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Effects of Retained Earnings on Financial Performance of Listed Commercial Service Sectors at Nairobi Securities Exchange in Kenya

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Abstract

The aim of this study was to the effects of retained earnings on financial performance of commercial and service firms listed at Nairobi Securities Exchange in Kenya. It was supported by Pecking order theory retained earnings. The study adopted descriptive designs. The target population of the study was all 11 commercial and services firms at Nairobi securities exchange. The study applied purposeful sampling technique to select10 firms as the sample size. Data was collected form published annual reports and financial statements for 10 from 2011-2020. Data analysis was done using descriptive (Mean and standard deviation and inferential statistics(correlation and inferential statistics). Analyzed data was presented in tables. This ought to increase the application of retained earnings as their source of funding. Retained earnings has no financial obligations thus enhancing financial performance. Increasing usage of retained earnings would positively and significant effect on financial performance.

Keywords: retained earnings, financial performance, listed commercial and service sectors in Kenya

1. Introduction

The cost of retained earnings refers to the implicit cost a company incurs when it chooses to reinvest its net profits back into the business instead of distributing them to shareholders as dividends. Although retained earnings do not involve direct payment like interest on debt or issuance costs for new equity, they carry an opportunity cost. This cost is represented by the return that shareholders expect to earn if those profits were distributed and invested elsewhere. To justify retaining earnings, a company should ensure that the return on reinvested funds meets or exceeds this expected return. The cost of retained earnings is commonly estimated using financial models such as the Dividend Discount Model (DDM), where the cost is calculated by adding the expected dividend yield to the dividend growth rate, or the Capital Asset Pricing Model (CAPM), which factors in the risk-free rate, the stock's beta, and the market risk

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premium. This cost is crucial for evaluating investment, formulating dividend policies, and calculating the company's Weighted Average Cost of Capital (WACC) (Alves, Pereira, Paulo & Morais, 2018)

Retained earnings is major sources of cheap fund to firms. Increased usage of retained earnings for investment, enhances significantly performance listed manufacturing firms in Nigeria. Retained earnings is at the center financing pattern. Retained earnings are readily available making the most suitable sources of financing. Additionally, it does not require period charges thus, it reduces monthly, and expense thus enhances financial performance (Muhammed & Shah, 2014).

Retained earnings is key part of investors and other stakeholders because it is the best way to determine effectiveness of management so that they can enhance market value firms. Retained earnings is a key part of Shareholders' investment criteria. They use it to determine the extent to which firms apply retained capital and measure how much value in terms of capital gain, business growth and asset net worth have been added by the company's retention of capital with time. Investors normally are concern not only with profits, but determine whether management can be trusted to generate growth with those profits (Akinkoye & Akinadewo, 2018).

Retained Profit is key underlining corporate financial Performance in Niger. Future earnings capacity of Niger Mills Ltd. Calabar depends on its retained profit. Retained profit in the business has the ability of prospering firms' future financial earnings the greater heights (Bassey, Edom & Aganyi, 2016).
Earnings retention is major contributor of income generated for the firm. However, retained earnings affected performance of firms listed at Nairobi Securities Exchange negatively. Increasing retained earnings when not needed, is not profitable and thus firms adopt dividend policies that directly enhance shareholders' contributions (Thuranira,2018).

Retained earnings play a critical role in shaping a firm's financial performance, particularly in their ability to support future growth and stability. In the context of Niger, retained profit is a key indicator of corporate financial performance. For example, the future earnings capacity of Niger Mills Ltd. in Calabar heavily relies on its ability to accumulate and effectively manage retained profits. According to Bassey, Edom, and Aganyi (2016), retained profits have the potential to elevate a firm's future financial earnings to greater heights, serving as an internal source of financing that reduces reliance on external debt and improves financial sustainability. However, the relationship between retained earnings and financial performance is not universally positive. Evidence from firms listed on the Nairobi Securities Exchange indicates that excessive retention of earnings, especially when not aligned with profitable investment opportunities, can negatively affect firm performance (Thuranira, 2018). This suggests that while earnings retention is a significant contributor to income generation, it must be managed strategically. Firms often adopt dividend policies that balance the need for reinvestment with the goal of enhancing shareholder value, ensuring that retained earnings contribute positively to financial performance rather than becoming a drag on returns.

