
ASSESSMENT OF THE RELATIONSHIP BETWEEN RETAINED EARNINGS AND SHAREHOLDER VALUE CREATION: PERSPECTIVES FROM LISTED MANUFACTURING FIRMS IN KENYA

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ABSTRACT

Purpose of Study: This study sought to analyze the effect of retained earnings on shareholder value in listed manufacturing firms in Kenya.

Problem Statement: Generating shareholder value remains a fundamental objective within the global corporate sphere, closely linked to corporate profitability. The manufacturing sector in Kenya contributes approximately 18% to the country's GDP and creates employment to over 2.3 million individuals across both formal and informal sectors. However, these firms consistently struggles to create and maintain shareholder value over the past decade. Despite a reported increase in shareholder wealth on the NSE in 2019, much of this growth was concentrated within a few companies, with East Africa Breweries PLC being the only manufacturing firm among them.

Methodology: The study adopted a positivist philosophy and a causal research design. The target population included 21 listed manufacturing firms on the Nairobi Securities Exchange (NSE). Secondary panel data for the period 2012–2023 was extracted from published financial statements and analyzed using Stata software, employing both descriptive and inferential statistical techniques. Descriptive statistics, Pearson's correlation, panel regression, multiple regression analysis were employed to analyze the data.

Result: Retained earnings had positive and significant on shareholder value creation ($\beta = 0.229617$, $p = 0.018 < 0.05$), showing that reinvesting internal funds supports shareholder value.

Recommendation: Retained earnings should remain the primary source of funding for listed manufacturing firms, given their strong positive relationship with shareholder value. In addition, firms should adopt dividend policies that balance investor expectations with the need for reinvestment in core operations.

Keywords: *Retained Earnings, Shareholder Value Creation, Internal Financing, Capital Structure Decisions, Listed Manufacturing Firms in Kenya.*

INTRODUCTION

Companies are established to enrich their shareholders by delivering superior returns compared to other potential investments. As noted by Kerosi, Mugo and Kalui (2018), achieving maximum shareholder value necessitates managers' expertise not only in understanding value drivers within their company but also those prevalent in the industry. These value drivers encompass both financial and non-financial aspects. Given the distinctive nature of firms, managers must pinpoint company-specific variables that wield significant influence on market value. Consistent application of these variables ultimately amplifies the shareholder value generated (Tiwari & Kumar, 2015). Firms scrutinize value creation for various purposes, primarily centered around strategy formulation and assessment. According to Tiwari and Kumar (2015), discerning the financial variables with the most substantial impact on stakeholder value facilitates the implementation of suitable financial strategies. The manufacturing industry significantly contributes to Kenya's economic growth. Kenya's Vision 2030 blueprint emphasizes the need for the sector to grow by 8% over 20 years to achieve its strategic objectives (Bulle & Omagwa, 2017).

Retained earnings serve as an accessible and cost-effective internal funding source, offering an advantage over external financing by avoiding ownership dilution while supporting a company's financial growth (Ogata, 2020). Kithandi and Katua (2020) highlight that firms enhance shareholder wealth by focusing on retaining more earnings instead of prioritizing dividend payouts. However, a greater emphasis on retained earnings often necessitates higher financial leverage, which introduces considerable risk. Firms with strong net profits are expected to accumulate substantial retained earnings unless they maintain a high dividend payout ratio. This connection demonstrates that robust financial performance results in higher earnings retention. On the other hand, firms reporting losses incur retained deficits, which reduce shareholders' equity (Mwangi, 2016). These earnings represent accumulated profits that have not been paid out but are instead retained for purposes such as funding future growth, settling debts, or investing in new projects. Retained earnings are a vital source of financing for manufacturing firms, offering several key advantages. M'rabet and Boujjat (2016) assert that retained earnings serve as an internal reservoir of funds accumulated from past profits that haven't been distributed to shareholders as dividends which makes it a cost-effective option compared to external financing methods like issuing new equity or taking on debt, as they don't involve interest payments or dilution of ownership.

Shareholder value is often referred to as average market capitalization, which is calculated by multiplying the average market price per share in a given year by the total number of shares outstanding (Caballero, Teruel & Solano, 2019). Alternatively, Chávez, Kramer and Santillán (2015) describe shareholder value as the generation of future returns that exceed what investors could achieve from similar investments elsewhere. An increase in shareholder wealth is typically reflected by a rise in value compared to a previous period. In Kenya, shareholder value creation is a critical focus for companies, particularly those listed on the Nairobi Securities Exchange (Muthoni, Jagongo & Muniu, 2019), with the firms striving to enhance

shareholder value by delivering sustainable financial returns through dividends and stock price appreciation (Makeni, 2018). Manufacturing firms in Kenya, however, have faced challenges in maintaining consistent shareholder value due to factors such as economic fluctuations, regulatory changes, and operational inefficiencies (Kenya Association of Manufacturers, 2020). Research indicates that listed manufacturing firms in Kenya have experienced variable performance, highlighting the need for improved financial structures and governance practices. The manufacturing sector plays a crucial role in driving Kenya's economic growth.

