PATTERN AND TREND ANALYSIS OF RETAINED EARNINGS AMONG LISTED MANUFACTURING FIRMS IN NIGERIA

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ABSTRACT
The study analysed the trend and pattern of retained earnings among listed manufacturing firms in Nigeria from 2008 -2018. The study adopted descriptive research design and used secondary data. The population of the study comprised of 78 listed manufacturing firms on the Nigeria Stock Exchange as at the end of 2018. Purposive sampling technique was used to select firms with up-to- date published financial data and whose stock were traded on the stock market totaling 56. The data was analysed using table, percentages and graph. The result showed marginal changes in retained earnings and a non-linear trend as retained earnings curve decreased by 1.8% between 2008 and 2011, levelled off between year 2013 and 2014, increased by 2.3% between 2015 and 2017 and then moved in opposite direction by 0.6% from 2017 to 2018. A policy implication with respect to this result is that Nigeria's manufacturing sector lacked adequate reserve to withstand any adverse unforeseen circumstances that may arise within the economy.
KEYWORDS: Dividend, Earnings, Retained Earnings

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1. INTRODUCTION

In the year 2008, the capital market across the globe suffered substantial losses due to several factors. These factors vary but not limited to the decline in market value of stock, the collapse of several corporate bodies, delisting of firms from capital market and the dwindling dividend payment. Other variables in this category ranged from inconsistence in earning reporting to the increasing cost of financial leverage and low capitalization has further reduced investors' confidence in the operation of the capital market. These situations have brought to the fore fundamental questions on the ability of management to make financial and investment decisions that can bring improvement or maximize the value of firms. Overtime, the value of shares in the Nigerian capital market (in terms of share price) and the performance of firms in relation to earnings and ratio of dividend payment seem to have fallen below the expectation as more returns are being agitated and expected annually on capital investment. Analyst attributed this trend to non-payment f dividend resulting in investors losing interest in shares, since their main objective of higher returns are not being met (Ordu, Enekwe & Anyanwaokoro, 2014). Theoretically, some scholars opine that non-payment of dividend may be attributed to retention policy. However, the concern expressed by investors and other stakeholders suggests without any doubt that values of firms in terms of share price are not in tandem with the intrinsic value (Ugah, Uche & Ogbu, 2019). Perhaps this might have been the source of motivation for a number of researchers that focused on the value of firms and factors that drive value particularly in the developing economies, Nigeria inclusive.

The general objective of any business establishment is to search for a lucrative investment opportunity and invest. Thereafter, ensure efficient and effective deployment and utilization of economic resources towards wealth creation. This wealth is expected to flow backwards to investors from the annual dividend and capital gain through share price appreciation. Traditionally, investors either individually or institutionally hold a particular belief whenever decisions in stocks are made. The goal is to achieve a higher premium at some preferred level of risk either through capital appreciation or through regular dividend receivable. Majorly, the expectation is to receive higher return in the absence of investment or alternative use of fund. However, firms usually retain part of the return in form of undistributed profit and management always demonstrate the possibility of putting the undistributed profit into proper use that would meet the future expectation of the shareholders. Internal resources are utilized in terms of investment opportunity, maintenance purpose or payment of financial obligation to reduce the excessive risk of financial leverage. This decision is only seen in the right direction where it generates more returns and leads to increased cash-flow and enhanced value. According to section 385 (1b) of CAMA 2020, every company shall prepare a Director's report clearly indicating the amount recommended to be paid as dividend or as retained earnings. However, there are evidences, though still limited and evolving in finance and accounting literature about the extent to which retained earnings (internal accrual) drive firm value and how they are significantly related. The relevant questions to ask at the moment is "to what extent do the corporate managers retain part of their profits against the raining day?. The main motivation for this study is to ascertain the level of preparedness or otherwise of listed manufacturers in Nigeria against the impending global recession that may be witnessed in the year 2023. Therefore, since the response to this question is still missing in finance and accounting literature necessitated this study.