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Financial performance across different sectors and regions is influenced by a range of factors, with capital structure playing varying roles. In the United States, capital structure does not significantly determine corporate financial performance, as changes in debt levels account for only 15% of performance variation, although specific components like debt can influence metrics such as Return on Assets (ROA) by up to 46% (Olaniyi et al., 2015). Conversely, in Kenya, capital structure—especially the use of equity financing—positively affects the profitability of listed firms on the Nairobi Securities Exchange, as reducing reliance on debt enhances financial outcomes (Githire & Muturi, 2015). Similarly, among SMEs in Nakuru, capital structure is a key indicator of profitability, with firm size, growth, and asset tangibility further contributing to financial performance (Chepkemoi, 2013).

In the cooperative sector, financial performance is shaped more by internal characteristics and operational efficiency than by capital structure alone. For SACCOs in Lesotho, improved financial performance is linked to member support, capital contributions, asset growth, and reduced loan delinquency, while high ratios of fixed to total assets and excessive share capital can hinder performance (Mmari & Thinyane, 2019). In Tanzania, employee-based SACCOs tend to outperform community-based ones due to better economies of scale, higher loan ratios, and effective cost management, although community SACCOs benefit from higher liquidity and adaptability in handling financial shocks (Sangali, 2015). These findings highlight that while capital structure matters, broader operational and structural dynamics often play a more pivotal role in determining financial performance across different organizational contexts.

1.2 Statement of the problem

The major problem affecting the financial performance of Kenya's commercial and services sector is the sustained decline in financing activities, leading to reduced profitability and growth. In the 2023/24 financial year, private sector credit growth slowed to 4%, down from 12.2% in the previous year, with significant declines in key sectors such as manufacturing, trade, construction, and transport. This slowdown is attributed to factors like currency exchange fluctuations, tighter lending conditions, and higher interest rates, which have made credit less accessible and more expensive for businesses. Consequently, firms are experiencing cash flow challenges, prompting cuts in expenditure and reduced hiring, which further dampen economic activity.

Moreover, the contraction in financing has been exacerbated by a weakening macroeconomic environment. In the third quarter of 2024, Kenya's GDP growth slowed to 4.0% from 6.0% in the same period in 2023, primarily due to declines in the construction and mining sectors, which are heavily reliant on credit. This broader economic slowdown has led to subdued business confidence and reduced demand for goods and services, further straining the financial performance of firms in the commercial and services. These challenges underscore the need for strategic interventions to enhance access to affordable redit, stabilize the macroeconomic environment, and foster investor confidence to revitalize the financial performance of Kenya's commercial and services sector. Al-Tamimi and Obeidat (2013), studied the impact of cost of capital, financial leverage, and the growth rate of dividends on rate of return on investment an

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empirical study of Amman stock exchange. The independent variables of the study were and growth rate of dividends. This study failed to study retained earnings financing.

Objective of the study

The general objective of the study was to determine the effects of retained earnings on financial performance of commercial and service firms listed at Nairobi Securities Exchange in Kenya.

1.3 Research Hypotheses

Ho_1: Retained earnings has no statistically significant on financial performance of listed firms in Nairobi securities Exchange in Kenya.

1.4 Scope of the study

The study focused on effects of retained earnings on financial performance of commercial and service firms listed firms at Nairobi Securities Exchange in Kenya. The study was centered on listed firms at NSE as December 2020. The sample size of the study 57 listed firms from all sector. Financial performance of listed firms assessed for 10 years from 2011- 2020. Data collection sheet was used to collect secondary data.