STATEMENT OF THE PROBLEM

Although listed manufacturing firms in Kenya contribute significantly to the economy, they have consistently struggled to create and maintain shareholder value over the past decade. For example, despite a reported increase in shareholder wealth on the NSE in 2019, much of this growth was concentrated within a few companies, with East Africa Breweries PLC being the only manufacturing firm among them (CMA, 2020). This underlines the limited contribution of the manufacturing sector to shareholder value creation. Furthermore, some firms have faced significant challenges in sustaining value, with Mumias Sugar Company PLC and ARM Cement Limited being suspended from trading in the years 2018 and 2019 respectively (CMA, 2020). Their suspension reflects a broader failure to protect or enhance shareholder value. As Kariuki, Jagongo and Muniu (2019) point out, diminished firm value expose companies to risks such as falling share prices, hostile takeovers, and eventual delisting from the stock market.

Several empirical studies have explored the relationship between financial structure elements and shareholder value. However, these studies have limitations that make their findings less applicable to listed manufacturing firms on the Nairobi Securities Exchange (NSE). For instance, Kaumbuthu (2019) examined the impact of capital structure and financial performance on the industrial and allied sectors of the NSE but did not include extensive diagnostic assessments, which may weaken the reliability of its conclusions. Gul, Khan, and Rehman (2013) found an inverse relationship between the short-term debt ratio and profitability. However, their study did not consider the effects of long-term debt and retained earnings on performance, which are relevant factors in the current research. Haque et al. (2019) investigated the impact of long-term debt on financial performance in the context of the Dhaka Stock Exchange and found a positive but statistically insignificant effect. Since their study included all firms, its findings are not directly applicable to listed manufacturing firms in Kenya.

Although existing empirical research has linked financial structure elements with shareholder value, several research gaps remain that require further exploration. First, many studies (Kaumbuthu, 2011; Gul, Khan, Rehman, 2013; Haque et al., 2019; Machado and Prado, 2016; Khasawneh and Dasouqi, 2017; Gul, Khan & Rehman, 2013; Haque et al., 2019; Machado & Prado, 2016; Khasawneh & Dasouqi, 2017) have been conducted in different geographical contexts, highlighting the need to investigate the specific challenges and dynamics within Kenya's listed manufacturing firms. Second, the above studies have focused on non-manufacturing firms, making their findings less applicable to the manufacturing sector. Third, some of the above studies have used cross-sectional data, which limits understanding of how time influences the relationship between the independent and dependent variables. Additionally, previous studies have assumed a direct effect between these variables, without considering the moderating and mediating effects of ownership concentration. The impact of ownership concentration on the relationship between financial structure and shareholder value among Kenya's listed manufacturing firms remains unexplored. Therefore, this study sought to analyze the effect of retained earnings on shareholder value in listed manufacturing firms in Kenya.

RESEARCH OBJECTIVE

To analyze the effect of retained earnings on shareholder value in listed manufacturing firms in Kenya.

RESEARCH HYPOTHESIS

H₀: Retained earnings has no significant effect on shareholder value among listed manufacturing firms in Kenya.

THEORETICAL REVIEW

A theoretical framework, as explained by Suresh (2010), illustrates the interconnection of variables in a study through hypotheses. According to Gathii et al. (2019), it is within this framework that the hypotheses guiding the research are formulated. This study was anchored on profit maximization theory and pecking order theory.

Profit Maximization Theory

This theory, proposed by Adam Smith, David Ricardo, and Alfred Marshall, provides the foundation for understanding how businesses operate in competitive markets with the goal of maximizing profits (Junankar & Junankar, 2016). The theory is based on the principle that businesses act rationally, carefully evaluating costs and benefits to make decisions that lead to profit maximization. This rational decision-making framework is key for businesses as they navigate market dynamics and competitive pressures (Islam et al., 2019). It asserts that businesses prioritize profit maximization above other objectives, such as expanding market share, increasing sales, or fulfilling social responsibilities. By focusing on maximizing profits, firms aim to improve financial performance and sustain long-term growth. The theory also assumes a market structure of perfect competition, where firms are price takers in an environment with homogeneous products, perfect information, and no barriers to entry or exit. In this idealized setting, businesses adjust production levels and pricing strategies to optimize profits based on prevailing market conditions (Hyde, 2013).

The Profit Maximization Theory explains that firms aim to reach equilibrium at the point where marginal cost equals marginal revenue, a concept that is key in resource efficiency and production decisions. Through equating these two metrics, firms are able to determine the most profitable output level, thus avoiding overproduction or underproduction that have the potential to erode profits. This marginal principle ensures that resources are allocated optimally, balancing production costs against consumer demand (Abu-Bakar, 2022). The theory also underpins pricing decisions, where prices reflect both market competition and internal cost structures (Nyandemo, 2023). In competitive markets, this encourages price efficiency, as firms that fail to produce at optimal levels risk being driven out by more efficient rivals (Mwangi, 2024). Additionally, the model provides an analytical tool for managerial decision-making, as profit maximization serves as a measurable benchmark for assessing firm performance (Karanja, 2022). Through its quantitative orientation, it allows firms to project revenues, forecast costs, and identify breakeven points critical for sustainability (Okello, 2021). Consequently, the theory remains central to microeconomic analysis, guiding firms toward rational profit-seeking behavior in dynamic market conditions (Mutua, 2025).

