

INFLUENCE OF RETAINED EARNINGS ON 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. The moderating effect of ownership on the relationship between retained earnings and financial performance was also found to be significant, with a correlation coefficient of 0.580 (p value < 0.05) and an increase in the model's explanatory power by 5 percent. Retained earnings serve as a valuable internal financing source, supporting growth and innovation while enhancing financial stability. The moderating effect of ownership structures, especially those involving government or institutional stakeholders, is essential for optimizing capital strategies and improving financial outcomes.

Keywords: Retained Earnings, Financial Performance, Listed Manufacturing And Allied Firms

BACKGROUND

Background of The Study

Conceptualization of retained earnings was introduced by Modigliani and Miller in 1958 following their respective seminal theory. Their work, though grounded on assumptions, laid the foundation for subsequent research. It addressed the notion, in efficiently perfect market, a company's worth remains not affected in any way by its capital structure (Natalie, 2023). Modigliani and Miller's contribution was significant as it set the stage for future scholars to advance their studies, acknowledging the imperfections inherent in real-world markets. Subsequent research has built upon their work, refining assumptions and

incorporating additional considerations. Various theories have emerged to elucidate firms' choices concerning optimal fuse of equity and debt, including market timing theory, the pecking order and target adjustment theories (Al-Najjar and Taylor, 2018). Such are theories that offer substantial insights towards complex dynamics of capital structure decisions, providing work frame for firms' in order to understand how they navigate trade-offs over debt and equity to maximize value and mitigate risk in an ever-evolving market landscape.

Failure by an entity to fund and meet its financial obligations marks its death bed. A study making use of Kenyan data done by Kiogora (2019) reveals a

negativity in correlation over firms' returns Vis-a-viz their levels of financial leverage. Current data indicates the issuance of 68 T-bonds by the Kenyan government, along with ten corporate bonds issued by seven firms, and the listing of stocks of 60 firms stocks in Kenya's N.S.E as of December 2012. Furthermore, these listed entities collectively did float over 5.1 billion worth of shares valued at Kshs. 868 billion, while an estimation value of bonds was Kshs. 92.48 billion towards end of 2012.

While leverage tended to rise among Kenyan companies, the prevalence of debt financing through bonds was low. This highlights the heavy reliance on banks and other costly forms of debt financing, adversely affecting firm profitability. Consequently, a presumed negative correlation exists between debt utilization and profitability among these entities. This observation underscores the importance of evaluating financing strategies carefully to mitigate adverse effects on financial performance and ensure sustainable business growth (Krieler, 2020).

The planned research in Kenya is motivated by the country's standing in global financial markets, with the World Economic Forum ranking its markets as the second deepest after South Africa (Krieler, 2020). Deep markets typically imply lower costs of debt financing, which ideally shouldn't adversely impact an entity's financial performance. However, evidence suggests a critical inquiry into whether debt financing correlates with the subpar performance of Kenyan firms.

This research addressed this fundamental question by investigating the domain relation between profitability of entities over retained earnings among those which are listed and quoted on the Nairobi's Securities market in the manufacturing and Allied Sector. Performance as such, was assessed through scales of profitability and value of a firm, including Tobin's Q, utilizing panel empirical strategies (Changaya and Fatoki, 2020). The results were analyzed using both random and fixed effects specifications, providing comprehensive insights into the dynamics at play within Kenya's financial landscape. By shedding light on these relationships, this specific study is aimed at informing strategic kind of decision-making methods thus make contribution to enhancing financial performance and market efficiency in Kenya's corporate sector.

Kenya's economic growth and overall competitiveness are linked to the performance of its manufacturing and allied sector, which ranks third in terms of GDP contribution. However, like many other sectors, this domain has faced challenges stemming from various financial conditions, resulting in fluctuating performance and growth rates. For instance, during the years 2008-2010, the niche industry contended with its lower GDP contribution rates of growth, at 1.7% while consecutively an improvement of 2.6% respectively (Kenton, 2024). Subsequent years showed signs of recovery, with the 2010 financial year. Nonetheless, the sector's growth was significantly hampered by the financial crisis and subsequent slowdown, leading

to decreased demand in the local market and currency depreciation. This highlights the vulnerability of the manufacturing and allied sector to external economic shocks and indicates the importance of implementing robust strategies to bolster resilience and sustain growth in the face of adversity (Lagat, 2020).

