoid undervaluation of their securities. By adhering to this approach, companies can navigate the complexities of capital structure management more effectively, optimizing their financing decisions to maximize value creation and mitigate potential risks associated with information disparities.

As asserted by Bhaduri (2017), companies, when seeking external funding, exhibit a preference for issuing securities perceived as the most secure, typically beginning with long-term borrowed funds, followed by convertible debt as a less common choice. The originator of this respective theory stated that entities tend and inturn follow a path of a predetermined hierarchy of capita finance sources, with internally generated finance being favored when available. In the event of requiring external funding, debt issuance is favored over stock issuance as a security. Pandey (2019) corroborated the theory's assertions, emphasizing that managers prioritize the utilization of internally generated funds generated internally and only consider issuing stock as a last escape route. This strategic approach is an indication of the significance of maintaining financial stability and minimizing risk exposure when sourcing external funds. By assuring they align their decisions with this hierarchical framework, entities aim mostly at optimizing their capital structure and bolster their financial resilience, ensuring sustainable growth and value creation in the long term.

Tests on this theory have not significantly showed on whether first-order importance is of determining an entity’s capital structure. Nevertheless, different authors in their works, have established situations where the same is of good reality approximation. Zeidan, Galil and Shaqir (2018) in his document where he examined and evidently proved firms indeed follow the pecking order theory. Linder and Shyam-Sunder (2019) found that a number of features of data are well explained by both the two theories. On the contrary, Frank and Goyal (2018)

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amongst many other things implies that that the theory fails to hold, especially to smaller firms which contends with the problems related to information asymmetry. This theory is relevant to the study to be conducted since, in regard to the its hypothesis, external finance acquisition attracts transactional costs which are higher as compared to utilizing internal finance which are funds that attract minimal or no transactional costs. Thus, firm's worth and investment risks remain determined by its capital structure.

2.2 Empirical Literature Review

In their study on the Effects of Retained Earnings on Financial Performance of Listed Commercial Service Sectors at Nairobi Securities Exchange in Kenya Moenga, Nyangau and Kurere (2025) employed Pecking order theory which is a corporate finance concept that recommend companies to finance investments using internal funding as a priority. In this study, it was found out that increased usage of retained earnings in investments is a key source of funding. Again, retained earnings have no financial obligations like interest payment leading to reduced operational expenditure that translates to improved financial performance. In essence, the study concluded that retained earnings has a positive and significant relationship with financial performance. Their study used data collected from published annual reports only. However, the current study will consider both primary (first hand) and secondary data in order to provide a comprehensive and accurate research approach.

Pibowei, Odong and Olusegun (2021) investigated the effect of retained earnings on financial performance of selected Nigerian breweries in times of crisis. The study examined extant empirical literature with shift-ability and anticipated income theories underpinning the research. The research used ex-post-facto research design, a target population of five (5) breweries listed on the Nigerian Stock Exchange. The actual sample size was four (4) selected breweries in Nigeria where each had nine-year observations dating from 2012 to 2020. Secondary data was gathered from published yearly reports and financial accounts of the listed breweries. The study used ordinary least squares (OLS) model, Analysis of Variance (ANOVA) and t-test for data analysis while hypothesis testing was conducted using IBM Statistical Package for Socia Sciences (SPSS) version 20. The research concluded that capital structure that is heavily embedded on retained earnings was not sufficient to increase the return on assets (ROA), return on equity (ROE) and earnings per share (EPS) significantly. A major critique of this study is that it relied on only 4 brewing firms that were listed with NSE. This means that the findings of the research may not be generalized to the entire economy in Nigeria while current study will explore 11 manufacturing and Allied firms increasing the generalization of the study results in the Kenyan economy. Lastly, Pibowei et al. (2021) study dealt with brewing firms only while the current study will explore a diversity of firms in the manufacturing and allied sector making the results more reliable and valid.

Yogo, Marangu, Kinogera and Okaka study in (2016) analyzed the effect of internal financing on financial performance of Savings and Credit Co-Operative Societies in Kakamega County, Kenya. The study used descriptive correlational research design to establish the connection between internal funding and financial performance. By doing a census survey, all SACCO's in Kakamega County that are registered under the Ministry of Cooperative Development and Marketing by 31st December, 2015 were included. First hand data from key informants and secondary data was gathered to provide a comprehensive and accurate approach to research.

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The study noted that internal financing had a significant and positive effect financial performance of the surveyed SACCO's thereby recommending changes in policies that would enhance employment of internal financing in carrying out investment projects. By using census survey to collect data from all respondents, the study may have incurred high costs in terms of materials needed for planning, hiring research assistants, processing data and printing. The current study will be less expensive and time consuming because it will consider line managers only.