In contemporary corporate finance, the profit maximization theory has evolved into broader models emphasizing shareholder wealth maximization, integrating risk, time value of money, and sustainability considerations (Ndungu, 2023). This extension recognizes that long-term firm value depends not only on immediate profits but also on maintaining stable cash flows and responsible governance (Wekesa, 2024). Researchers argue that profit maximization remains a necessary but not sufficient condition for value creation, as firms must now integrate

environmental, social, and governance principles into strategic decisions (Otieno, 2022). In this context, profit maximization serves as the operational base, while value maximization represents the strategic objective (Omondi, 2023). Financial managers therefore use this principle to evaluate investment and financing decisions that optimize both profitability and shareholder satisfaction (Mbugua, 2025). The Profit Maximization Theory was considered relevant to the current study as it presents a relevant proposition as it supports the variable on retained earnings and explains how it affect shareholder value. This indicate that listed manufacturing firms might aim to maximize profits by optimizing their retained earnings.

Pecking Order Theory

The Pecking Order Theory, introduced by Majluf and Myers in 1984, explains the hierarchy firms follow when selecting financing options. As Dommès et al. (2019) point out, the theory suggests that firms prefer using internal funds first, such as retained earnings, and only turn to external financing when internal resources are insufficient. Within this hierarchy, retained earnings are prioritized, followed by debt, and finally equity issuance (Rahma, 2021). For example, when a firm has sufficient internally generated funds for a project, it will use those reserves before considering debt or equity. If external financing becomes necessary, the firm will prefer to issue debt before turning to equity, due to the higher costs and potential dilution of ownership associated with equity financing.

The Pecking Order Theory argues that equity issuance signals overvaluation, so firms avoid issuing shares when internal funds or debt are available (Myers, 2001). Accordingly, firms follow a hierarchy of financing; first internal funds (retained earnings), then debt, and lastly external equity (Mabrouk & Boubaker, 2019). Empirical literature further argues that this preference ordering stems from adverse selection costs associated with external financing, particularly equity, and informational costs with external funding in general (Abdullazade, 2019). In this context, firms with large internal funds will thereby rely less on outside financing, consistent with POT (Guizani, 2020). Thus, the theory frames financing choices as dynamic responses to internal cash flows and information asymmetries rather than as static optimisation of a target leverage ratio (Machielsen, 2013).

Pecking Order Theory suggests that firms avoid targeting a specific debt-equity ratio, instead adopting a hierarchical financing approach. They prioritize retained earnings, turn to debt when needed, and consider external equity only as a last option (Endri et al., 2021). This approach can influence dividend policies, as firms relying on retained earnings may prefer to reinvest profits rather than distribute them as dividends, potentially affecting share price stability and investor sentiment (Andow & Wetsi, 2018). This theory is particularly relevant to the current study, as it sheds light on how decisions regarding short-term debt, long-term debt, and share capital impact shareholder value among listed manufacturing firms in Kenya. By understanding this financing hierarchy, the study provides insights into how these firms optimize shareholder value while managing their capital structure.

EMPIRICAL REVIEW

Dahmash, Alrabba and Al-Qudah (2023) investigated firms listed on the Amman Stock Exchange (Jordan) over 2010–2021 using unbalanced panel data for 2,281 firm-years. They measured retained earnings in the form of the retention per share (RPS) ratio, and they used Tobin's Q as a proxy for shareholder value. Their pooled sample results indicated that the retention per share ratio exerted a low negative but statistically insignificant effect on Tobin's Q, whereas the dividend per share ratio had a strongly positive and significant effect. They concluded that in the Jordanian context, retaining earnings did not increase market valuation unless accompanied by credible dividend signals. They recommended that firms reconsider

blanket retention policies and instead ensure retention is justified by high-return investment opportunities or redirect excess cash to dividends to enhance market value.

Oganda, Museve and Mogwambo (2022) examined the effect of retained earnings financing on the financial performance and shareholder value of listed manufacturing and allied firms in Kenya. The study adopted a dynamic panel design using data from nine firms listed on the Nairobi Securities Exchange for the period 2010–2019. Retained earnings were measured using the retained earnings to total assets ratio, while shareholder value was proxied by return on assets (ROA) and return on equity (ROE). The findings revealed that retained earnings financing had a statistically significant positive effect on both ROA and ROE, indicating that firms that relied more on internal financing generated higher shareholder returns. The study concluded that retained earnings serve as a stable source of funding that enhances firm value through reinvestment in productive activities. The study thus recommended that manufacturing firms adopt a balanced retention policy that is consistent with internal reinvestment with long-term growth opportunities while maintaining transparent communication with investors to sustain confidence and firm valuation.