Within Kenya's economic landscape, the manufacturing industry holds a significant position, ranking as the fourth largest in terms of the volumes of contribution towards the country's (GDP). Following agricultural sector, transportation and communications, retail trade and wholesale trade, the manufacturing makes a contribution of 18 per cent to the country's GDP, playing pivotal role in both domestic and regional trade dynamics. Notably, it actively engages in exports to the larger Central and East Africa region, further solidifying its importance in the broader economic framework (Mule & Mukras, 2018)

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 sectors. 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 sector's capacity for sustained growth and competitiveness on both local and regional scales.

Initially identified as Nairobi Stock Exchange, the Nairobi Securities Exchange (NSE) stands as Kenya's primary securities exchange market. Established in 1954 during Kenya's colonial period, it operated as an overseas stock exchange under the auspices of the London Stock Exchange (Nairobi Securities Exchange, 2020). Today, the NSE operates within the framework of the African Securities Exchanges Association, reflecting its integration into broader regional financial systems. The securities exchange market is key to this study as apart from being the source of the secondary data the study consumed, it is a pertinent element from the regulatory perspective of firms to the

platform it offers for firms to trade in equities and debt, the variables used in the study.

The NSE's significance transcends national borders, contributing to the vibrancy of Africa's financial landscape. In terms of stock trading volumes, it ranks as the fourth largest stock exchange, proving its pivotal role in facilitating investment and capital flows within the region (Changaya and Fatoki (2020)). This rich history and strategic positioning highlight the NSE's stature as a key player in Kenya's financial sector, serving as a conduit for capital mobilization and investment opportunities.

Over recent years, the Nairobi Securities Exchange (NSE) has undergone significant transformations, notably the automation of its operations between 2006 and 2007. This pivotal shift empowered stockbrokers to conduct transactions remotely, no longer tethered to physical presence at the NSE premises. Consequently, trading hours expanded from a mere two to a more dynamic six hours per day, enhancing accessibility and liquidity within the market.

The foundation of these activities is the regulatory oversight of the Capital Markets Authority, ensuring compliance with established standards and safeguarding the integrity of the financial ecosystem (Kariuki, 2018). This regulatory framework serves as a cornerstone of investor confidence, fostering transparency and accountability within the NSE's operations. As the NSE continues to evolve, these initiatives are a testament of its commitment to driving innovation and efficiency in Kenya's

financial markets, thereby bolstering its position as a leading hub for investment and capital formation.

Statement of the Problem

According to (Kariuki, 2018)), the manufacturing and allied sectors of the Kenyan economy have exhibited a pattern of recovery in recent years, demonstrating growth rates of 4.9% in 2004, 5.8% in 2005, and 6.9% in 2006. This upward trajectory reflects positively on the sector's overall financial performance during the same period, an indication of the interconnectedness between manufacturing activity and individual company financial outcomes. However, despite these initial gains, the sector still experienced fluctuations. From 6.85% in 2015, it declined to 5.83% in 2016 and further to 2.42% in 2017. Subsequently, there was a notable rebound to 9.65% in 2018, followed by a setback to 4.6% in the last quarter of 2019. The year 2020 brought unprecedented challenges, with Kenya recording a negative growth of 0.42% attributed to adverse impacts of the COVID-19 scourge. Moreover, manufacturing GDP for Kenya has displayed a concerning trend of persistent decline from 2011 to 2021. Starting at 11.16% in 2011, it gradually decreased to 7.24% in 2021, reaching an alarming low of 3.7% in the fourth quarter of 2022 (CBK Economic Outlook-2023). These statistics underscore the need for strategic interventions to revitalize the manufacturing sector and mitigate the challenges that have hampered its growth trajectory in recent years.

The country's GDP surged by 5 percentage in the first quarter of 2023, marking a notable increase from the 4.2 percent growth observed during the same period in 2022. This upturn signals a promising trajectory of economic recovery, attributed to the gradual relaxation of containment measures aimed at combating the spread of COVID-19. Notably, key sectors such as food service, accommodation, and manufacturing have exhibited improved performance, contributing significantly to GDP growth (Natalie, 2023). She continues to explain that a part from the direct contribution to the GDP, the sector offers the greatest employment opportunities to the citizenry hence improvement on social living due to the generated income to households. The collapse of the sector means loss of income thus impacting heavily to income earners. Such may lead to social vices like stealing, prostitution, corruption negative impact on mental health, satisfaction over life, economic resources access and social integration (Kariuki, 2018). He continues to opine that, the said condition as far as declining industries is concerned often affect the economy significantly in forms including job losses, decreased government revenues, and impacts negatively on related industries.