2 LITERATURE REVIEW

Retained earnings or retentions represent part of the trading surplus not paid out to investors as return on their investment but retained by management for future growth and business expansion of the organisation. Retained earnings constitute the inflows of the company's surplus after the deduction of all attributable costs and dividend payable. Chasan (2012) posit that major dispute always exist between managers and shareholders with regards to the retention policy for the organisation. The managers of the company may naturally prefer an increased earnings retention value, while the shareholders may think otherwise. The rationale behind this position is that with increase in retained earnings, investors influence on their stocks and company finances become uncertain. Therefore, retentions constitute a major sacrifice on the part of equity investors towards the organisation growth.

2.1 Theoretical Review

The focus of retention policy is to identify and explain the rationale behind dividend payment or non-payment by listed organization. In practice, firms are usually torn in between retention policy and payment of dividends to investors. Relevant theories associated with retention policy includes pecking order theory, bird-in- hand theory, Walter's dividend model and dividend irrelevance model. Donaldson in 1961, originated the Pecking Order Theory in its various dimensions. The theory postulate that for the purpose of financing any investment opportunities, management will traditionally prefer to source the required fund internally before considering external sources of funding. According to Kishore (2009), the rationale why management prefer retained earnings to other sources of finance is due to no floating cost and additional disclosure in the financial statement may encourage loss of competitive edge in the market. The theory of bird-in-the hand originated by Gordon (1963) and Lintner (1962). The theory observed that in identifying the market value of an organization, payment of dividend is crucial and relevant. Gordon (1963) therefore developed a model which situate that a firm cost of capital equates the amount of return that the organization is able to generate to the provider of funds (investors) in a perpetuity together with the potential yearly growth and the company's market value. The critics of the theory opine that the underline assumptions of this theory may not be realistic in practical terms. For example, the assumption that only retained earnings are utilized by company in making future investment decision without external borrowing may not be workable. According to Walter's dividend model propounded by Walter in 1963, the market value of the organization is not directly related to the dividend policy of such establishment. It is believed that dividends paid to shareholder are usually re-invested back into the company in other to attract increased returns. The argument of this theory is that dividend paid to shareholders equal to amount of retained earnings if it is not paid to the investors. The position of Walter's dividend model is closely related to the views enumerated by the signaling theory. Both theories emphasized the importance of aggressive retention policy as a way of financing future investment opportunities. However, financing future project through internal savings alone may not necessarily increase the market value of firm except through strict compliance with the corporate governance code. In 1962, Modighani and Miller postulated the dividend irrelevance theory in a seminar paper delivered in that year. Modighani and Miller posited that investors' wealth is not directly related to whether an organisation pays dividend or retain such for future expansion and growth. MM opine further that both the dividend policy of an organisation and its associated cost of capital will not in any determine the market value of the organisation.

2.2 Empirical Review

The extant literature of retained earnings in developed and developing countries provided contradictory findings on the effect of retained earnings and market value (Akinkoye & Akinadewo, 2018). While the extent of retention among firms are not given me needed attentions. Various researchers have associated firm value with retained earnings, but the results are not convergent. Ugah, Uche & Ogbu (2019) investigated the existing interrelationship among retained earnings, dividend payout, total assets and share price. The study obtained secondary data from the annual account of selected oil and gas firms in Nigeria from 2000 to 2017. Using inferential statistics in analyzing the data, findings established a negative correlation between retained earnings and share. However, Masood (2018) opine that the relationship between retained earnings. Urooj, Sindhu, Hasmi and Hussain (2017) evaluated the effect of retained earnings on future profitability and stock return in Pakistan. Using inferential statistics to analyse the data obtained from Karachi Stock Exchange (KSE) for eleven years (2006 – 2015), the results revealed a significant and positive relationship between retained earnings and profitability. Inose (2018) opine that organisation retains its earnings when cash capital ratio is low and productivity is high. This position was established in a study designed to investigate the effect of retained earnings on the firm's market value using equity issuance costs as friction.