Dahmash, Alrabba and Al-Qudah (2023) sought to establish the effect of retained earnings on firm market value among industrial and manufacturing firms listed on the Amman Stock Exchange in Jordan. The study adopted a panel regression approach using data spanning from 2010 to 2021 and measured retained earnings through the retention-per-share (RPS) ratio, while shareholder value was represented by Tobin's Q. The findings revealed that retained earnings had a negative and statistically insignificant relationship with Tobin's Q, whereas dividend payout exhibited a strong positive association with market value. The study concluded that in the Jordanian manufacturing sector, retained earnings alone do not necessarily enhance shareholder value unless accompanied by profitable reinvestment opportunities. The study thus recommended that managers formulate retention policies based on the firm's investment pipeline and return on capital rather than arbitrary retention targets, and maintain optimal dividend distributions that signal financial health to investors.

Odufisan and Oyetayo (2025) evaluated the effect of the earnings retention ratio on shareholder value of selected manufacturing firms in Nigeria. The study adopted a fixed-effects panel regression model based on data from 2010–2022, using the market price per share as a measure of shareholder value. The findings revealed that the retention ratio had a statistically insignificant or weak negative effect on market price per share, indicating that increased retention without corresponding profitable investment did not translate into higher firm valuation. The study concluded that merely retaining profits does not improve shareholder wealth unless the retained funds are effectively reinvested in high-return projects. The study thus recommended that firms link retention decisions to project-specific investment returns, improve transparency in the utilization of retained funds, and maintain dividend policies that reflect sustainable growth potential and investor expectations.

A study by Okeke and Nwosu (2024) examined the effect of retained earnings reserves on shareholder value of industrial goods firms listed in Nigeria. The study adopted a panel regression design covering the period 2010–2021, where retained earnings reserves were used as the independent variable and Tobin's Q served as the proxy for shareholder value. The findings revealed that retained earnings reserves exhibited a negative but statistically insignificant relationship with Tobin's Q, suggesting that accumulation of earnings without clear investment strategy did not enhance firm value. The study concluded that excessive reserve accumulation points to underutilization of funds and weaken investors' perception of growth prospects. The study thus recommended that manufacturing firms should set upper limits for retained reserves, periodically evaluate the productivity of internally reinvested

funds, and consider alternative uses such as dividends or debt repayment when retention does not yield tangible value improvement.

CONCEPTUAL FRAMEWORK

A conceptual framework offers a visual representation of how various factors relate to one another. In this framework, retained earnings is the independent variable, while shareholder value is the dependent variable. This can be observed in the conceptual framework in Figure 1.

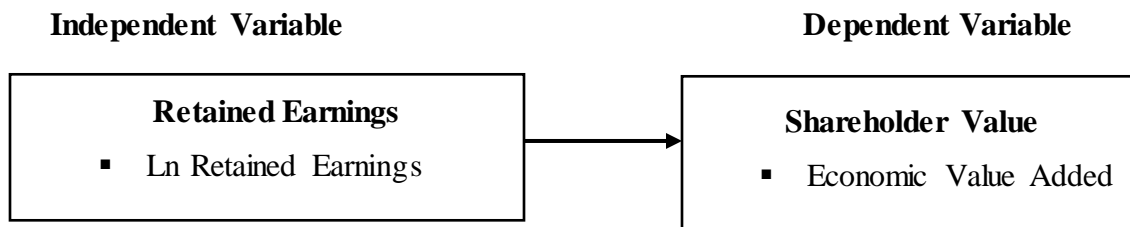


Figure 1: Conceptual Framework

RESEARCH METHODOLOGY

In this study, the quantitative paradigm was adopted to uncover cause-and-effect relationships among quantitative variables, employing a correlational research design. Crotty (1998) notes that the positivism philosophy evaluates real, objective, neutral, and predictable facts about social phenomena, often with little regard for individual subjectivity. Positivism serves as the relevant philosophical foundation to guide the study's purpose, investigation type, extent of involvement, data collection time frame, analysis, and presentation. Furthermore, the positivist paradigm maintains that the researcher remains independent of the observations made during the study. By adopting a positivist perspective, this approach does not begin from established theories (Saunders et al., 2008). Positivism emphasizes objectivity and impartiality in research. This study adopted a causal research design based on its philosophical approach, objectives, and data accessibility. The causal design aims to demonstrate how certain variables influence others and seeks to uncover the underlying causes of observed changes (Kerlinger & Lee, 2000).

EMPIRICAL MODEL

The study adopted the static panel data model developed by Arellano and Bover (1995). The Arellano and Bover (1995) model is well-suited for examining the relationship between financial structure and shareholder value over time (Adenutsi, 2014). To test the direct effect of the independent variable on the dependent variable of shareholders' value creation measured by Economic Value Added (EVA), the following static panel data regression Model 1 was employed:

$$SV_{it} = \beta_0 + \beta RE_{it} + \varepsilon_i$$

Where SV_{it} is Shareholder's Value for firm i during year t ;

RE_{it} is retained earnings for firm i during year t

ε_i is the disturbance term

The study targeted twenty-one listed manufacturing firms as of December 2023 on the Nairobi Securities Exchange (NSE, 2023). The listed firms were selected because of their important role in Kenya's manufacturing sector and the availability of reliable data, as they are mandated

to publish their financial statements, which ensures the credibility of the variable measurements. The study conducted a census of the specific firms in focus and thus all 21 listed manufacturing firms at the NSE (Nairobi Securities Exchange, 2023) were examined. Secondary data was sourced from the published financial statements of 21 listed manufacturing firms, focusing on their financial structure, Economic Value-Added variables, and ownership concentration. The data covered the period from 2012 to December 2023, providing a total of 252 data points.