As per the Economic Survey of 2019, a 6.3 economy expansion for the country was registered in 2018, largely propelled by notable growth in the agriculture, manufacturing, and transport sectors. This marked a significant improvement from the 4.7 percent growth registered in 2017,

the lowest in five years. Particularly impressive was the manufacturing sector's growth, which surged from 0.5 percent in 2017 to 4.2 percent in 2018, signaling a robust rebound. The diverse financial performance observed among manufacturing and allied firms in Kenya during this period cannot solely be attributed to capital structure decisions for financing operations. Instead, it was largely influenced by government tax waivers and subsequent reductions in production costs (Deloitte Touche, 2019). Moving forward to 2021, the manufacturing sector demonstrated resilience with a real value-added growth of 6.9 percent, a notable recovery from the negative 0.4 percent recorded in 2020. During this period, the manufacturing sector contributed 7.2 percent to GDP, accompanied by a commendable 6.0 percent expansion in output volume (Economic Outlook, 2023). Such trends affected grossly the pivotal role of the sector and the entire industry in an economic growth drive.

In his seminal work on firms' financial performance determinants, Ebaid (2012) performed an assessment analyzing the outcome of retained earnings decisions over Egyptian companies, prominent economic force in Northern region of Africa. The research spanned from 1997 to 2005 and focused on non-financial quoted companies across ten distinct industries, comprising a sample of sixty-four firms. Ebaid's study utilized (ROE) and gross profit margin as metrics to gauge companies' profitability, employing

multiple regression analysis as the primary methodology. However, it overlooked the inclusion of ROA, a critical indicator in assessing companies' financial performance. Most research works have been conducted but all have come up with mixed reasons as to why firms may not reach their optimal performance. Many of the researches have not expounded on capital structure as one of the reasons, but instead delved in other parameters such as multiple taxation and cost of production among many others. Building upon such gap, present study is to investigate retained earnings in relation to a firm's financial performance specifically within manufacturing and allied sectors listed on the Kenya's Securities market. By addressing such a gap in literature, the exercise endeavored in offering comprehensive insights on the intricate dynamics shaping firms' financial performance within the Kenyan context.

Purpose of the Study

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

LITERATURE REVIEW

Theoretical Literature Review

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 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) 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.

Empirical Literature Review

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.

Nnenna and Nkeiruka (2020), wrote a paper titled "Impact of Retained Earnings on Financial Progression of the Manufacturing Segment," scrutinized the ramifications of retained earnings on the profitability dynamics within the food and personal care goods industries listed on Pakistan's Karachi Stock Exchange. This exhaustive analysis focused on a cohort of seven prominent companies operating within the food industry, with data spanning from 2009 to 2014. They used a strategic approach that included convenience sampling, the researchers harnessed the power of non-probability methods to distill meaningful insights from the available data pool. The researchers used a robust analytical framework comprising linear regression models and Spearman's correlation analysis, to dissect the difficult relationships underlying the variables under scrutiny. The findings of the study unveiled a complicated landscape, revealing a tenuous and inconsequential relationship between retained earnings and cash dividends per share. However, a moderately positive correlation emerged between retained earnings and the closing price of stock, shedding light on the complex interplay between financial metrics within the studied context.

In an insightful investigation by Kibor (2018), the dividend policies together with

performance metrics of SACCOs in the county of Uasin Gishu, were assessed. According to primary data extracted from the audited financial reports of SACCOs, this study focused on 120 registered SACCOs doing business in the county of Uasin Gishu. A purposive sampling technique, representing 10% of dividend-paying SACCOs, yielded a pragmatic sample size of 12 SACCOs, thus ensuring a robust analysis. Employing a quantitative research design, the study methodically synthesized the collected data to extract pertinent insights relevant to the research objectives. Leveraging statistical tools such as the SPSS and STATA Version 12, the research team conducted comprehensive multiple regression analyses to discern meaningful patterns and relationships within the dataset. The results of the assessment underscored discernible positivity in correlation of net income and payout ratio of dividend, indicative of a symbiotic relationship between dividend distribution and SACCO performance. Conversely, an intriguing inverse relationship emerged between the dividends amounts paid, the total value of dividends, and the percentage of dividends paid, underscoring the challenging interplay between dividend policies and SACCO performance metrics at a 5% level of significance. These findings not only provide valuable insights into the operational dynamics of SACCOs but also offer actionable recommendations for stakeholders aiming to optimize performance and dividend distribution strategies within the sector.