In their respective paper titled "The Effect of Profit Reserves on firms' profitability," Oghenekohwo and Theresa (2017) undertook a study to explore and substantiate a distinctive U-shaped correlation on leverage and retained earnings within the oil sector firms of Nigeria. This pioneering study focused on a sample size comprising six prominent Nigerian Oil and Gas companies, analyzing data spanning from 2002 to 2011. The examination adopted a descriptive methodology to dissect the intricacies of the subject matter by using a secondary research approach. The scholars utilized a suite of simple statistical tools including regression analysis and correlation coefficient models, to process data and to unveil meaningful insights. The findings of the study unequivocally affirmed that retained earnings, are pivotal components of the capital structure, exhibit a robust and positive correlation with borrowing activities. Furthermore, the research drew a noteworthy conclusion regarding the tangible interplay between ploughed back returns and borrowed funds, illuminating the intricate dynamics governing these financial interactions. However, the study only concentrated with companies dealing with oil and gas while the present study will explore an array of manufacturing firms in Kenya.

3.0 RESEARCH METHODOLOGY

The study was done using a mixed methods approach due to its ability to mix elements of both qualitative and quantitative strengths. The research design was guided by positivist research paradigm that involved testing of hypotheses and theories. A research design serves as the blueprint that systematically links various components of the research process (Trochim, 2016). The target group consisted ten manufacturing and allied firms listed on the Nairobi Securities Exchange (NSE), which formed the primary unit of analysis. Within these firms, the research specifically focused on line managers working in finance and related departments, who were identified as the key informants. A total of 198 respondents constituted the accessible population, and their distribution across firms was documented in an annex for clarity and methodological rigor. The results indicated a response rate of 85% which according to Mugenda (2013) was considered adequate for structure detection since it is above 70%.

To get a comprehensive and unbiased data, the study used a census method which enabled the assessment of every eligible respondent within the target population. This approach reduced sampling error and enhanced reliability of the study findings. Data was gathered using both primary and secondary sources to ensure breadth and depth of analysis. Primary data were collected using structured interviews and self-administered questionnaires. The items in the questionnaires were designed using a Likert scale with key questions covering retained earnings financial performance variables. Secondary data were collected using a data extraction schedule and consisted of information drawn from company profiles, financial statements, and

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other relevant publications covering a seven-year period (2016–2023). The combination of primary and secondary data strengthened the validity and completeness of the dataset.

Data analysis involved both descriptive and inferential statistical techniques. Descriptive statistics included measures of central tendency and variability in-order to summarize the characteristics and distribution of the data (O'Brien, 2017). These summaries provided initial insights into the patterns present within the dataset. Inferential analysis employed both correlation and regression modelling to examine the relationships between retained earnings variable and financial performance. Correlation analysis was essential for identifying the direction and strength of associations between variables, while regression analysis allowed for the investigation of potential causal relationships. To ensure the validity of these analyses, the data underwent a Shapiro–Wilk test for normality, and all statistical tests conducted were within p-value of 0.05.

4.0 STUDY FINDINGS AND DISCUSSIONS

4.1 Descriptive Statistics on Retained Earnings

Table 1 below shows that the first attribute to be examined was whether the firm has a policy on retained earnings, which received a mean score of 3.44. This score, while positive, suggests that there may be variability in how firms formalize their policies regarding retained earnings. A standard deviation of 1.521 indicates a relatively high level of disagreement among respondents, which could imply that some firms do have a formal policy, while others may not prioritize or have clarity on this aspect. This points to variability in governance practices across firms which mirrors the findings of Waweru and Njenga (2022), who observed that while some firms have clear policies to guide retained earnings, others rely on ad hoc decision-making influenced by market conditions and financial performance. The second attribute focused on the necessity of retaining a portion of earnings each year to finance growth, achieving a mean score of 4.14. This indicates strong agreement among respondents about the importance of retained earnings for fostering growth within the organization. The standard deviation of 0.966 is relatively low, suggesting a consensus among firms on this practice, highlighting that many organizations view retained earnings as a critical source of internal financing for expansion.