Akinkoye and Akinadewo (2018) examined the impact of retained earnings on the market value of listed companies in Nigeria. Relying on sample data obtained from seventy-five (75) non-financial listed firms for 2003 to 2014, the result discovered a positive relationship between retained earnings and market value. The result of the survey carried out by Alves (2018) revealed that retained earnings and cash holding are not related in any way. The study adopted a firm level database covering forty-one (41) countries across Europe to investigate firm's abnormal retained earnings. Using regression analysis to investigate the effect of retained earnings dividend on share prices for a period of ten (10) years, Thirumalaisamy and Al-Baloushi (2017) opine that retained earnings revealed significant and positive influence on the market price of share. Munir and Kharal (2017) established same position with Al-Baloushi (2017) by positing that retained earnings and stock value exhibited a positive relationship. According to Ball, Gerakos, Linnainmaa and Nikolaev (2019), the relationship between retained earnings and book to market is a good proxy for earnings yield. In a similar study carried out by Bassey, Godwin and Aganyi (2016) findings from the analysis revealed that the future earnings capacity of Niger Mills Company Limited, Calabar, Nigeria depends on its retained profit. The implication of this submission is that the higher the level of retained earnings of the company, the higher the future earnings capacity. According to Isola and Akanni (2011), business organisations in Nigeria give priorities to retained earnings and equity finance as against debt and loans. Duke, Ikenna and Nkamare (2015) however, opine that retention ratio and share price are negatively correlated.

Most researchers revealed that effective and consistent retention policy is an important panacea for increase in market value of shares, as well as the economic growth of the nation (Urooj et. al, 2017; Ball, Grakos, Linnainman & Nikolaev, 2019; Muniru, Khara & Abidi, 2017, Akinkoye & Akinadewo, 2018; Thirumalaiosamy & Al-Baloushu, 2017). After all, Zarmouritz (1992) observed that the level of corporate investment can be used to gauge the performance level of any economy from both micro and macro level. From different scholars on the effect of retained earnings and market value reviewed journals can be group into three categories, positive, neutral and negative. Among the several empirical researches reviewed for the purpose of this study, a selected sample of (24) twenty-four journals reveal that seventeen (17) studies show a positive relationship, five (5) revealed a negative relationship while the remaining two (2) exhibited no relationship at all.

Majority of researchers therefore supported the position that a positive relationship exist between retained earnings and market value of firms (Akinkoye & Akinadewo, 2018; Urooj, Sindhu, Hashmi & Hussain, 2017; Ball, et .al, 2017; Munir & Kharal, 2017; Thirumalaisamy & Al-Baloushi, 2017; Akparhuere, Eze & Unah, 2015; Javed & Shah, 2015; Farah & Firzitya, 2015; Oyinlola & Ajeigbe, 2014; Troudi & Milhem, 2013; Naamon, 1989; Harkavy, 1953). Other researchers opine that retained earnings merely decreases the firm value (Ugah, Uche & Ogbu, 2019; Josh, 2015; Thuranira, 2014; Jalai, Shabir, Hamad, Iqbal & Muhammad, 2014; Friend & Pucket, 1964). Some scholars however establish no relationship between firm value and retained earnings. This position implies that retained earnings has no effect on share value of an enterprises (Gul, Sajid, Razzaq & Khan, 2012; Toby, 2014).

In Nigeria, scholars are also divided with regards to the effect of retained earnings on firm value. Researchers opine that the relationship is positive and as such retained earnings increases firm value (Akinkoye & Akinadewo). Some researcher posit that retained earnings decreases the firm value (Ugah, Uche & Ogbu, 2019) while Toby, (2014) argued that retained earnings has no effect on firm value, thereby supporting the notion of irrelevance dividend policy postulated by Modigliani and Miller in 1958.

3 METHODOLOGY

The research design consisted of balanced panel data that comprised both annual and cross-sectional data analysis.