Kariuki (2018), examined association of dividend policies and loan performance within the SACCOs regulated by Nairobi County's Sacco Society Regulatory Authority. A descriptive research design was employed. The examination employed use of a census technique by scrutinizing entire population comprising 43 SACCOs operating within the County of Nairobi. Secondary data gleaned

from the financial statements of these SACCOs over a five-year period formed the cornerstone of the analysis. Taking into consideration, a robust regression model, the research endeavor sought to elucidate the association over the dependent variable, namely loan performance, and various independent variables including dividends, asset growth rates, and organizational growth. The results of the study unveiled a compelling narrative, highlighting the influential role of dividends, growth rate of asset, and organizational growth in shaping loan performance within regulated SACCOs in Kenya. Similarly, Monogbe (2016) examined the association between dividend payout with financial returns within the manufacturing sector in Malaysia. The researcher used a descriptive survey approach, coupled with regression and correlation analysis techniques, to unravel a noteworthy correlation between increased financial returns and dividends disbursed to shareholders. These findings not only provide valuable insights into financial dynamics of SACCOs together with manufacturing companies but also offer actionable recommendations for stakeholders seeking to optimize their financial strategies and enhance performance outcomes.

Khadija, Maria, and Nabil (2017), researched to elucidate impacts of dividend policy on both firm performance and investors' within the context of Pakistan. The discourse surrounding dividend policy is still one of the most contentious element in the context of corporate finance literature. Despite numerous attempts by scholars to dissect various facets of dividend policy, a definitive explanation regarding its behavioral underpinnings continues to elude us. This study strategically employs dividend policy, investors' wealth, and firm performance as the focal variables of analysis.

Dividend per share and dividend yield serve as the primary metrics for gauging dividend policy, while earnings per share and share price act as proxies for investors' wealth. Firm performance is quantified using return on equity. Through panel analysis, the research discerns a compelling revelation: dividend policy exerts a positively significant impact on both investors' wealth and firm performance. These results does not just contribute to scholarly discourse on dividend policy but also hold profound implications for practitioners and policymakers navigating the intricate terrain of corporate finance. By shedding light on nuanced correlation over dividend policy, investors' wealth, and firm performance, this study provides invaluable insights that can inform strategic decision-making and foster sustainable financial outcomes in Pakistan's corporate landscape.

RESEARCH METODOLOGI

The study employed a mixed methods approach, integrating both positivist and interpretivist philosophical foundations. As noted by Trochim (2016), a research design serves as the blueprint that systematically links various components of a research process. Guided by this understanding, the study adopted a causal research design, which is particularly suited for quantitative studies due to its structured and pre-determined nature. The research focused on a well-defined population comprising the ten manufacturing and allied firms listed on the Nairobi Securities Exchange, which together constituted the primary unit of analysis. Within these firms, the study specifically targeted 248 line managers as respondents, identified as the core units of inquiry. Their distribution is documented in an annexed form to ensure clarity and methodological

rigor. To gather data, the study utilized the census method, which involves assessing each individual or element within the entire population. This approach ensures comprehensive coverage and minimizes the risk of sampling bias by including all eligible subjects in the analysis.

Within these firms, the respondents comprised all 198-line managers working in finance, financial management, and related departments. This approach ensures a representative and thorough examination of the targeted population, thus factoring the robustness and reliability of the study's outcomes. In this assessment, comprehensive approach was adopted to gather data from finance line managers of manufacturing and allied firms registered at the Securities Exchange market (NSE). Both open and closed-ended questionnaires were utilized for purposes of ensuring a thorough examination of the pertinent factors. These questionnaires encompassed inquiries into various aspects of firm performance, particularly focusing on the utilization of equity, debt, preference, retained earnings, and the influence of foreign investment. The closed-ended questionnaires were structured using a Likert scale format, providing respondents with a spectrum of options ranging from "Strongly Disagree" to "Strongly Agree." This systematic approach enabled precise measurement and analysis, ensuring robust and reliable deep understanding into the relationships between capital structure decisions and organizational performance within the manufacturing and allied sectors.

In relation to the findings of this research exercise, methodology of data collection involved a combination of primary and secondary approaches. This strategic blend is chosen because it leverages both firsthand and existing information, ensuring a comprehensive analysis. Primary data to be used will be gathered through structured

interviews and the completion of predefined questionnaires by selected respondents. Meanwhile, secondary data was acquired using designed data collection schedule tool, facilitating the extraction of insights from various sources such as company profiles, financial statements, and other pertinent published reports between a 7- year periods from 2016 to 2023.