The collected panel data was analyzed using Stata statistical software due to its strong capability in handling econometric and panel data models. The analysis comprised both descriptive and inferential statistics. Descriptive statistics included measures such as means, standard deviations, minimum, and maximum values, which summarized the characteristics and variability of the study variables across firms and time periods. Trend analysis was also conducted to observe the direction and movement of key financial indicators and shareholder value over the study period (2012-2023). Inferential statistics included Pearson’s correlation analysis and panel regression analysis. Pearson’s correlation was employed to examine the strength and direction of the linear relationships between financial structure variables. Panel regression analysis was then applied to estimate how variations in short-term debt influenced shareholder value over time.

RESULTS, FINDINGS AND DISCUSSION

Descriptive Statistics

Descriptive statistics provided overview of the general financial position of the sampled manufacturing firms, including their reliance on retained earnings utilization. These patterns were analyzed in relation to their potential influence on shareholder value which was measured using economic value added. The descriptive statistics results are presented in Table 1.

Table 1: Descriptive Statistics

Variable	Obs.	Minimum	Maximum	Mean	Std. Deviation
RE	250	65337.41	973359.8	341880.5	198633.0803
SV	250	-92233.7	92233.72	-9223.37	9223.372037

RE= Retained Earnings, = SV= Shareholder Value

Source: Research Data, 2025

The descriptive findings on Table 1 depicts that retained earnings had a mean of KSh 341,880.5 million with a standard deviation of 198,633.08, revealing wide variations across firms. The minimum and maximum values were KSh 65,337.41 million and KSh 973,359.8 million respectively. These results indicate that while some manufacturing firms consistently plough back profits to support internal growth, others have limited retained surpluses possibly due to lower profitability or higher dividend payouts. The findings support Mbuvi and Gekara (2015), who argued that many firms prefer to reinvest earnings rather than seek external financing as a prudent and cost-effective strategy. This enhances long-term sustainability and shields firms from interest obligations. However, Kinyua, Njogu, and Maina (2020) observed that in developed markets, companies often distribute larger portions of profits as dividends to signal stability and maintain investor confidence. The considerable variation in retained earnings among Kenyan firms may therefore reflect differing profitability levels, reinvestment policies, and growth strategies, which ultimately influence shareholder value.

Shareholder value, measured by Economic Value Added (EVA), had a mean of -9,223.37 with a standard deviation of 9,223.37, ranging between -92,233.7 and 92,233.72. This wide

dispersion shows that while some firms generated positive economic value, others eroded shareholder wealth during the study period. The negative mean suggests that, on average, listed manufacturing firms in Kenya faced challenges in achieving returns above their cost of capital. This contrasts with Achieng, Muturi, and Wanjare (2018), who found positive EVA trends in other emerging markets, indicating that firms there were able to enhance shareholder value.

Trend Analysis

Trend Analysis on Retained Earnings

The trend analysis for retained earnings focused on assessing how the utilization of internally generated retained funds changed among listed manufacturing firms in Kenya between 2012 and 2023. This analysis sought to determine whether firms increasingly relied on retained profits as a stable source of financing to support reinvestment, business expansion, and long-term shareholder value creation. The observed trend pattern is illustrated in Figure 2.