3.1 Theoretical Framework

This study was anchored on Pecking Order Theory. The theory postulate that for the purpose of financing any investment opportunities, management will traditionally prefer to source the required fund internally before considering external sources of funding. Kishore (2009), however argued that corporate managers may also decide to retain surplus even though profitable investments are not in sight but preferable instead of seeking external funding for future projects.

3.2 Population, Sample and Data collection

The study employed secondary data from the audited financial statements of listed manufacturing firms for eleven (11) years from 2008 to 2018. The period was specifically selected due to the fact that capital market crisis in Nigeria started in the year 2008 when majority of investors lost their investments in several organisations. The rationale for the choice of manufacturing firms was premised on the fact that manufacturing entities constitute agents or means of economic growth and development. Population framework for the study comprised of 78 listed manufacturing firms traded consistently between 2008 and 2018 on the Nigerian Stock Market. Distressed firms and those that did not meet the data requirement were excluded from the population leading the adoption of purposive sampling technique. A sample of 56 manufacturing firms was therefore selected through purposive sampling technique, representing about 72% of the entire population. Data on economic value of firms such as earnings per share, retained earnings and dividend were sourced from the audited financial statements and other public and relevant data disclosed by the sampled firms. Analysis of the data was done using descriptive statistical techniques.

4 DATA ANALYSIS, RESULTS AND DISCUSSION OF FINDINGS

4.1 Descriptive Analysis

Table 4.1 shows frequency distribution of the firms during the sample period. Data collected and used in this study is a balanced panel data that comprised both annual and cross-section data. The categories of firms by industry in Table 4.2 distribution by years are shown in Table 4.1

Table 4.1 Distribution of Firms

Period	Firms	Observation (%)
2008	56	100%
2009	56	100%
2010	56	100%
2010	56	100%
2012	56	100%
2013	56	100%
2014	56	100%
2015	56	100%
2016	56	100%
2017	56	100%
2018	56	100%

Source: NSE Fact book publication 2020

Table 4.2 Distribution by Sectors

Sectors	Number of Firms	% of sample

AGRICULTURE	5	0.089
CONSUMER GOODS	20	0.357
HEALTHCARE	11	0.196
INDUSTRIAL GOODS	15	0.267
NATURAL RESOURCES	4	0.071
TOTAL	56	100

Source: Nigeria Stock Exchange Publication 2020

The study also performed properties check on all the variables. The descriptive analysis indicted average, maximum and minimum values of the variables. It also shows the extent of dispersion of the variables from the mean. In Table 4.3, the descriptive analysis of earnings per share and retained earnings per share was conducted on 5% level of confidence. The retained earnings per share value range from a minimum of 0.462 to a maximum of 0.883 indication that some firms reinvested as much as 80% of earnings accrued to shareholders. The mean value equal to 0.734 which implies that each share has (an average) a large amount of retained earnings, and standard deviation equal to 0.106. This implies low variations among manufacturing firms listed on the Nigerian Stock Exchange over the period of 2008 to 2018. Earnings per share value ranges from 0.091 to 7.667 which means some firms performed relatively well as the amount of earnings accrued to equity is high. The mean value is 2.347 indicating that manufacturing firms listed on the Nigerian Stock Exchange, on average make a good return and equity and standard deviation of 2.181 which means the value sparely dispersed from the mean.

Table 4.3 Descriptive statistics of the variables

	EPS	**RPS**
Mean	2.347	0.734
Median	2.482	0.746
Maximum	7.667	0.883
Minimum	0.091	0.462
Standard Deviation	2.181	0.106
Skew	1.091	-1.124
Kurtosis	3.577	4.542
Jarque Bera	130.79	190.67
Probability	0.000	0.000
Observation	616	616

Source: E-view Output

4.2 DISCUSSION OF RESULTS

Retained earnings by listed manufacturing firms were analysed during 2008 to2018. In analysing the extent, firms current retained earnings and how the retained earnings values have changed in the past were taken into consideration. The analysis was done to determine the amount of profit retained by firms in the past 11 years and whether the retained earnings were growing consistently over time or declining. The percentage of the growth rate in retained earnings was analysed to see whether retained earnings grows constantly or fluctuates and whether it is relatively easy to project the earnings into the future.