The third statement addressed whether shareholders approve retained earnings to finance working capital needs, garnering a mean score of 4.11. This result implies that there is significant support among shareholders for retaining earnings to address the firm's immediate financial needs. With a standard deviation of 0.824, the data suggests a consistent agreement among respondents, indicating that firms generally align their retained earnings policies with shareholder expectations regarding the allocation of earnings for operational requirements. Another important aspect evaluated was whether retained earnings are not distributed to shareholders in years when firms do not make profits. This attribute received a mean score of 4.26, reflecting a strong consensus that firms typically refrain from distributing retained earnings during unprofitable years. The relatively high agreement that retained earnings are not distributed during unprofitable years (mean = 4.26, SD = 0.750) mirrors the findings of Otieno and Mwangi (2022), who reported that firms often withhold dividends to conserve financial resources during challenging periods. This practice underscores the importance of retained earnings as a financial cushion that supports stability and operational continuity during downturns. The low standard deviation of 0.750 indicates a high level of agreement among

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respondents, reinforcing the notion that firms prioritize their financial stability and reinvest earnings when they are not performing well.

The preference for retained earnings over dividends scored a mean of 4.05, suggesting that firms prioritize reinvestment strategies over immediate shareholder returns. The standard deviation of 0.872 indicates a moderate level of agreement, which may imply that while many firms favour retaining earnings, some still consider the importance of providing dividends to their shareholders. This finding aligns with the insights of Kinyua and Ngugi (2023), who found that many firms in the manufacturing sector prioritize reinvestment strategies to fund expansion and innovation. However, this practice may occasionally conflict with shareholder expectations, particularly among investors who prioritize short-term returns. This could explain the moderate variability observed in the preference for retained earnings over dividends.

Finally, the statement regarding whether retained earnings decisions are guided by the firm's cash flow position resulted in a mean score of 4.08. This score reflects the importance of cash flow considerations in the decision-making process related to retained earnings, with a standard deviation of 0.859 indicating a relatively consistent view among firms regarding the influence of cash flow on these decisions. The finding resonates with Gitau and Kamau (2023), who emphasized that cash flow management is central to retained earnings policies. Their study noted that firms with healthy cash flow are more likely to allocate retained earnings toward growth initiatives and financial restructuring.

The aggregate mean score of 4.01demonstrate that retained earnings have a great effect on financial performance of manufacturing and allied firms in Kenya

Table 1: Retained Earnings Component

Retained Earnings Component	Mean	Std. Dev
The firm has a policy on retained earnings.	3.44	1.521
Firm has to retain part of the earnings every year to finance growth.	4.14	0.966
Shareholders approve retained earnings to finance working capital needs.	4.11	0.824
Retained earnings are not distributed to shareholders in years when firm doesn't make profits.	4.26	0.750
Preference is given to retained earnings as opposed to dividends.	4.05	0.872
Retained earnings decisions are guided by firm cash flow position.	4.08	0.859
Average Mean score	**4.01**	**0.965**

Source: Research Findings (2025).

After descriptive analysis, factor analysis was done to condense numerous correlated variables into smaller set of meaningful factors for simplification of analysis. It was done using the Kaiser-Meyer-Olkin (KMO) measure that range from 0 to 1. According to Thao, Tan and Tuyet (2022) a KMO value larger than 0.5 indicates sufficient sample adequacy and supports further analysis. The results from Bartlett's Test of Sphericity were also be considered. For data to be deemed suitable for additional analysis, p-values from Bartlett's test must be less than 0.05. The sample adequacy results are presented in Table 2. Table 2 displays a KMO index value of 0.637, that exceeds the threshold of 0.5, indicating adequate sample adequacy. Additionally,

Bartlett's test yielded a p-value of smaller than 0.05. According to Thao et al. (2022), these values are within the acceptable range.

Table 2 KMO and Bartlett's Test

Bartlett's Test		
Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.640
Bartlett's Test of Sphericity	Approx. Chi-Square	303.57
	Df	10
	Sig.	.001

Source: Research Findings (2025).

Table 2 gives a KMO index value of 0.64 which is greater than 0.5. The P value of the Bartlett's test was smaller than 0.05.

4.2 Regression Analysis on the effect of retained earnings on the performance of listed manufacturing and Allied firms.

Regression analysis was done to understand the relationship between retained earnings and financial performance of listed manufacturing and allied firms for purpose of making inference and predictions. From Table 3, the coefficient of determination (Adjusted R2) implied that that the regression could explain up to 28.6 percent of the variation in the financial performance. The remaining percent of the variation could be due to other predictors not in the model.

Table 3: Model Summary on the relationship between retained earnings and financial performance

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.538[a]	.289	.286	.689

a. Predictors: (Constant), retained earnings
b. Dependent Variable: financial performance

The model result of fitness indicates an F-statistic of 85.397 and a p-value of 0.000<0.05. This indicates that the model is fit for prediction at 95 percent confidence level. This shows that retained earnings had a significant effect on the financial performance.

