RETENTION POLICY, CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE OF LISTED MANUFACTURING FIRMS IN NIGERIA

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ABSTRACT
Sequel to the economic policy direction of the new administration in Nigeria with regards to fuel subsidy removal and uniform foreign exchange rate, together with its attendants effect on the GOP. This paper examined the nexus between retention policy and the financial performance of listed manufacturing firms in Nigeria using corporate governance as a moderating variable together with financial leverage, li9quidity, tangibility, firm size and firm age as control variables. Descriptive survey research design was adopted using secondary data. Based on purposive sampling techniques the study obtained relevant data from 56 firms, whose stocks were traded consistently from 2008 to 2018 out of a population of 78 listed firms. Tables, percentages and random effect estimations were used to analyze the data. The result of the analysis empirically revealed that at 1% level of significance, a positive relationship exist among retention policy, corporate governance and the financial performance of firm (proxy with ROA). In addition, all the control variables also exhibited significant relationship at 1% level. The study therefore concludes that retention policy and practices of efficient corporate governance contributed and significantly enhance financial performance of firms in Nigeria.
KEYWORDS: Corporate governance, Earnings, Retention Policy, ROA
JEL CODE: D46, G32, G34, G38.

1. INTRODUCTION

In today's business world, many firms retain part of their income for reasons ranging from maintenance, fixing of equipment, investment opportunities, growth and expansion, flexibility, asset replacement, reducing liability to enhance, smooth operations. Most establishments in Nigeria, just like any organizations in developed and developing countries disclosed information in their financial reporting system that include amount retained from their annual earnings and the amount distributed to ordinary shareholders in form of dividend. To date, the extent of the retention has not been empirically and extensively explored to ascertain the rate of retained and the reasons adduced for the retention. The position of the law is not helping in this regard. Section 385 (16) of CAMA 2020, LFN merely posited that every company shall prepare a Director's report clearly indicating the amount recommended to be paid as dividend and the amount to be retained. Extant literature however posit that the reasons for retaining earnings might include settling outstanding liability, assets expansion, introduction of new production lines, extension of products and businesses to a new market and acquisition of an existing firms to broaden their production or distribution base. Thus, corporate firms in Nigeria seemed to be relying heavily on internal accruals for their investment needs and the whole essence must have been to generate future income and enhance value.

Apart from the numerous reasons adduced above for retention policy by manufacturing firms in Nigeria, the financial outlook for year 2023 provides another justifications for various business entities to embrace aggressive revenue reserve policy. According to the World Bank projections for 2023, Nigeria's growth rate is expected to hit 2.8% for a population of over 200 million.