The analysis was done by calculating the payout ratio for each firm during the sample period. A payout ratio greater than 1 means that firms paid out more in dividends for the year while a low payout ratio indicates that firms retained greater proportion of their earnings instead of paying out dividends. In this study, retained earnings is taken as profits earned by the firms over time either used for business growth, expansion or reinvestment. Dividend payments by the firms from earned profit to shareholders during the sample period were not part of retained earnings calculation. The retention ratio, otherwise known as plougback ratio, is the proportion of profit reinvested back in the business. It is calculated in this study as the percentage of net income that is retained to grow the business, rather than being paid out as dividends. The calculation was based on the cumulative collection of profit retained overtime. This metric normally suggests to investors about how much money a firm is retaining in the business from the annual earnings to reinvest in the operations of the business. Ordinarily, young or newer firms are expected to have high retention ratios because earnings can be invested back into the business to accelerate growth. The analysis shows that most firms retained part of their earnings annually although, the degree of retention varies across firms and industries. The total amount of profit per share retained (RPS) by each firm over the sample period against the change in profit per share over the same period of time were analysed. The analysis was done using panel data pertaining to 56 manufacturing firms. The variability observed in the degree of retention necessitated the classification of the firms within industries. The firms were grouped into large (22) and small (34), older (25 well established) and younger (31- growth stage) and multinational (13) and domestic (43).

From the analysis of the firms' financial data, it was observed that some firms paid out all their earnings to shareholders and this was found among the older firms. In order to determine the amount of profit retained, the retention ratio was calculated for each firm and the calculation was also done among firms within industries and different categories. The differences in the level of retention were also analysed and several considerations were given while analysing the differentials. The most important consideration is firms' level of maturity. Newer firms with growth-orientation aiming at expanding, developing new products, and moving into new markets were found reinvesting most or all of their earnings or having low payout ratio. This is quite understandable because manufacturing firm in capital intensive industries and growing firms need assets to operate hence, the need to retain more of their earnings. In this analysis, the retention ratio showed that the extent and trend of retention are industry specific as the rate varies widely across industries. In finance literature, the ratio like other ratios are most useful for comparison within a given industry. Table 4.4 shows the computation of retention ratio across the industries. The computation indicates that corporate retained earnings in Nigeria remained low throughout the period for older firms with several years of historical performance. This is expected as older firms had significantly larger amounts of retained earnings than identical younger firms because retained earnings represent profits retained since the inception of a company. More so, the older companies with low growth prospects and of which investors expect a reasonable dividend seem to have their retention ratio typically low compared to the high dividend payout ratio. Another consideration for the low retention rate by older firms may be ascribed to the fact that older firms considered other sources of finance such as debt which is always cheaper to finance new investment and their operations. The need to maintain market share might also be a source of motivation driving older firms to pay out more of earning to shareholders in form of dividend.

From the computations, it was also observed that those domestic and multinational companies as well as small and large establishments have different attitudes towards appropriation of profit. The analysis shows that multinational companies appeared to be less concerned about industrial growth with retention ratio less or equal 15%. The result also indicates that in Nigeria there are small and large concerns. The small firms as shown on Table 4.4 are in regular practice of retaining earnings because these firms do not have surplus funds to payout as dividends and for the reason of expansion and investment opportunity, a higher percentage of the annual profit is retained. Therefore, most of these firms use retained earnings to invest in expansion related investment projects and so, low dividend or no dividend is paid.