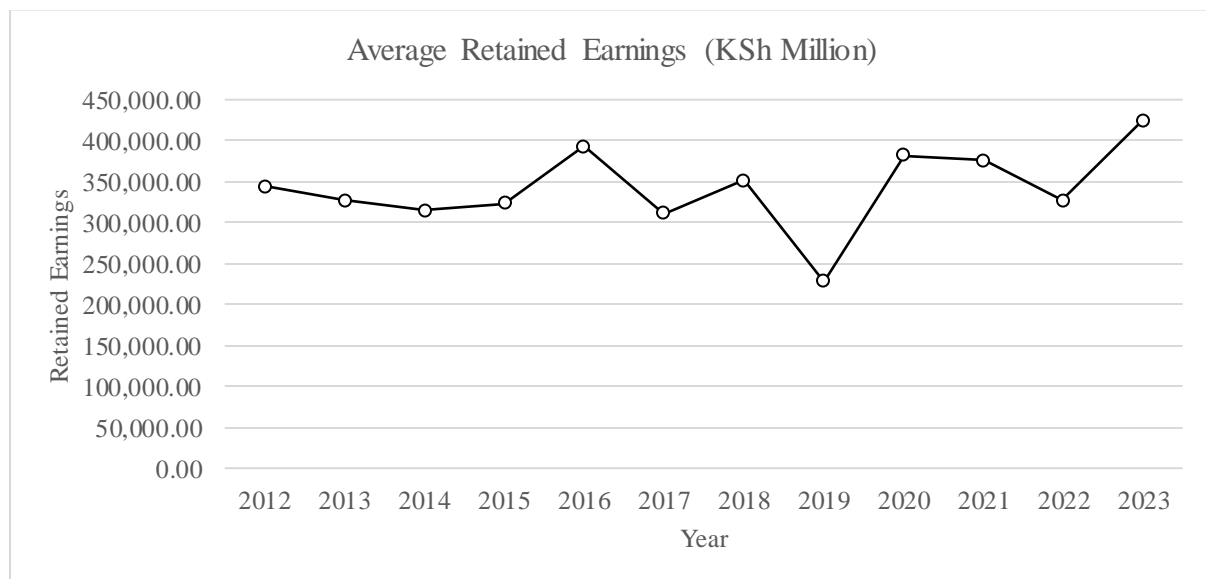


Figure 2: Trend Line on Retained Earnings

Source: Research Data, 2025

The trend results in Figure 2 depicts that, in 2012 the average retained earnings was KSh. 344,149.64 million, indicating a strong internal capacity for reinvestment and capital accumulation. This high level suggests that manufacturing firms began the period with a healthy reserve of undistributed profits, likely reflecting a conservative approach to dividend distribution and a preference for self-financing. In 2013, retained earnings slightly declined to KSh 326,734.81 million, signaling reduced profit retention, possibly due to higher dividend payouts or reinvestment in operational restructuring to enhance competitiveness.

A gradual decline continued into 2014, where retained earnings dropped to KSh 315,255.02 million, indicating constrained internal financing capacity or lower profitability in that year. However, in 2015, a modest rise to KSh 323,716.38 million suggested a partial recovery, with firms possibly channeling more profits back into business expansion. A significant increase was observed in 2016, reaching KSh 392,754.01 million, reflecting improved operational performance and a stronger tendency toward profit reinvestment rather than external borrowing. This upward movement indicate that firms recognized retained earnings as a cost-effective and stable financing avenue that strengthens shareholder value over time.

In 2017, retained earnings dropped to KSh 311,323.64 million, indicating reduced internal savings or possibly higher dividend disbursements. However, 2018 marked a rebound to KSh 350,850.90 million, underscoring renewed profit retention in response to stabilizing market conditions and operational efficiency improvements. The decline to KSh 227,671.14 million in 2019 represents the lowest point during the study period and likely reflects economic headwinds that eroded profitability, forcing firms to draw on retained earnings to sustain liquidity.

Despite these fluctuations, a sharp recovery occurred in 2020, with retained earnings rising to KSh 382,116.32 million, suggesting that firms strategically held back dividend payouts during the early stages of the COVID-19 pandemic to preserve cash flow and ensure business continuity. This upward momentum was maintained in 2021, where retained earnings stood at KSh 375,558.75 million, indicating sustained profitability and prudent financial management amid a recovering economy. Although 2022 saw a mild reduction to KSh 326,876.43 million, the strong rebound in 2023 to KSh 424,946.26 million demonstrated a renewed commitment to internal capital retention as firms pursued post-pandemic expansion and long-term value creation. The trend pattern indicates that retained earnings remained a pivotal and consistent financing source throughout the 12-year period. The fluctuations observed agrees with macroeconomic conditions, firm profitability, and dividend policy adjustments. The consistent rebound in retained earnings during recovery periods reflects the resilience of listed manufacturing firms and their strategic preference for internally generated funds over external borrowing, in line with the Pecking Order Theory which prioritizes internal financing before resorting to debt or equity issuance.

These findings concurs with the findings of Ofori-Sasu, Abor, and Osei (2017), who established a statistically significant positive relationship between retained earnings and shareholder value among Ghanaian listed firms. Their results highlight that reinvesting profits contributes directly to shareholder wealth, reinforcing the argument that retained earnings enhance long-term financial sustainability. However, unlike their cross-sectional approach, the current study's longitudinal perspective provides deeper insights into how retained earnings fluctuate with economic cycles and firm-specific conditions. Similarly, the results corroborate Adjei and Mensah (2019), who found that Ghanaian manufacturing firms reinvesting larger proportions of profits achieved notable gains in profitability and market competitiveness. Their findings support the current study's evidence that consistent profit reinvestment creates both operational efficiency and shareholder value creation in capital-intensive industries like manufacturing.

Trend Analysis on Shareholder Value

The trend analysis for shareholder value, the dependent variable in this study, examined the variations in firms' economic value added (EVA) among listed manufacturing firms in Kenya between 2012 and 2023. This analysis aimed to evaluate how effectively these firms generated wealth for shareholders over time by comparing returns to the cost of capital. A positive EVA indicates value creation, whereas a negative EVA signifies value erosion. The observed trend pattern is illustrated in Figure 3.