However, from the data released by the National Bureau of Statistics, Nigerian economy grew by 2.25% in Q3 of 2022, 4.03% in Q3 of 2021, contracted negatively in Q3 of 2019 and improved to 2.55% in Q4 of the same year. In the year 2022, the manufacturing sector merely contributed 1.93% to the GDP. In the inaugural speech of the new president, a GDP growth of 6% was envisaged. To achieve this target, a removal of subsidy on fuel (PMS) was announced and subsequently, a liter of petrol moved upward from around N180 to ₦580 on average depending on the location within the country. While the official rate of increase and its attendance effects on inflation is currently been awarded, the NBS opined in September 2022 that the cost of diesel went up by 215% gas by 70.6% and petrol by 17% in one year. One of the leading firms of assurance providers however described the 6% envisaged growth rate as unattainable by the president. With the current epileptic power supply at expensive rate, the implications of this policy on production costs are better imagined. Also, on the 28 of May 2023, the new Finance Acts 2023 was signed into law with effective date of May 1st, 2023. While the Act contains various provisions designed majorly to increase government revenue, the short end of the stick belongs to the manufacturing entities and by extension, the potential consumers. For example, the new Finance Act, the Tertiary Education tax rate increased from 2.5% to 3% of assessable profits, Telecom at the rate to be prescribed by the president, VAT are now to be passed on goods purchased via electronic or digital platform from non-resident supplier appointed as agent of IFRS; taxation of gains on disposal of digital assets at the rate of 0.5% levy on goods imported into the country among others. With the obvious negative impact that the aforementioned provisions will have on the various entities, most of these burdens will automatically be transferred to the consumers. However, with the obvious low purchasing power due to inadequate income, consumers will naturally draw "a scale of preference" focusing entirely on food, drugs and housing while other items are regarded as luxury. Therefore, with the potential low patronage, leading to low managers may have no other option than to fall back on previous savings (if any) or bow out of the market. There is evidence in the literature today on the significance of both internal and external funds in the finance of investment requirements of the firms. However, the relative importance of internal accruals in financing investment project to generate cash flow and enhancing value has also been established in a considerably number of studies in developed (Ball Geratos, Linuainmaa & Nikola, 2019) and emerging economies (Munir & Kharal, 2017) but yet to be adequately explored in Nigeria. Retention policy of any establishment is informative and the expectation is that the reinvested capital will generate future cash flow and subsequently increase firms' value and ultimately maximize shareholders' wealth. Furthermore, investors are more concern about return on their investment as they pay considerable attention to the retention policy of firms while taking investment decision. Prospective investors look at dividend policy vis a vis the amount of earnings retained for expansion and growth. In particular, investors are not only concerned with what management does with the money but the extent to which the amount ploughed back has been put into efficient and effective use in enhancing stock value. Additionally, attention is also paid to corporate governance mechanism put in place to ensure efficiency, transparency, shareholder's right and accountability. The main objective of this study is to examine the impact of retention policy on the financial performance of listed manufacturing firms in Nigeria, using corporate governance as the moderating variable. The paper is subsequently divided into four sections. Literature review comprises of conceptual, theoretical and empirical review while the methodology comprises of theoretical framework, population and data collection together with specification of empirical model. Results and discussions of findings includes descriptive and

inferential statistics, discussion of results and implications of findings, while conclusions and policy recommendations finalized the paper.

2. LITERATURE REVIEW

2.1 Conceptual Literature

The three main concepts involved in this study are highlighted in the following subsections.

2.1.1 Retention Policy (RP)

Retention policy can be described as a basic management decisions where internal savings of surplus funds is considered appropriate as against dividend payments to shareholders especially when organizations requires finance. Retention policy and dividend policy are directly a clear opposite to each other when ownership and control functions are separated due to agency conflicts. According to the proponents of the pecking order theory, corporate managers considers internal savings through profit plough book as the most preferable financing option, followed by safety debt and risk debt. The underlying rationale behind retention policy is the belief that internal savings through retention enhances business growth.

2.1.2 Corporate Governance (CG)

The origin of corporate governance emanated from the need to protect the resources of an organization and ensure it judicious uses. In the early days, guidance was very much on an informal basis. Generally, the guidance has been developed in the areas of financial controls, risk, operational controls, the conduct and remuneration of directors. In the last three decades, corporate governance has been more formally developed but it varies from country to country. However, considerable amount of influence originated from the principles developed in Canada, United States and the United Kingdom. As a results of this wide spread application, researchers globally have made tremendous efforts not only to define the concept but also to rationalize its existence. However, the definition presented by the organization for Economic Cooperation and Development (OECD) is universally adopted. According to OECD (2004), the rules and practices that governed the relationship among the managers and shareholders of corporations, which contribute to the growth and financial stability by underpinning market confidence, financial market integrity and economic efficiency is known as corporate governance.

2.1.3 Financial Performance (FP)

Financial performance represents the various monetary values or indicators adopted by a performance manager or a decision maker to evaluate the general well being of a given organization or entity. According to Bhunia, Mukhuli and Roy (2011), financial performance represents the overall financial health of an entity over a given period of time. Performance measurement aims to establish how well something or somebody is doing in relation to the planned activity and desired result. The thing may be a machine, a factory, a subsidiary company, an organization as an entity, a sector of the economy or an economy as a whole. A typical business requires performance measurement in terms of its relations with external parties, across the organization, within each of the sub-divisions or at the level of individual activities. Traditionally, scholars and decision makers usually adopt ratio analysis as an indicator of financial performance. In this study, return on asset (ROA) is adopted as a proxy for financial performance. The term return on assets (ROA) refers to a financial ratio that indicates how profitable a company is in relation to its total assets. This measure is relied upon by investors to ascertain how management

or corporate managers are utilizing the available assets or resources of the establishment to generate more income.