In the literature, the ideal ratio for retained earnings to total assets is expected to be 1:1. However, for all the firms in various categories, this ratio is practically unachievable. The retention ratio remained unstable as it changed yearly. The change largely depended on the volatility of firms' earnings and management philosophy on dividend policy. The analysis and the results showed that many big firms paid dividend steadily and increasingly. This actually suggested a policy of stable dividends whereas, the retention rate for smaller and newer or younger firms is high particularly at the early stage of development. The younger firms were found generally paying low dividend and the retention ratio was relatively higher than the older firms which had positioned themselves on the growth spectrum of their respective industries.

Table: 4.4: Retained Earnings by Categories of firms

Category	Retained earnings %	Dividend payout %	Profit Growth %	Retained Earnings growth rate %
Older Firms	**24**	**76**	**11**	**8**
Younger Firms	**76**	**24**	**7**	**10**
Large Firms	**23**	**77**	**9**	**4**
Small Firms	**77**	**23**	**8**	**3**
Multinational	**15**	**85**	**11**	**6**
Domestics	**85**	**15**	**8**	**11**

Source: Author's computation 2021

The study analysed further the corporate retained earnings, the growth rate in income and change in earnings per share, year by year to show the trend. The analysis showed on average that listed manufacturing firms retained some percentage of earnings and paid out more of their earnings to the shareholders (investors) in form of dividend. The appropriation of income into dividend and retained earnings depends on a vast number of factors ranging from firms' profitability, cash flows, liquidity, leverage, capital structure, firm's life cycle, growth, macro and micro economic factors, investment opportunities, informational asymmetries, ownership structure, to governance.

The result showed that manufacturing firms in Nigeria retained profit and made payment of dividend to ordinary shareholders. The motivation for and the whole essence is to generate future income or internal funds for their investment needs and enhance value. Table 4.5 shows the distribution of earnings into retained and dividend payout by listed manufacturing firms between

2008 and 2018. The analysis showed that more of the earnings are paid in form of dividend and the growth rate in profit after tax of the firms ranges from 11% to 22% during the sample period. Changes in retained earnings vary from firms to firms and on average the growth is not significant and it ranges from 1% to 1.5%. This suggests that firms used part of the profit for future investment and maintenance of their operations. The percentage of retention of funds is found to vary considerably from one firm, industry and period to another in this study and this is consistent with other studies particularly in emerging economies. The analysis provided a clear view on how management of firms appropriate/distribute earnings into payment of dividend and retained earnings.

Table 4.5: Retained, Dividend Ratios, Retained per share and Profit Growth Rate

Year	Retained ratio%	Dividend ratio%	RPS	Profit growth%	changes earnings
2008	32	68	9.50%	0.20	0.050
2009	35	65	9.30%	0.12	0.020
2010	32	68	8.30%	0.11	0.010
2011	29	71	7.70%	0.09	0.013
2012	30	70	8.60%	0.14	0.009
2013	30.5	69.5	8.80%	0.15	0.002
2014	31	69	8.80%	0.17	0.000
2015	30.1	69.9	8.20%	0.11	0.006
2016	37	63	9.70%	0.20	0.015
2017	42.2	57.8	10.50%	0.22	0.035
2018	40.3	59.7	9.90%	0.18	0.006

Source: Author's computation, 2021

Above analysis in Table 4.5 is further shown graphically in fig 4.1 to indicate the trend in retained earnings. The movement shows a downward slope though fluctuating, but a clear indication that retained earnings per share in Nigeria is relatively low. Although, the analysis on Table 4.4 showed that smaller or younger firms retained more of their profit after tax but on average and for the period under review, the retention is insignificant as more of the earnings in the case of larger concern and multinational companies are paid out in form of dividend.