2. Literature Review

2.1Theoretical Review

2.1.1 Pecking order theory retained earning

Pecking order theory is champion by Donaldson and it was introduced in 1961. It was later advanced by modified by Stewart Myers and Nicolas Majluf in 1984. According to Pecking order firms are financially handicapped due to the information asymmetry between managers/ owners and investors and thus firms apply a hierarchy in deciding on sources of finance. Further, the theory states firms have to rank their sources of finances. According to this theory firms have three main sources to fund the financial needs i.e. internal funds, debt and new equity. The theory argues that often firms prefer internal finances like excess liquid assets or retained earnings to external sources. Further the holds the views that firms only uses external finances from sources like debt, then, they must have little or no risk. Firms starts with short term debt and external equity as the last resort (Njeru, 2013).

This theory is guided by the following assumptions. Firms prefer internal sources like retained earnings for they are cheap and easier to access. Internal sources like retained earning arises from the profits earned in year, such profits can be paid as dividends or retained for reinvestment. Further, the theory assumes that firms only apply external funds when internal sources are not sufficient. Additionally, the theory assumes that, firms choose debt over equity form external sources. This is because, debt takes long time to mature unlike equity where dividends are payable annually. Similarly, the theory assumes that firms introduce financial policy, aimed minimizing costs associated with asymmetric information (Fan, Titman & Twite, 2012).

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The limitations of the of the theory includes: The theory assumes that firms only depend on internal sources as sources of funding. Over-reliance on internal sources my limit the ability of firms to invest in riskier projects that require a lot of funds. Additionally, the application of the assumes that a hierarchy of financing and prefer internal financing first; debt is preferred over equity as equity would mean bringing external ownership into the company. Additional ownership reduces dividends payable to exiting equity holders. Also, the does not factor the impact of taxes and financial distress. The theory assumes that there is no target capital structure. The firms choose capital as per preference order; internal finance, debt finance and then equity finance. This may not be the case for many firms as they may lack retained earnings (Wahome, 2017).

This theory is relevant for this study as it informed retained earning financing and financial performance of listed firms in Kenya. They prefer internal funding as the main source of funding their investment. This is because, internal sources are cheap, readily available, no procedures. However, not all firms can be able to finance their investment from retained earnings because they cannot make enough profits to fund their projects. Thus, such firms turn to external funding to fiancé their projects but follows a preference order.

2.2 Empirical review

2.2.1 Retained earnings and financial performance

Falak and Faiza (2015), assessed the impact of retained earnings on stock returns of food and personal care good industry listed in Karachi Stock Exchange. A quantitative method and explanatory research design were adopted by the study. The variables of the study were: stock prices, retained earnings and capital gain/loss yield. The study applied secondary data obtained from Annual reports between 2009- 2014. The study applied convenience sampling to select a sample size of 7 firms from food and personal care good industry. Collected data was analyzed through descriptive and inferential statistics. It was established that retained earnings and cash dividend per share and capital gain/loss yield had a weak and insignificant relationship. The study further identified that retained earnings and closing price of stock had medium positive and significant correlation. Additionally, the study identified that the relationship between retained earnings and capital gain/loss yield was weak direct and insignificant. The study concluded that keeping earnings had weak and insignificant linkage stock returns. The study recommended that managers ought to pay astronomical number of dividends, as they keep earnings contribute minimally to improved t stock returns.

Le, Tran, Viet, Ngoc, Tran, Thong and Scott (2020), did a Study on relationship between retained earnings and firm performance: Evidence from Vietnam. The study adopted a descriptive research design. The sample size for the study was 37 construction-listed companies. Retained earnings (RE), liquidity, leverage and firm age were independent variables of the study. Financial performance was the dependent variables and it was measured using ROA and ROE. The study used secondary data collected annual reports contained in STOCKPLUS database between 2005 and 2016. Collected data was analyzed using, descriptive statistics time series analysis technique is employed and Hausman test. The study identified that retained earnings

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have a positive effect on firm performance. In addition, the study identified that Liquidity had a direct and insignificant effects on company's performance. On the other hand, the study discovered that company's age had significant and inverse effect on the company's performance. The study suggested that should keep more earnings so as fund their investment and increase their firm performance.