2.2 Theoretical Review

From the available literature, one can observe that no particular theory is all embracing simply because it represents an area of specialization with different interpretations by different scholars based on their perception and background (Huillier, 2014). On this premise, the theory in this paper is focused on retention policy, corporate governance and financial performance. Specific theories in this regard include Pecking Order Theory, Signaling Theory, Walters Dividend Model, Agency Theory and Stewardship Theory. According to Kishore (2009) and Alfred (2007), the pecking order theory is associated with Donaldson (1961), Myers (1984, 1993) and Baskin (1989) in its various dimensions. The theory opined that for the purpose of financing any investment opportunities, management would traditionally prefer to source the required fund internally before considering external sources. However, a major source of dispute in investment environment and corporate finance is the lack of symmetric information among all investors. According to Lintner (1956), the share price may not represent the true value of an entity because of the problem of information asymmetry. Management of an entity is always in possession of the current and future prospect of an entity, which is available to the public. From the Nigerian manufacturing sector's perspective, relevant information is not freely available to the investors. According to Walter's dividend model (1963), the market value of any organization is not directly related to the dividend policy of such establishment. It is believed that dividends paid to shareholders are usually reinvested back into the company in order to attract increased future 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. However, the problem of whether or not to pay dividend or retain the profit is domiciled with the management. According to Easterbrook (1984), the issues associated with dividend policy can be viewed from two Agency cost perspectives. Firstly, managers must ensure that the rate of debt to equity must not fluctuate too rapidly. Secondly, shareholders do not necessarily put all their eggs in one basket. Stewardship theory examined the relationship that exists between management and the ownership of an organization from a different perspective as against the position expressed by the Agency theory. The stewardship theory opines that managers are not motivated by personal goals but rather they are steward whose motives are in consonant with the shareholders' objectives. Thus, stewardship theory believed in the uniformity of the long-term corporate objective of the entire organization. In practice, for any retention policy to be properly implemented, corporate managers (agents) must obtain the required trust and confidence of the principals (shareholders), otherwise investors would naturally prefer to transfer their funds to such establishments that pay dividends regularly.

2.3 Empirical Review

The controversy associated with retention policy in the extent literature originated from the Agency theory and the dichotomy between the ownership and control of an organization. Where the ownership and control of an establishment are fused together, then agitation for either dividend or retention will not be a serious issue requiring this level of public interest. However, Modighani and Miller propounded the dividend irrelevance theory in a seminar paper delivered in 1961. MM opined that the wealth of an investor is not directly related to retention or dividend policy and that the market value of an establishment is only influenced by the ability of such concern to earn money and the associated risk of its activity. Findings among numerous scholars clearly disagreed

with this postulation. Though, several factors are responsible for the financial performance of an organization, retention policy is a key factor.

In the extent literature, several studies here associated retention policy with firm's financial performance (or value), but the results are diverse. Adeniji (2022) investigated the effect of retention policy on the market value of listed firms in Nigeria using Tobin's Q in three different dimension. The result from random effect estimations established a significant negative relationship between the two variables. Ugah, Uche and Ogbu (2019) also examined the interrelationship among retained earnings, dividend payout, and market value of oil and gas firms in Nigeria using inferential statistics, findings revealed that market share price and retained earnings negatively correlated. Urwoji Sindhu, Hashmi and Hassain (2017) however established a significant positive relationship among retained earnings, distributed earnings and profitability from the study of non-financial firms listed on Karachi Stock Exchange (KSE) in Pakistan. Inose (2018) evaluated the effect of retained earnings on firm's market value using equity issuance costs as friction. Findings indicate that firms generally retain its earnings when cash capital ratio is low and productivity is high. Using a sample data obtained from seventy-five (75) non-financial listed firms on the Nigerian Stock Exchange (NSE), Akinkoye and Akinadewo (2018) investigated the effect of retained earnings on the market of listed companies in Nigeria, findings established a positive relationship among earnings per share, retained earnings and market value. Using regression analysis, Thirumalarisamy and Al-Baloushi (2017) posited that earnings and dividends have significant positive effect on the market value but at a later stage, retained earnings show a significant positive influence on the market price of shares. According to Ball, Gerakos, Linuaininaa and Nikoler (2019), the relationship between retained earnings and book-to-market is a good proxy for earnings yield. Apart from the fact that the aforementioned positions of scholars are contradictory, none of the researchers included corporate governance index as a moderating variable in their studies.