By employing a comprehensive approach, the analysis encompassed statistical methods such as mean calculation, correlation assessment, regression modeling, and ANOVA f-test application. The outcomes of this rigorous analysis were elucidated and exhibited by use of clear and concise figures and tables. Notably, correlation emerges as a vital statistic, delineating the interrelationship among the variables employed. Additionally, measures of central tendency were employed to provide further insight into the data. Regression analysis, a potent tool for probing causal relationships, were employed in the study. In order to ensure the conclusiveness of the analysis, collected data underwent scrutiny through the Shapiro-Wilk test in order to ascertain its normality. Researcher adhered to a significance level of 0.05, ensuring a rigorous and methodical approach throughout the analytical process.

This analysis served to explain the patterns evident in both primary and secondary data sources. Descriptive statistics, fundamental in nature, offer concise summaries of datasets, whether they represent the entire population or merely a sample thereof. These statistics are structured into two categories: Measure of variability and measures of central tendency, depicting both the typical values and the extent of dispersion within the dataset (O'Brien, 2017). The measures of central tendency, including the mode, median mean, provide pivotal deep understanding into the average or most representative values within the data.

Conversely, measures of variability, such as standard deviation, variance, and range, indicates the degree of divergence or spread among the data points. By using a methodological approach enriched with these compelling insights, the researcher aims to synthesize a comprehensive understanding of the gathered data, facilitating the creation of meaningful summaries and actionable metrics (Kothari, 2018).

RESEARCH FINDINGS AND DISCUSSIONS

Descriptive Statistics

Retained Earnings Component

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 approves 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

As per the results above, the first attribute 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. 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 low standard deviation of 0.750 indicates a high level of agreement among 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 favor retaining earnings, some still consider the importance of providing dividends to their shareholders. 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 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.

Similarly, the preference for retained earnings over dividends (mean = 4.05, SD = 0.872) 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.

The finding that retained earnings decisions are guided by the firm's cash flow position (mean = 4.08, SD = 0.859) 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.

On the other hand, the relatively lower agreement on the existence of formal policies on retained earnings (mean = 3.44, SD = 1.521) points to variability in governance practices across firms. This aligns with 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.

Foreign Ownership

Table 2: Ownership

Ownership Component	Mean	Std. Dev
Firm has a foreign ownership component	4.01	0.959
Firm relies heavily on foreign direct investment	4.20	0.784
Ownership structure between local and foreign ownership influences capital structure.	4.04	0.862
Foreign ownership influences financial performance of the firms.	4.26	0.840
Foreign ownership will limit the amount of debt capital issued.	4.29	0.798
Foreign ownership will limit the number of ordinary shares issued.	3.84	1.137
Average mean score	4.06	0.934

As shown, the respondents strongly agreed that foreign ownership plays a significant role in their firms, as indicated by the high mean score of 4.01 (Std. Dev = 0.959) for the statement that firms have a foreign ownership component. This shows that a substantial proportion of firms in the sector have some degree of foreign involvement. The reliance on foreign direct investment (FDI) was rated even higher, with a mean score of

4.20 (Std. Dev = 0.784). This suggests that many firms depend heavily on FDI as a source of capital and growth, highlighting the importance of external financial inflows to the sector.

Another critical finding is the belief that the ownership structure, specifically the balance between local and foreign ownership, influences the firm's capital structure. This was supported by a mean score of 4.04 (Std. Dev = 0.862), indicating a strong agreement among respondents that the mix of local and foreign ownership affects decisions regarding debt and equity financing. Similarly, foreign ownership was seen as an influential factor in financial performance, as demonstrated by the highest mean score in the table, 4.26 (Std. Dev = 0.840). This result underscores the perception that firms with foreign ownership tend to perform better financially, likely due to access to additional resources, expertise, and international markets.

Moreover, the findings suggest that foreign ownership affects a firm's debt-related decisions. The statement that foreign ownership limits the amount of debt capital issued received a mean score of 4.29 (Std. Dev = 0.798), the highest in this section. This result implies that firms with foreign ownership may adopt more conservative debt policies, possibly due to the risk aversion or stringent financial oversight imposed by foreign investors. On the other hand, when it comes to issuing ordinary shares, the mean score was somewhat lower at 3.84 (Std. Dev = 1.137), indicating that while foreign ownership does influence the issuance of ordinary shares, the effect is not as strong as it is for debt issuance. This could be due to differences in how foreign investors view equity financing versus debt financing in the firms they invest in.

Overall, the average mean score across all ownership attributes was 4.06 (Std. Dev =

0.934), reflecting a generally strong agreement that foreign ownership significantly affects key aspects of firm behavior, including capital structure, financial performance, and the issuance of both debt and equity. This average suggests that, on the whole, firms in the sector view foreign ownership as a critical factor in shaping their strategic financial decisions.