Okeke (2020), analyzed the effect of retained earnings, cash reserve ratio and statutory reserve on earnings of deposit money banks in Nigeria. Ex-post facto was adopted by study as a research design. This study was guided by the following variables retained earnings, cash reserve ratio and statutory reserve. The sample size for the study was 9 deposit money banks listed on the Nigeria Stock Exchange. Simple random sampling technique was applied to select a sample size. Secondary data utilized in the study was collected from published annual reports and financial statements. Obtained data was analyzed through, panel data regression analysis, spearman rank-order correlation analysis, t-statistics and descriptive statistics. The study revealed that retained earnings and statutory reserve directly and significantly affect earnings per share of deposit money banks while cash reserve ratio had directly and insignificant influence on earnings per share of banks during the period. The study concluded that additionally, the study noted that - independent variable affected earnings per share positively and significantly.

Okechukwu and Chiekwugo (2020) wanted to find out the determinants affecting retained earnings of quoted manufacturing firms in Nigeria. The study adopted an ex-post facto research design. It was guided by earnings retention ratio, dividend payout ratio and net profit margin. Adopted purposive sampling technique to select a sample size of 28 consumer good manufacturing firms listed on Nigeria Stock Exchange (NSE). Secondary applied in the study was extracted from financial statements for 10 years (2009 to 2018). Collected data was analyzed through ordinary linear multiple regression and panel data regression analysis. The findings of the study indicated that, earnings retention ratio (ERR) affected RAO negatively and insignificantly. Further, the study found d out that dividend payout ratio (DPR) affected ROA positively but and insignificantly. Additionally, the study noted that while net profit margin (NPM) similarly, had a direct and significant effect on ROA. The study concluded that retained earnings significantly affects the growth of quoted manufacturing firms in Nigeria. The study recommended that the dividend policy applied to be relevant with the nature of the potential investment opportunity.

Thuranira(2014), studied the influence of retained earnings on the returns of firms listed at the Nairobi securities exchange. The adopted a descriptive study design. The variables of the study were stock returns, dividend yield, net asset value per share and price to book value was the intervening variable. The study applied secondary data that was obtained from secondary data obtained from company's annual reports between 2009 and 2013. Census method was applied to select a sample size of 61 listed firms at NSE. Regression and correlation analyses was applied to analyze collected data. The findings of the study indicated that earnings retentions and the stock returns had a very weak and inverse correlation. The study further found out that further, stock returns and retained earnings were negatively related. The study concluded that retention of earnings is irrelevant in influencing the amount of stock returns earned by of the investors of

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NSE listed firms. The study recommended that the corporate organizations should not keep too much earnings that is unwanted because it negatively affects investors' stock returns.

Nduati and Wepukhulu (2020), carried out a study to determine the influence of retained earnings on financial performance of saving and credit co-operative societies in Nairobi County, Kenya. This study followed a descriptive survey research design. Census method was applied to select 29 registered DTS as a sample size for the study. The study applied secondary data extracted from financial reports in Deposit Taking SACCOs. Collected data was analyzed through descriptive and inferential statistic that. The findings of the study indicated that retained earnings had a significant and positive impacts on financial performance in Deposit Taking SACCOs. The study recommended that management and policymakers ought to enhance total earnings to increase retained earnings because they have significant and positive relationship on financial performance of Deposit Taking SACCOs.