Table 4: ANOVA for the relationship between retained earnings and financial performance

ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	40.553	1	40.553	85.397	.000[b]

	Residual	99.725	210	.475
	Total	140.278	211	

a. Dependent Variable: financial performance
b. Predictors: (Constant), retained earnings

The study further sought answer the research questions. This was done by testing the null hypothesis:

H01: there is no significant relationship between retained earnings and performance of Listed manufacturing and allied firms in Kenya.

Table 5 below shows regression results from the analysis done to examine the effect of retained earnings on financial performance. The constant B = 2.218 means that when retained earnings = 0, the predicted value of financial performance is 2.218 which represents the financial performance in the absence of retained earnings. The unstandardized coefficient B = 0.484 means that for every 1-unit increase in retained earnings, financial performance increases by 0.484 units, ceteris paribus. The t-value = 10.082 and p-value = .000 show that the effect of retained earnings on financial performance is statistically significant, since $p < .05$. The null hypothesis was therefore rejected and the study concluded that retained earnings is a significant positive predictor of financial performance. This shows that the firms should consider prioritizing internal funding when seeking funding for investments in order to achieve a competitive position in the market due to reduced operational expenditure on instalment and interest payments on debt capital.

Table 5: Model coefficients for the relationship between retained earnings and financial performance

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.218	.220		10.082	.000
	Retained Earnings	.484	.052	.538	9.241	.000

5.0 DISCUSSION, CONCLUSION AND RECOMMENDATIONS

Retained earnings had a positive relationship with performance of listed manufacturing and allied firms. In this case the null hypothesis that retained earnings had no relationship with performance of listed manufacturing and allied firms in Kenya was rejected. The retained earnings measures that included opening balance carried from the previous year, net income plus cash and stock dividends were all found to be determinants of financial performance of listed manufacturing and allied firms in Kenya. These findings underscore retained earnings' role in reducing dependency on external financing while supporting operational and growth-related expenditures. The study findings further resonate with Njoroge and Omondi (2021) research in Kenya who argued that retained earnings reduce dependence on external financing, thereby improving financial health and profitability. Owusu and Asiedu (2021) in Ghana also found retained earnings to be a critical driver of growth in family-owned businesses, which

rely heavily on internal financing. However, Singh and Kaur (2022), studying Indian firms, found that retained earnings only positively affect performance when firms have clear reinvestment strategies, suggesting that idle retained earnings may not contribute to performance. Pham and Nguyen (2022), examining Vietnamese firms, also argued that firms with high retained earnings may become complacent and underinvest, leading to stagnation in financial performance while Kim and Lee (2023) in South Korea observed that retained earnings are less effective in sectors with high capital expenditure needs, where external financing is more advantageous.

Retained earnings also had a statistically significant relationship with performance of listed manufacturing and allied firms in Kenya. This is consistent with the pecking order theory which posits that firms should prioritize utilization of internal funds/retained earnings, then debt and lastly equity. This argument is premised on the idea that internal funds are cheaper and has less risk, while issuing new equity should be the last option since it may signal that a company is in financial distress which could also dilute ownership. However, excessive dependence on internal funds may affect dividend pay-out policies and retard aggressive expansion (Pham & Nguyen, 2022).

This study therefore concludes that retained earnings serve as a valuable internal source of financing that positively impacts the financial performance of listed manufacturing and allied firms. Retained earnings offer firms a cost-effective way to reinvest in their operations, allowing them to finance expansion, innovation, and strategic initiatives without relying on external debt or equity markets. The reinvestment of profits into the firm not only sustains growth but also enhances financial stability, positioning the firm for long-term success.

The study recommends that firms should strategically utilize retained earnings to finance operations and expansion projects. Retained earnings provide a cost-effective alternative to external financing, as they do not involve interest payments or share dilution. Firms should develop policies that balance the distribution of profits with the reinvestment of earnings into the business. This reinvestment can fuel innovation, operational efficiency, and competitive positioning. By prioritizing retained earnings, firms can improve financial performance while maintaining internal control over their growth strategies. The continuous reinvestment of profits will also enhance the firm's long-term financial stability.

The study further recommends that firms be encouraged to reinvest their retained earnings through favourable tax policies and reinvestment incentives. Government policies could reduce the tax burden on profits that are retained and reinvested into the business. This would incentivize firms to use retained earnings as a strategic source of capital for expansion and innovation. Policymakers could also offer matching grants or low-interest loans to firms that demonstrate a strong commitment to reinvesting their earnings. Such initiatives would reduce dependence on external financing while promoting sustainable growth. Firms could thus strengthen their financial stability and long-term performance through reinvestment strategies.

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