Studies by Mwangi and Nyang'au (2023) found that foreign ownership significantly influences capital structure decisions, especially in developing economies like Kenya. In the current study, the strong agreement (mean = 4.01, Std. Dev = 0.959) on the presence of foreign ownership within firms supports the notion that foreign participation is prevalent and influential in the manufacturing sector. This aligns with the view that foreign ownership often brings access to additional capital and expertise, both of which are crucial for fostering growth and enhancing financial performance.

The high reliance on foreign direct investment (FDI) (mean = 4.20, Std. Dev = 0.784) in the current study resonates with findings from Kamau and Gitau (2023), who emphasized the critical role of FDI in driving financial performance in Kenya. This result highlights the essential role that foreign capital plays in supplementing local financial resources, enabling firms to invest in expansion and technological advancements. FDI not only supports the capital structure but also acts as a conduit for the infusion of advanced managerial practices and international market access, which are vital for improving financial outcomes.

Additionally, the study's finding that the balance between local and foreign ownership influences capital structure decisions (mean = 4.04, Std. Dev = 0.862) supports the perspective outlined by Otieno and Wanjiku (2022), who argued that a well-structured mix

of local and foreign ownership provides a strategic advantage in making optimal financing decisions. This hybrid ownership model allows firms to leverage the financial strength and risk tolerance of foreign investors, while also maintaining some level of local control to safeguard national interests.

The perception that foreign ownership positively influences financial performance (mean = 4.26, Std. Dev = 0.840) echoes the findings of Kinyua and Ngugi (2023), who identified that firms with foreign ownership tend to perform better due to better financial discipline, access to broader markets, and improved governance standards. This could be attributed to the fact that foreign investors often bring a wealth of experience, financial networks, and international market connections that enhance the firm's competitiveness and profitability.

The findings on debt capital are particularly telling, with a strong belief that foreign ownership limits the amount of debt capital issued (mean = 4.29, Std. Dev = 0.798), which is consistent with studies by Waweru and Njenga (2022). They found that foreign investors, often more risk-averse, may encourage firms to adopt conservative debt policies to avoid over-leveraging, thus ensuring long-term financial sustainability. The risk-aversion tendencies of foreign investors likely stem from their desire to protect their investments and avoid high financial distress costs that might arise from excessive debt. This aligns with the current study's observation that foreign ownership can indeed have a moderating effect on firms' approach to debt financing.

On the other hand, the somewhat lower mean score regarding the impact of foreign ownership on the issuance of ordinary shares (mean = 3.84, Std. Dev = 1.137) suggests that foreign ownership does not have as significant an impact on equity financing decisions. This result contrasts with findings from Kariuki

and Wanjiku (2023), who suggested that foreign ownership also influences equity financing, albeit in a more nuanced way. It is possible that foreign investors place more emphasis on maintaining control over the firm's capital structure via debt and prefer not to dilute their ownership stakes through the issuance of new shares.

Regression Analysis

Influence of retained earnings on financial performance in listed manufacturing and allied firms in Kenya.

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

From Table 3, the coefficient of determination (Adjusted R²) implied 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. The model test of fitness results is presented in Table 4.42 indicating the reliability of the model in predicting financial performance.

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

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 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. The study of multiple

regression model coefficients obtained which could be used for prediction are presented in table 5

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

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

As shown above, retained earnings was found to positively influence financial performance in the listed manufacturing and allied firms. This implies that an increase in this practice would result in improvement of the financial performance. In addition, the variable has a p-value of .000, which is less than 5% ($P < 0.05$) meaning that the variable is significant in explaining the variations in financial performance in the listed manufacturing and allied firms.

Moderating effect of ownership on the relationship between capital structure and financial performance in listed manufacturing and allied firms in Kenya

Table 6: Model Summary on the moderating effect of foreign ownership on the relationship between retained earnings and financial performance of listed manufacturing and allied firms in Kenya

Model Summary ^b					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.626 ^a	0.392	0.365	0.43843	1.276

a. Predictors: (Constant), inter retained share and ownership, debt capital, preference shares, ordinary share, ownership component, retained earnings, inter debt earnings share and ownership, inter preference share and ownership, inter ordinary share and ownership

b. Dependent Variable: profitability

From Table 6, the coefficient of determination (Adjusted R² Square) brought about by the moderating variable implied that the regression could explain up to 36.5 percent of the variation in the financial performance. The remaining percent

of the variation could be due to other predictors not in the model. This implies that incorporating the ownership has a minimal impact on the relationship that exists between capital structure and financial performance as it weakens the influence obtained by 5 percent (Δ Adjusted R² = -0.053). The model test of fitness results is presented in Table 4.48 above indicating the reliability of the model in predicting financial performance.