2.4 Conceptual framework

According to Mugenda & Mugenda, (2006), a conceptual framework is a hypothesized model that identifies the model to be used in a study and hence the relationships between the dependent variable and the independent variables. A framework conceptualizes the relationship between variables in the study and it can be represented either graphically or diagrammatically. A conceptual framework is made up of independent, and dependent variables. Kothari(2003), states that a variable is a concept which have qualities of quantitative values. A dependent variable is the predicated outcome variable. In this study distribution of cost of equity, cost debt, cost retained earnings and cost of preferences shares are independent variables while financial performance the dependent variable.

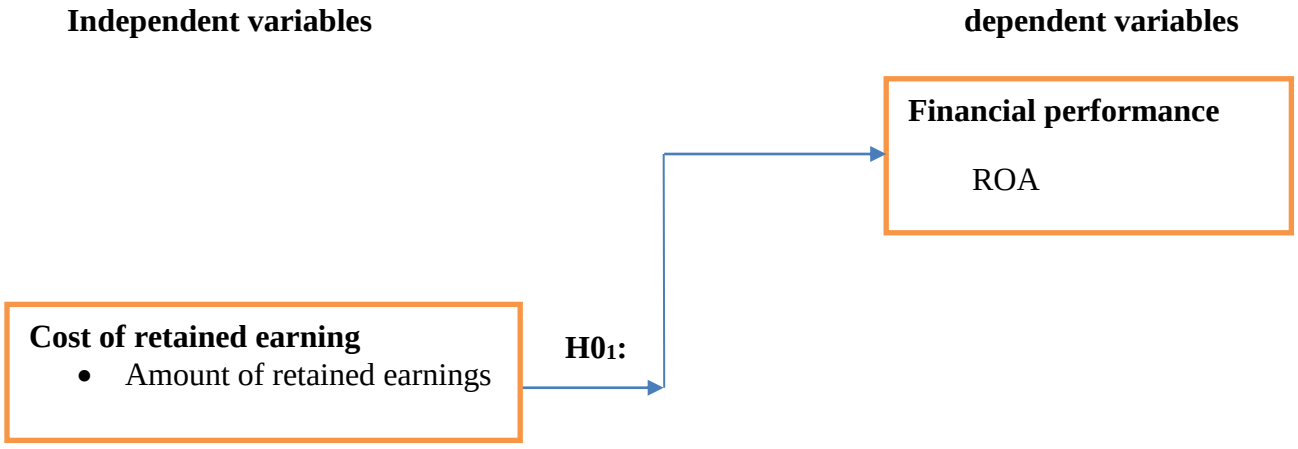

Figure 2.1 conceptual framework
Source: researcher (2025)

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Retained earnings are saving from annual proceeds. It's another internal source of funding for investments. Retained is the best source of funding because its cheap and easily available even on the shortest notice. Increase in the use of retained earnings as source of funding enhances performance.

3. Research Methodology

The study utilized a descriptive and correlational research design, as described by Ogula (2005), to investigate the relationships between various variables in listed firms in Kenya, without altering the environment (Maranga W.O and Mogwambo 2025). A descriptive design was employed to gather data through structured questionnaires or interviews (Stangor, 2011), while the correlational design was instrumental in identifying the connections between dependent and independent variables (Bari, Muturi & Samantar, 2019). The focus was on 11 firms listed in the commercial services sector of the Nairobi Securities Exchange (NSE) as of December 2023. To select these firms, a purposive sampling technique was used, ensuring that they had complete data from 2010 to 2020. Secondary data was sourced from published annual reports and financial statements, which are readily accessible, cost-effective, and straightforward (Mugenda & Mugenda, 2009). For data analysis, both descriptive and inferential statistics were applied to draw meaningful conclusions from the collected data (Bryman & Bell, 2003).According to Ogula (2005), a research design as a plan, structure or strategy that outlines of how to get answers on research questions and control variance. The study adopted descriptive and correlation design research design. Saunders, Lwesi and Thorn hill (2013) observed that design is suitable if it shows the characteristics and association between variables without affecting the environments. Descriptive design is a technique applied in data collection through distributing a structured questionnaire to a sample of respondents or interviewing the individuals (Stangor, 2011). According to Bari, Muturi and Samantar (2019), correlation design enabled the researcher to identify the nature of relationships between dependent and independent variables applied by listed firms in Kenya.