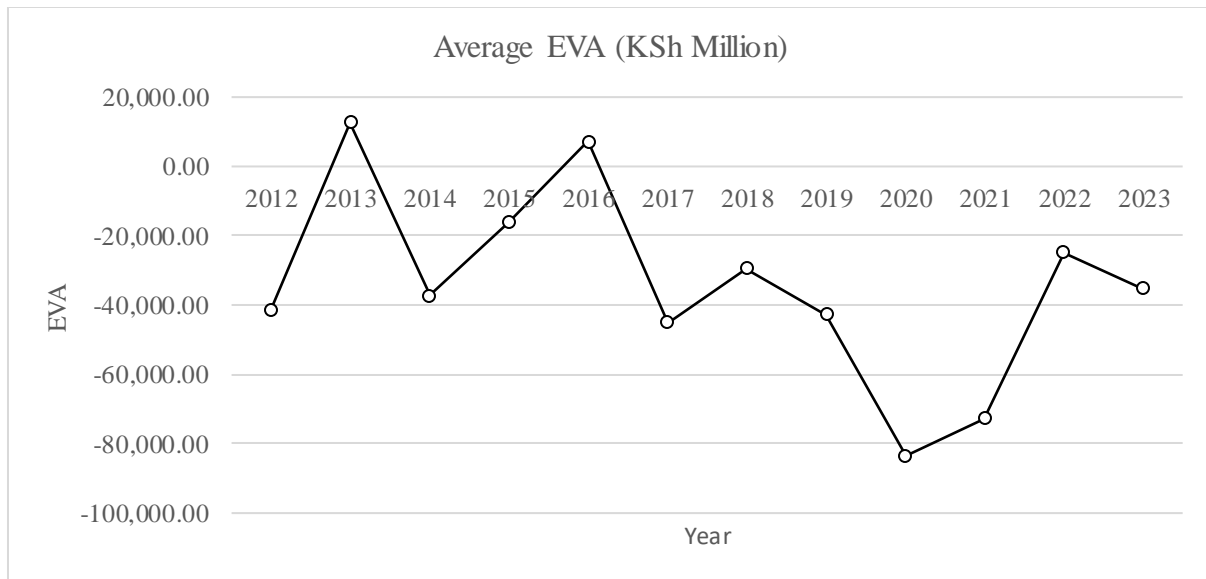


Figure 3: Trend Line on Shareholder Value

Source: Research Data, 2025

The trend analysis of economic value added among listed manufacturing firms in Kenya from 2012 to 2023 reveals fluctuating performance, indicating inconsistent value creation for shareholders over the period. In 2012, the average EVA stood at -41,279.9 million, signifying that firms were unable to generate returns above their cost of capital. An improvement occurred in 2013, with EVA rising to 12,546.7 million, suggesting enhanced profitability and operational efficiency, possibly due to better cost management and favorable market conditions. However, this improvement was short-lived, as EVA declined to -37,282.4 million in 2014, reflecting a regression in performance and potential increases in financing or operational costs.

In 2015, EVA improved modestly to -16,081.7 million, indicating reduced value erosion as firms possibly optimized working capital and adopted leaner cost structures. The only other positive EVA was recorded in 2016 at 7,211.8 million, suggesting that listed manufacturing firms briefly managed to achieve returns exceeding the weighted average cost of capital (WACC), thereby creating shareholder value. Unfortunately, this momentum reversed sharply in 2017, where EVA dropped to -45,112.6 million, marking one of the lowest points in the period, likely due to rising production costs and external market shocks.

Between 2018 and 2021, EVA remained negative, reflecting continued challenges in value creation. In 2018, EVA averaged -29,305.4 million, a moderate improvement compared to 2017, possibly driven by stabilization in operating margins. However, subsequent years recorded deeper declines: -42,570.2 million in 2019, -83,457.3 million in 2020, and -72,746.3 million in 2021. The sharp drop in 2020 aligns with the economic slowdown caused by the COVID-19 pandemic, which disrupted supply chains, reduced demand, and increased financing constraints. By 2022, firms appeared to recover slightly, with EVA improving to -24,882.6 million, before dipping again to -35,195.7 million in 2023, indicating lingering inefficiencies and slow post-pandemic recovery in profitability. The trend suggests that Kenya's listed manufacturing firms struggled to maintain consistent shareholder value creation over the twelve-year period. The sporadic positive EVA values (2013 and 2016) demonstrate that while firms have the capacity for value creation, structural and operational inefficiencies continue to hinder long-term performance.

These findings agrees with the assertions by Chen and Dodd (2017) that, EVA is a more comprehensive measure of financial performance than traditional accounting metrics, as it

integrates both profitability and capital costs. They observed that firms with persistent negative EVA often face challenges in aligning operational efficiency with capital structure optimization. Similarly, Uwuigbe, Jafaru, and Ajayi (2018) analyzed listed manufacturing firms in Nigeria and found that financial leverage and cost of capital significantly influenced EVA, where high debt exposure often eroded value creation potential. This supports the observed volatility in Kenya’s manufacturing sector, where financing costs and market pressures have constrained profitability.