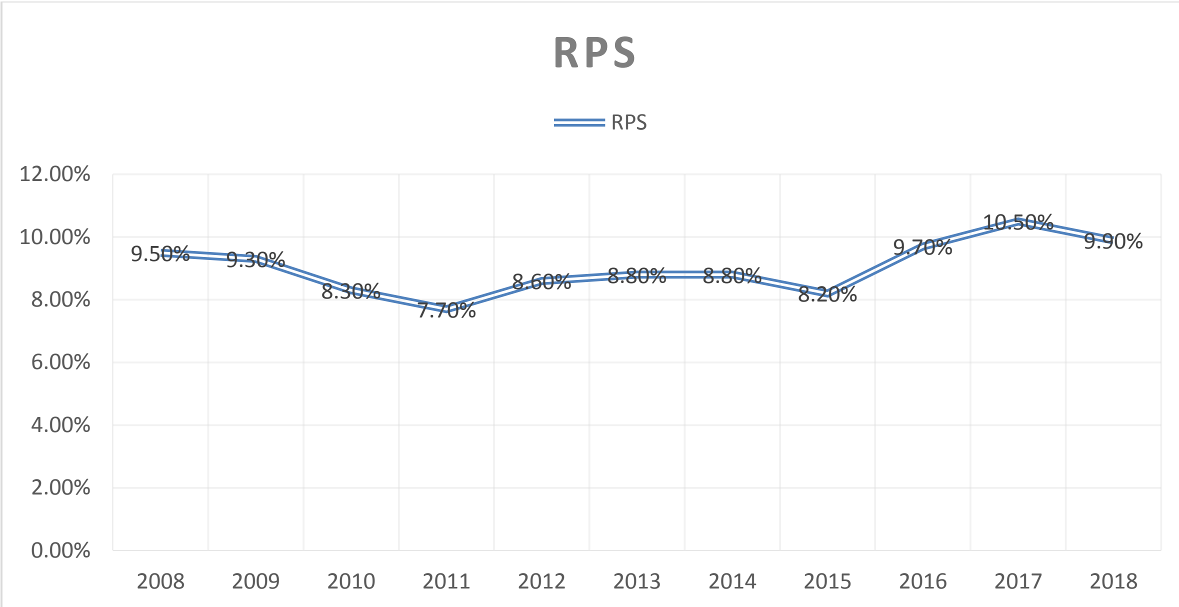

Fig 4.1 RPS

Given the position in Fig 4.1, the trend is not linear as retained earnings decreased, increased and levelled off over the period. There was no overall significant increase or decrease. The pattern or trend has either increased or decreased or levelled off or begun to move in opposite direction. For instance, there was a prevalence decrease between 2008 and 2011 and increase between 2015 and 2017 but these were not enough to be a significant linear change. The curve levelled off between 2012 and 2014 and between 2017 and 2018 it began to move in the opposite direction. Today, the focus and attention of investors is more on the effect of undistributed profit on the value of their investment. A keen interest is always shown in value creation that is, on extra value being created by the amount retained. Thus, the efficiency, effectiveness or otherwise of management in the use of retained capital now form part of the criteria that inform investors' investment decision. Firms retention policy is evaluated viz-a viz the market value and attention are now placed on what the firms do with retained earnings.

5 CONCLUSION AND POLICY RECOMMENDATIONS

Findings from the study clearly indicate that most firms retained part of their earnings yearly, but the degree of retention varies across firms and industries. The retention ratio is found to be industries specific as the rate varies widely across industries. The study concluded that firms in growing stages tend to retain more of earnings while matured firms appeared to be financially strong and paid out more of their earnings in form of dividend. Newly established and small manufacturing firms in Nigeria financed their operations using more of internal accruals specifically retained earnings than external sources. This may be attributable to the underdeveloped nature and small capacity of the debt capital, capital market. The study of this nature is valuable and crucial for policy implication. It has been demonstrated clearly in support of the earlier studies that retained earnings invested in profitable ventures or used to reduce debt liability can generate future cash-flow that will enhance returns to the shareholders. Also, the aim of retention by managers is to generate additional returns to the stakeholders and not for the purpose of mitigating the adverse effect of unforeseen situations. Therefore, effective management of the fund ploughed back can only be achieved through proper and efficient utilization of available resources with adequate corporate governance compliance.

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