Table 8: Model coefficients for the moderating effect of ownership on the relationship between capital structure and financial performance of listed manufacturing and allied firms in Kenya

	Unstan- dardized Coeffi- cients	Std. Error	Standardized Coefficients	T
	B		Beta	
(Constant)	-5.698	2.157		-2.641
preference shares	0.369	0.457	0.363	0.807
ordinary share	0.632	0.601	0.543	1.051
debt	1.083	0.418	1.078	2.593
capital retained earnings	0.126	0.415	0.132	0.303
ownership component	1.788	0.515	1.757	3.475
inter	-0.142	0.113	-0.883	-1.258
preference share and ownership	-0.008	0.145	-0.049	-0.058
inter	-0.272	0.100	-1.724	-2.718
ordinary share and ownership				
inter debt earnings				
share and ownership				
inter	0.014	0.099	0.097	0.146
retained share and ownership				

a. Dependent Variable: profitability

The findings obtained showed that the constant term is -5.698 (Std. Error = 2.157, $t = -2.641$), indicating a baseline negative effect. Preference shares show a positive but insignificant effect on profitability, with a coefficient of 0.369 (Std. Error = 0.457, Beta = 0.363, $t = 0.807$). Ordinary shares similarly have a positive but insignificant influence, with a

coefficient of 0.632 (Std. Error = 0.601, Beta = 0.543, $t = 1.051$). Debt capital, however, has a significant positive influence on profitability, with a coefficient of 1.083 (Std. Error = 0.418, Beta = 1.078, $t = 2.593$). Retained earnings show a minor, non-significant effect, with a coefficient of 0.126 (Std. Error = 0.415, Beta = 0.132, $t = 0.303$). Ownership itself has a strong, significant positive effect, with a coefficient of 1.788 (Std. Error = 0.515, Beta = 1.757, $t = 3.475$). The interaction between preference shares and ownership is negative but not significant, with a coefficient of -0.142 (Std. Error = 0.113, Beta = -0.883, $t = -1.258$). Similarly, the interaction between ordinary shares and ownership is minimal and insignificant, with a coefficient of -0.008 (Std. Error = 0.145, Beta = -0.049, $t = -0.058$). The interaction between debt capital and ownership has a significant negative impact on profitability, with a coefficient of -0.272 (Std. Error = 0.100, Beta = -1.724, $t = -2.718$), while the interaction between retained earnings and ownership is insignificant, with a coefficient of 0.014 (Std. Error = 0.099, Beta = 0.097, $t = 0.146$).

DISCUSSION OF FINDINGS

Influence of Retained Earnings on Financial Performance

Retained earnings are the strongest predictor among the variables, explaining up to 28.6% of the variation in financial performance. With a significant positive relationship ($p\text{-value} < 0.05$), retained earnings appear to be a critical internal funding source that supports reinvestment and growth. This finding underscores the importance of sound earnings retention policies, allowing firms to build reserves for strategic investments and enhance shareholder value without incurring additional liabilities or diluting equity.

Retained earnings were free from multi-collinearity issues, as shown by a tolerance value of 1.105 and a VIF of 0.484. Normality tests (skewness: 0.185, kurtosis: -1.447) confirmed the data's suitability. Factor analysis indicated that two components accounted for 62.44% of the variance, emphasizing the importance of retained earnings in capital structure decisions. Retained earnings emerged as a preferred source of financing, guided by firms' cash flow positions and shareholder approvals. These findings underscore retained earnings'

role in reducing dependency on external financing while supporting operational and growth-related expenditures.

Njoroge and Omondi (2021) in Kenya 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 argue that firms with high retained earnings may become complacent and underinvest, leading to stagnation in financial performance. 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.

Moderating Effect of Ownership on the Relationship between Retained Earnings and Financial Performance

The moderating effect of foreign ownership improves the explanatory power of the model to 36.5%, demonstrating its importance in shaping the capital structure's influence on performance. Ownership has a strong positive effect on financial performance, likely reflecting the managerial expertise, global market access, and financial stability brought by foreign investors. However, the interaction between ownership and individual capital structure components yields mixed results, with significant negative interactions for debt capital and insignificant ones for retained earnings and shares. These findings suggest that while foreign ownership generally enhances firm performance, it may alter the dynamics of specific capital structure elements.