4. Results and Discussions

4.1 Cost of Retained Earnings

The study assessed the cost of retained earnings of commercial and service firms listed at Nairobi securities exchange. The study obtained data from annual financial reports. This data was analyzed using descriptive statistics and its findings were presented in table 4.1;

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Table 4.1 cost of retained earnings

	N	Minimum	Maximum	Mean	Std. Deviation
Deacons east Africa plc 2.50	10	.09	1.41	.4852	.39504
Eveready east Africa ltd Ord 1.00	10	.12	.70	.3141	.21732
express Kenya plc	10	.6	6.03	.7765	24.02541
Longhorn publisher	10	.15	.52	.3309	.10512
Nairobi business ventures plc Ord 0.50	10	.04	16.81	.7256	7.30186
Nation Media Group plc Ord 2.50	10	.68	7.08	.4555	2.73789
Sameer Africa plc Ord 5.00	10	.09	1.33	.8265	.46511
standard group plc 5.00	10	.48	1.53	1.0795	.35883
TPS east Africa ltd (serena) 1.00	10	1.50	2.64	2.3859	.34366
WPP scan group PLC	10	.19	4.03	1.7389	1.08878
Average mean				0.91186	
Valid N (listwise)	10				

Source: filed data 2025

The study revealed varying levels of financial performance among listed firms based on their retained earnings. Deacons East Africa PLC recorded a mean value of 0.4852 with a standard deviation of 0.39504, while Eveready East Africa Ltd had the lowest mean of 0.3141 and a standard deviation of 0.21732. Express Kenya PLC registered a mean of 0.7656 with a notably high standard deviation of 24.02541. Longhorn Publishers posted a mean of 0.3309 with a standard deviation of 0.10512, while Nairobi Business Ventures PLC recorded a mean of 0.7256 with a high standard deviation of 7.30186. Nation Media Group PLC exhibited a higher mean of 4.5559 and standard deviation of 2.73789. Sameer Africa PLC showed the highest performance among the firms with a mean of 0.8265 and a standard deviation of 0.46511. Additionally, Standard Group PLC posted a mean of 1.0795 with a standard deviation of 0.35883, TPS East Africa Ltd (Serena) had a mean of 2.3859 and standard deviation of 0.34366, while WPP ScanGroup PLC recorded a mean of 1.7389 with a standard deviation of 1.08878. The findings indicated that Sameer Africa PLC had the highest retained earnings and correspondingly high financial performance, while Eveready East Africa Ltd, with the lowest retained earnings, recorded the weakest performance. Firms such as Nairobi Business Ventures PLC faced higher costs of debt, which led to reduced financial performance. Conversely, firms like Standard Group PLC, Express Kenya PLC, Nation Media Group PLC, and Deacons East Africa PLC exhibited lower average costs of debt and better financial outcomes. These results align with the findings of Nduati and Wepukhulu (2020), who emphasized that retained earnings are a critical source of investment funding for Deposit-Taking SACCOs in Kenya, directly influencing profitability and shareholder returns. The study supports the notion that retained earnings not only reflect a firm's earning capacity but also enhance net income and dividend payouts, confirming their positive impact on financial performance.

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4.1.2 Financial Performance

Section 4.1.2 presents an analysis of the financial performance of companies in the commercial and service sectors listed on the Nairobi Securities Exchange. The data was obtained from the published annual financial reports of these firms and analyzed using descriptive statistical methods. Return on Assets (ROA) was used as the primary indicator of financial performance. The results of the analysis are presented in Table 4.2.