Contrary to the positions established among scholars above, majority of researchers are unanimous with regards to the effect of corporate governance and financial performance. Adeniji and Adeniyi (2022) evaluated the level of corporate governance compliance and its effect on market value of listed manufacturing firms in Nigeria. Using random effect estimation findings established positive and highly significant relationship in the three different estimations. Adeniji (2023) also examined corporate governance practice and compliance level among listed firms from 2008 to 2018. Findings indicated that at a compliance rate of 73.66% on average, listed firms in Nigeria have embedded corporate governance initiatives with the highest and lowest compliance rate of 82% and 60%. Yamen, Farhan and Tabach (2019) relied on evidence from Indian Tourism sector, evaluated the effect of corporate governance practice on firms performances. Using least square regression model findings reveal that corporate governance practices influences firm performances in different ways. Egbunike, Amughoro and Ovbieko (2019) opined that firm value, board independence, board size and audit committee meeting are positively correlated. According to Mansur and Yaugl (2018), ownership structure exert the greatest influence on firm performance scholars who established positive relationship between corporate governance and financial performance or market value includes: Agbaeze and Ogosi (2018); Olayiwola (2018); Balagobei (2018); Urhoghide and Korolo (2017); Bwallay, Hamdan and Zureigat (2017); Ahmed and Durga (2019); Shin and Kim (2018) among others. However, despite the avalanche of prior studies relating corporate governance compliance with financial performance, none of these scholars was able to investigate the combined effect of both retained earnings and corporate governance compliance index on the financial performance of firms in Nigeria.

3 METHODOLOGY

3.1 Theoretical Framework

Two theories need to anchor this research are the pecking order theory and the Agency theory. From pecking order theory, it is believed that management will traditionally prefer to source the required financing for investment purposes internally before considering external sources of funding to validate this assumption, organization must adopt aggressive retention policy as against regular dividend payments. In practice, the objective of investors is to obtain regular returns on their investments either through capital appreciation or through constant dividends. In the absence of dichotomy between ownership and control, retention or dividend policy may not attract serious attention. However, Agency theory critically, examined the ownership structure of an organization, where managers represents the agents while the shareholders and other stakeholders constitute the principal the object of this relationship is for the agent to represent the principal and also to act on behalf of the principal with the third party in all transactions. Therefore, for effective retention policy in nay organization, the agents must always act in the best interest of the principal.

3.2 Population, Sample and Data Collection

The yearly data covering a period of eleven (11) years from 2008 to 2018 was obtained from the published accounts and other relevant data disclosed by the sampled firms. The scope of the study is determined by the availability of relevant data among the listed manufacturing firms. The study therefore adopted descriptive survey research design and through purposive sampling technique selected fifty-six (56) out of a total population of seventy-eight (78) firms representing seventy-two percent (72%) of the population. The secondary data obtained for this study consisted of retention policy (proxy with RPS, EPS), corporate governance (proxy with the log of corporate governance index) and financial performance (proxy with ROA). Control variables (financial leverage, liquidity, tangibility, firm size and firm age) whose influence on financial performance cannot be ignored were also included. Descriptive and inferential statistics was adopted in analyzing the effect of retention policy and corporate governance on firm's financial performance in Nigeria.