Ownership structure had a tolerance value of 0.624 and a VIF of 0.994, indicating no multi-collinearity. The normality test

revealed appropriate distribution, with skewness (0.350) and kurtosis (1.938) values within acceptable ranges. Factor analysis highlighted that ownership explained 54.92% of the variance, with foreign direct investment (FDI) and the mix of local and foreign ownership being significant. The findings suggest that ownership structures play a pivotal role in shaping capital structure decisions, particularly through FDI inflows. This reflects a strategic reliance on diverse ownership forms to enhance financial performance and competitiveness in the Kenyan manufacturing sector.

The finding that ownership moderates the relationship between retained earnings and financial performance resonates with Ali and Rehman (2021), who found that ownership structure, particularly institutional ownership, positively impacts financial performance by enhancing governance and capital allocation in Pakistani firms. Ntimbane and Mukuka (2023), studying South African firms, also found that government ownership introduces strategic control that strengthens financial performance, particularly in regulated sectors. Conversely, Bello and Yusuf (2020), studying Nigerian firms, found that family ownership negatively moderated the capital structure-performance relationship due to conflicts of interest and risk-averse strategies. Khattak and Jamil (2021), in their study of firms in Pakistan, found that concentrated ownership could lead to poor corporate governance, reducing the positive impact of capital structure on financial outcomes. Youssef and El-Sharawy (2023), examining Egyptian firms, found that state ownership tends to introduce inefficiencies due to bureaucratic decision-making, weakening the influence of capital structure on performance.

SUMMARY, CONCLUSION AND RECOMMENDATIONS

Summary

Influence of Retained earnings on financial performance

The fourth objective of the study was to determine the influence of retained earnings on financial performance of listed manufacturing and allied firms. Retained earnings were also positively correlated with financial performance, though to a lesser extent than other capital components. The average mean score of 4.01 indicates that retained earnings are widely used by the firms studied. The correlation coefficient ($r=0.538$, $P=0.000$) reflects a weak but statistically significant positive relationship between retained earnings and financial performance. This suggests that while retained earnings are a cost-effective and readily available source of internal financing, they may not be as effective in driving performance as external capital sources like shares or debt, possibly because firms may reinvest less aggressively when relying solely on retained earnings. The study's finding of a weak positive relationship between retained earnings and financial performance contrasts with Musoke and Kyeyune (2020), who found that in Ugandan firms, retained earnings significantly enhanced financial performance by providing firms with low-cost capital for reinvestment.

Moderating Influence of Ownership on the relationship between Retained Earnings and financial performance in listed manufacturing and allied firms in Kenya.

The last objective of the study was to determine the moderating effect of ownership on the relationship between capital structure and financial performance in listed manufacturing and allied firms in Kenya. The study also examined the moderating effect of ownership on the relationship between capital structure and financial performance. Ownership was positively and significantly correlated with financial performance ($r=0.580$, $p>0.05$),

indicating that ownership structure can influence financial outcomes. The moderated regression analysis showed that incorporating ownership strengthened the capital structure's influence on performance by 5 percent (Δ Adjusted $R^2 = -0.053$), a minimal yet significant effect ($P < 0.05$). This suggests that ownership, particularly government policies or major shareholders, can shape how capital structures impact financial performance by introducing governance and strategic control, although the effect is relatively small.

Conclusion

The study 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 also concludes that ownership plays a significant moderating role in the relationship between retained earnings and financial performance in listed manufacturing and allied firms. Specifically, ownership structures, particularly government or institutional ownership, enhance the positive effects of capital structure strategies on financial performance. This finding suggests that ownership configurations can influence decision-making processes, risk tolerance, and the strategic direction of firms, leading to optimized capital utilization and improved financial outcomes. In addition, the study concludes that retained earnings is a key determinant of financial performance in listed manufacturing and allied firms in Kenya.

Recommendations

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 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.

The study recommends that ownership structures, especially in listed firms, be factored into policy decisions related to retained earnings. Policies could support diverse ownership models that include both institutional and government shareholders, as these tend to strengthen financial performance. Regulatory frameworks should encourage transparent reporting of ownership stakes to ensure alignment of interests between shareholders and management. Additionally, government ownership could be leveraged as a tool to influence strategic decisions, particularly in key industries like manufacturing. By supporting ownership diversity, firms can better balance risk and reward in their capital structure. Such policies would also help in

enhancing corporate governance and accountability in listed firms.

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