Table 4.2 Financial performance

	N	Minimum	Maximum	Mean	Std. Deviation
Deacons east Africa plc 2.50	10	.05	3.13	.9066	.83032
Eveready east Africa ltd Ord 1.00	10	.05	1.27	.4490	.44874
express Kenya plc	10	.05	4.70	.8186	1.41193
longhorn publisher	10	.08	1.04	.4878	.36034
Nairobi business ventures plc Ord 0.50	10	.12	4.14	.7935	1.21198
Nation Media Group plc Ord 2.50	10	.10	70.76	7.3938	22.26960
Sameer Africa plc Ord 5.00	10	.16	4.39	.7400	1.29549
standard group plc 5.00	10	.12	.74	.4999	.16649
TPS east Africa ltd(serena) 1.00	10	.01	1.04	.4762	.30583
WPP scan group plc	10	.34	3.84	.8840	1.06604
Valid N (listwise)	10				

Source: Filed data 2025

Table 4.2 presents the financial performance of selected commercial and service firms listed on the Nairobi Securities Exchange, measured using Return on Assets (ROA) over a 10-year period. The results show significant variations across firms. Nation Media Group PLC recorded the highest average ROA of 7.3938, with a wide range from 0.10 to 70.76 and a high standard deviation of 22.26960, indicating high profitability but considerable volatility. Deacons East Africa PLC and WPP ScanGroup PLC followed with mean ROAs of 0.9066 and 0.8840, respectively, suggesting moderately strong performance with some variability. Express Kenya PLC and Nairobi Business Ventures PLC also recorded relatively high mean ROAs of 0.8186 and 0.7935, though with high standard deviations, reflecting fluctuating performance. Sameer Africa PLC showed a mean ROA of 0.7400 with notable inconsistency. On the other hand, Longhorn Publishers, Standard Group PLC, and TPS East Africa (Serena) had lower but more stable ROAs, averaging between 0.4762 and 0.4999. Eveready East Africa Ltd registered the lowest financial performance with a mean ROA of 0.4490, albeit with minimal fluctuations. Overall, the findings suggest that firms with higher and more stable retained earnings, such as Nation Media and Deacons, generally posted stronger financial performance, supporting the view that internal financing can enhance profitability while minimizing risk associated with external funding.

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4.2 Inferential statistics

4.2.1 Correlation analysis

The study carried out correlation analysis to uncover the nature of linkages between independent variables (cost of retained earnings) and financial performance of commercial and services firms listed at NSE. The findings of the study were presented in the table 4.3.

Table 4.3 Correlation analysis

		Cost of retained earning	Financial performance
Cost of retained earning	Pearson Correlation	1	-.332**
	Sig. (2-tailed)		.001
	N	100	100
Financial performance	Pearson Correlation	-.332**	1
	Sig. (2-tailed)	.001	
	N	100	100

Source: Filed data 2025

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

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

Table 4.3 presents the correlation analysis between cost of retained earnings and financial performance for commercial and services firms listed at the NSE. The findings indicate a statistically significant **negative correlation** ($r = -0.332$, $p = 0.001$) between the **cost of retained earnings** and **financial performance**, suggesting that as the cost of retained earnings increases, financial performance tends to decline. This inverse relationship implies that firms facing higher costs in retaining earnings may experience reduced profitability, possibly due to inefficient reinvestment or opportunity costs associated with retained funds. The significance level ($p < 0.05$) confirms that this relationship is not due to random chance, highlighting the importance of managing retained earnings efficiently to enhance firm performance.

4.3 Simple Regression analysis

4.3.1 Cost of Retained earnings and its effect on financial performance

The study conducted a simple regression analysis to assess the effect of **cost of retained earnings** on the **financial performance** of commercial and service firms listed on the Nairobi Securities Exchange (NSE). The objective was to determine whether changes in the cost of retained earnings significantly influence a firm's return on assets (ROA). The regression results, including the model summary, ANOVA, and coefficients, are presented in the table below and provide insight into the strength, direction, and statistical significance of this relationship.