Correlation Analysis

Correlation analysis was employed to explore how short-term debt relate to shareholder value among listed manufacturing firms in Kenya. The correlation matrix results are presented in Table 2.

Table 2: Correlation Matrix

Variables	SV	lnRE
SV	1.0000	
lnRE	0.4737*	1.0000

SV=Shareholder’s Value, RE=Retained Earnings

Source: Research Data, 2025

The correlation results in Table 2 depicts that that retained earnings (lnRE) has a positive and statistically significant relationship with shareholder value ($r = 0.4737^*$), indicating that firms that rely on internally generated funds for reinvestment tend to create higher shareholder value. This finding concurs with the findings of a study conducted by Ofori-Sasu, Abor, and Osei (2017) who found a significant positive relationship between retained earnings and shareholder value in Ghanaian listed firms, as well as Adjei and Mensah (2019), who concluded that reinvested earnings improve profitability and competitiveness in manufacturing sectors. These findings collectively supports the Pecking Order Theory, which emphasizes internal financing as a preferred and value-enhancing funding sources.

Panel Regression Analysis

The regression revealed that retained earnings (lnRE) positively and significantly affect shareholder value ($\beta = 0.229617, p = 0.018 < 0.05$). This indicate that firms that reinvest their profits rather than relying on external borrowing tend to experience higher shareholder value creation. The study also tested null hypothesis that retained earnings has no significant effect on shareholder value among listed manufacturing firms in Kenya at 0.05 significance level. Since the results revealed $p\text{-value}=0.018 < 0.05$, the null hypothesis was rejected and the study thus found that retained earnings had a positive and statistically significant effect on shareholder value. The findings are consistent with those of Ofori-Sasu, Abor, and Osei (2017) who found that retained earnings significantly enhanced shareholder value among firms listed on the Ghana Stock Exchange. Likewise, Adjei and Mensah (2019) and Ogunyemi and Olufemi (2020) demonstrated that reinvested profits foster profitability and competitiveness by financing growth internally. These findings agrees with the Pecking Order Theory, which suggests that firms prefer internal financing to avoid the costs and risks of external debt and equity issuance. Retained earnings provide flexibility, reduce dependency on lenders, and signal strong management efficiency and profitability. For Kenyan manufacturing firms, reinvesting earnings into capacity expansion, technology adoption, and innovation can significantly enhance productivity and long-term firm value. This supports the notion that effective internal financing strategies remain a cornerstone of sustainable value creation.

CONCLUSION

Internal financing through retained earnings is one of the most reliable paths for sustaining shareholder value in the Kenyan manufacturing setting. Firms that reinvest earnings rather than distribute them fully or fund growth through expensive borrowing are better positioned to strengthen their value position over time. This supports a governance posture where management favours disciplined reinvestment, strengthens productive capacity, improves efficiency, and builds resilience without exposing the firm to the instability that comes with external debt markets. The implication for practice is that dividend policy in this sector cannot be driven only by short term shareholder pressure. It must be aligned with long term value preservation and strategic reinvestment. Retained earnings, when managed well, act as a stabilizer that shields the firm from shocks and supports future competitiveness.

RECOMMENDATIONS

Retained earnings should remain the primary source of funding for listed manufacturing firms, given their strong positive relationship with shareholder value. Firms should adopt dividend policies that balance investor expectations with the need for reinvestment in core operations. Retained earnings provide a stable and low-cost source of financing that minimizes external dependency and enhances long-term competitiveness. Management should therefore channel a greater proportion of retained profits into innovation, production efficiency, and market expansion. This will ensure sustained profitability and higher firm valuation over time. Shareholders should also appreciate that moderate dividend payments contribute to future growth, as reinvested profits ultimately strengthen firm fundamentals and share price performance.

There is need for policy interventions aimed at improving access to affordable financing for manufacturing firms. The high cost of long-term debt remains a major constraint that undermines shareholder value creation. Policymakers should strengthen industrial financing institutions such as the Industrial and Commercial Development Corporation (ICDC) and Kenya Industrial Estates (KIE) to provide targeted credit facilities at competitive interest rates. In addition, the Central Bank of Kenya (CBK) and commercial banks should collaborate to develop credit guarantee schemes that enable manufacturing firms to secure long-term loans for capital-intensive investments. By reducing borrowing costs and enhancing access to patient capital, such policies would enhance firm competitiveness, stimulate production capacity, and contribute to sustained shareholder wealth creation.

Furthermore, corporate governance policies should be supported to ensure that ownership structures do not hinder firm performance or capital efficiency. The study found that ownership concentration did not significantly moderate the relationship between financial structure and shareholder value, indicating that policy emphasis should shift from ownership control to governance quality. The CMA and NSE should strengthen existing corporate governance codes to promote independent oversight, transparency, and accountability in financial decision-making. Regulators should also enforce policies that protect minority shareholders from expropriation risks associated with concentrated ownership. By doing so, the policy environment would foster equitable participation, enhance investor confidence, and ensure that all shareholders benefit fairly from firm performance.

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