3.3 Specification of empirical model

The assumption is that firms retained their earnings and the retained funds are effectively utilized to have significant influence on the cash flow generated by firms. The presence of corporate governance is believed to strengthen the relationship between firm's performance and retained earnings. The study adapted multiple regression, which was used to provide a basic test of the relationship between the dependent and independent variables. The regression model regressed return on assets against the retention and corporate governance variables, as well as other control variables. The equation that respectively captures the regression is given as follows:

$$ROA_{it} = a_o + {}_1rps_{it} + {}_2eps_{it} + {}_3cgi_{it} + {}_4lev_{it} + {}_5size_{it} + {}_6age_{it} + {}_7liqud_{it} + {}_8tang_{it} + T_{it}$$

In the model, ROA_{it} denotes financial performance; rps_{it} denote amount of earnings retained per shares; eps_{it} represents earnings accrued to outstanding shares; cg_{it} denotes composite governance index; Lev_{it} indicate the ratio of debt capital to total debt capital to total asset; $sizei_t$ denotes firm total asset; age_{it} denotes the number of years firms have been listed; $Liquid_{it}$ equals current assets divided by current liabilities; $Tang_{it}$ =ratio of tangible assets to total assets and denotes the error term. The key primary explanatory variables were rps, eps, cgi and other variables. Firm size, firm age, financial leverage, liquidity and tangibility serves as control variables.

4. RESULTS AND DISCUSSION OF FINDINGS

4.1 DESCRIPTIVE STATISTICS

In Table 4.1, retained earnings per share are the first independent variable located in column 6 on the table. Its values range from a minimum of 0.462 to a maximum of 0.883. This implies that some establishments re-invested as much as 80% of earnings accrued to shareholders. It has a mean value of 0.734 indicating that each share (on average) has a large amount of retained earnings and standard deviation of 0.106, implying low variations among firms listed on the Nigerian Stock Exchange over the period of study (2008-2018). Earnings per share is the second independent variable positioned in the first column. It 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 firms listed on the Nigerian Stock Exchange, on average, make a good return on equity and standard deviation of 2.181 implies that the value sparely dispersed from the mean. The mean value of corporate governance index (LCGI) located in the second column is 1.336. This implies that the level of compliance with governance code among manufacturing firms is moderate as the minimum value is 1.279 and the maximum is 1.398. The high standard deviation of 0.045 clearly indicates that the differences in levels of compliance among firms are insignificant.

Table 4.1 Descriptive Statistics of the Variables

	EPS	LCGI	LEV	LIQ	ROA	RPS	SIZE	TAN	LAGE
Mean	2.347	1.336	0.155	0.826	0.254	0.734	8.796	0.062	1.475
Median	2.482	1.342	0.134	0.753	0.255	0.746	8.873	0.063	1.477
Maximum	7.667	1.398	0.287	1.265	0.453	0.883	9.029	0.097	1.544
Minimum	0.091	1.279	0.064	0.479	0.025	0.462	8.525	0.022	1.398
Standard Dev	2.181	0.045	0.067	0.241	0.099	0.106	0.161	0.024	0.046
Skewners	1.091	0.076	0.606	0.363	-0.386	-1.124	-0.489	-0.343	-0.125
Kutnersis	3.577	1.655	2.289	1.989	4.079	4.542	1.944	1.930	1.801
Jarque Beva	130.79	47.02	50.62	39.77	45.19	190.67	53.15	41.47	38.52
Probability	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Observation	616	616	616	616	616	616	616	616	616

Source: E-Views output.

Table 4.2 Retained Earnings Corporate Governance Index Regression on Return on Asset

Independent Variable	Dependent Variable
Retained Earnings Corporate Governance	ROA
Constant	11.444
LCGI	(37.534) 5.741
RPS	(10.680) * -0.447
EPS	(-3.626) * 0.032
LEV	(7.579) * 1.168
LAGE	(6.181) *

	-0.992
LIQ	(0.869) -1.032
TAN	(-8.016) * 11.420
SIZE	(-6.051) * 0.093
Observation No.	(6.308) 616
R^2	0.97
Adj R^2	0.97