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Table 4.4 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.332[a]	.110	.101	2.44349

Source: Field data 2025

a. Predictors: (Constant), Cost of retained earning

b. Dependent Variable: Financial performance

Table 4.4 presents the model summary for the regression analysis examining the effect of cost of retained earnings on financial performance of commercial and service firms listed on the Nairobi Securities Exchange. The correlation coefficient (R) is 0.332, indicating a moderate negative relationship between the cost of retained earnings and financial performance. The R Square value is 0.110, which means that approximately 11% of the variation in financial performance can be explained by the cost of retained earnings. The Adjusted R Square value of 0.101 accounts for the number of predictors in the model, suggesting a slightly lower but still meaningful level of explanatory power. The standard error of the estimate (2.44349) indicates the average distance that the observed values fall from the regression line. Overall, the results show that while cost of retained earnings has a statistically significant impact on financial performance, its explanatory power is relatively modest.

Table 4.5 ANOVA

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	72.354	1	72.354	12.118	.001[b]
	Residual	585.124	98	5.971		
	Total	657.478	99			

Source: Field data 2025

a. Dependent Variable: Financial performance

b. Predictors: (Constant), Cost of retained earning

Table 4.5 presents the ANOVA (Analysis of Variance) results for the regression analysis examining the relationship between the cost of retained earnings and financial performance. The regression sum of squares is 72.354, indicating the variation explained by the model. The residual sum of squares is 585.124, which represents the unexplained variation. The F-statistic is 12.118, with a p-value of 0.001, which is less than the significance level of 0.05. This indicates that the model is statistically significant, meaning that the cost of retained earnings has a significant effect on financial performance. The results suggest that the relationship between the predictors (cost of retained earnings) and the dependent variable (financial performance) is not due to random chance, but rather reflects a meaningful association.

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Table 4.6 Regression Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	.323	.405		7.992	.000
	Cost of retained earning	-.245	.070	-.332	-3.481	.001

Source: Filed data 2025

a. Dependent Variable: Financial performance

Table 4.6 presents the regression coefficients for the relationship between the cost of retained earnings and financial performance. The unstandardized coefficient for the constant is 0.323, and for the cost of retained earnings, it is -0.245. The negative coefficient for the cost of retained earnings indicates that as the cost of retained earnings increases, financial performance tends to decrease. The standardized coefficient (Beta) for the cost of retained earnings is -0.332, which suggests a moderate negative effect on financial performance.

The t-statistic for the cost of retained earnings is -3.481, and the corresponding p-value is 0.001, which is less than the significance level of 0.05. This indicates that the relationship between the cost of retained earnings and financial performance is statistically significant. The negative sign of the coefficient suggests that higher costs of retained earnings lead to lower financial performance. The results confirm that cost of retained earnings is a significant predictor of financial performance for the firms in the study.

$Y = \beta_0 + \beta_1 X_1 + \varepsilon$, $\beta_{0=} .323$, $\beta_1 X_{1=} -.245$

$Y=.323-.245 X_1$

5. Conclusions and Recommendations

It was concluded that the cost of retained earnings had a weak, significant, and indirect relationship with the financial performance of listed commercial and service firms at the Nairobi Securities Exchange. According to these findings, a unit increase in the cost of retained earnings led to a significant reduction in the financial performance of these firms. Additionally, the study concluded that the cost of retained earnings had a positive and significant effect on financial performance. This means that increasing the amount of retained earnings results in a 30.7% increase in the financial performance of commercial and service firms listed at the Nairobi Securities Exchange.

The study recommended that, commercial and services listed at Nairobi Securities Exchange ought to increase the application of retained earnings as their source of funding. Retained earnings has no financial obligations thus enhancing financial performance. Increasing usage of retained earnings would positively and significant effect on financial performance. More studies should be on earning risk management on financial performance of other listed firms in Kenya.

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