Note: The * indicate significance at 1% level
Source: E-View Output

4.2 Discussion of Result

Based on the analysis on Table 4.2 above, the study regressed return on asset (ROA) on corporate governance and retained earnings measures and all the control variables. The result shows the relationship between return on asset and retained earnings using two measures, that is, retained earnings per share and earnings per share as well as corporate governance index. The Hausman test conducted showed also that random effect was a best fit as there was no correlation between the regressors and the explanatory variable. The regressors were found to be uncorrelated with the explanatory variables. The result is found to be generally robust and significant for the aggregate corporate governance index and retained earnings components. However, the results showed varying significant levels and the control variables except age, are significant in return on asset regression using random. The coefficient of the relationship is strong which suggests that the presence of good governance practice brings improvement in the management of firms' resources and consequently enhances performance in terms of return on capital employed. The retained earnings measure comprising of retained earnings per share and earnings per share were also found to be positively and significantly related to financial performance. The result is consistent with earlier studies in the literature (Thuranira, 2014; Omete 2013; Chasan, 2012; Black & Jang, 2003; Klapper & Love, 2002). The result can also be substantiated with the positive relationship between return on asset and corporate governance. The result showed that the presence of corporate governance, which is an indication of firms' compliance with the dictates and code of corporate governance, enhances efficient use of firms' resources to generate future income. Thus, efficient and effective use and management of economic resources of firm will certainly culminate to growth in return. The study showed that a change in total retention policy (EPS & RPS), corporate governance measures and other control variables predicts 0.97 of the return on asset. The adjusted r^2 indicates the effects of the independent variable on the dependent variable and explains over 3% of the variance in return on asset of the firms. The model is fit to show the significant effects of the independent variables on the dependent variables given the results of Durbin – Watson (DW) and F-statistics. The F-statistics in the estimation is significant at 1% level and the result of the statistics of Durbin-Watson of 2.18 in the estimation shows that the regression equation is free from serial correlation problem in the model.

4.3 Implications of findings.

The results of the research have implications for both institutional and corporate investors, private investors, government and regulatory agencies, creditors and lenders together with researchers and scholars. The study empirically revealed that while earnings per share exhibited a significant positive relationship with firm value, retained earnings per share and firm value are negatively correlated. This implies that an increase in the percentage of retention policy leads to a decrease in the market value of an organization. However, depending on the nature of the investors, if majority of the shareholders are risk-takers, suspending current benefits for higher returns in the future may not be a serious problem. Therefore, higher retention policy for the purpose of growth and development of small and medium size establishments may be a sound economic decision. For the multi-national corporation with market dominance, shareholders may not be too comfortable with a higher retention policy.Corporate managers are provided with information regarding internal sources of funds for business expansion. Government agencies are exposed to important variables that can reduce corruption and enhances public accountability (for instance, the percentages of dividend paid, retention and corporate tax). Lenders and its creditors are provided with information and its effects on the credit policy of an organization. For instance, bankers will be more comfortable to lend to organizations with a higher retention policy than those with little or no retentions. To researchers and scholars, the study provides additional literature in the field of accounting, finance and investment beyond those currently those currently reviewed

5. CONCLUSION AND POLICY RECOMMENDATIONS

The study confirmed prior findings from extant literature with regards to the nexus between either retention policy or corporate governance and financial performance of firms. From the results, the influence of both retention policy and corporate governance on the financial performance and by extension firm value cannot be overemphasized. Based on the current harsh economic realities, it may be difficult for companies without effective retention policy to survive. As earlier observed, fuel subsidy removal implies increase in inflation on the short-run. Traditionally, where extra cost burden are shifted to the consumers with weaker purchasing power, then the consequence on the manufacturer is low sales. Therefore, without effective and aggressive retention policy, coupled with good corporate governance structure being put in place, then the going concern of some establishments may be in jeopardy. Consequently, corporate managers who act as an agent on behalf of the shareholders must earn the trust of the owners and other stakeholders by strictly complying with the corporate governance codes. In addition, ensures that the retained earnings are judiciously invested in profitable ventures that increase the future benefits of the stakeholders. The stakeholders must show adequate interest in the management of the beyond just attending the AGM. Financial regulators and the capital market operators must also be proactive enough to ensure adequate compliance with the laws and the internal rules of the organization.

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