

IRJTP

INTERNATIONAL
RESEARCH JOURNAL OF
**TRANSDISCIPLINARY
PERSPECTIVES**

VOLUME 2 ISSUE 2, 2026

E-ISSN: 3121-9071



**CHRONIVA
PUBLISHERS**

Indexed:  DOAJ

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IMPACT OF RETAINED EARNINGS ON BUSINESS GROWTH OF MANUFACTURING COMPANIES IN NIGERIA

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Abstract

This study examined the impact of retained earnings on the business growth of manufacturing companies in Nigeria. The persistent challenges of limited access to external finance, high borrowing costs, and economic instability have increased the reliance of manufacturing firms on internally generated funds, particularly retained earnings, as a major source of financing growth and expansion. Despite this reliance, empirical evidence on the extent to which retained earnings contribute to business growth remains mixed and inconclusive. The study adopted an ex-post facto research design using panel data extracted from 30 selected manufacturing companies across the six geopolitical zones of Nigeria over a ten-year period (2015–2024). Data were obtained from audited financial statements and analyzed using descriptive statistics, correlation analysis, and panel regression techniques, including fixed effect estimation. The findings revealed that retained earnings have a positive and statistically significant effect on business growth of manufacturing companies in Nigeria. Firm size was also found to significantly influence business growth, indicating that larger firms tend to utilize retained earnings more effectively for expansion and operational improvement. The study further established that retained earnings explain a substantial proportion of variation in business growth among manufacturing firms. The study concluded that retained earnings remain a critical internal financing source for enhancing business growth in the Nigerian manufacturing sector, although their effectiveness depends on managerial efficiency and reinvestment decisions.

Keywords: Retained earnings, Business growth, Manufacturing companies, Internal financing, Nigeria.

Introduction

Retained earnings represent the proportion of profit that firms retain after dividend distribution and reinvest back into the business to support expansion, modernization, and operational sustainability. In manufacturing firms, particularly in developing economies like Nigeria, retained

earnings are a critical internal financing source due to limited access to affordable external capital and the high cost of borrowing. As such, they are expected to play a significant role in driving business growth through investment in productive assets, technology adoption, and capacity expansion.

Empirical literature on Nigerian manufacturing firms shows mixed evidence regarding the effect of retained earnings on business growth and performance. Some studies indicate that retained earnings positively and significantly influence firm growth and financial performance by improving reinvestment capacity and supporting long-term value creation (Okechukwu & Chiekwugo, 2020; Aloys, Elijah, & Vitalis, 2022). Similarly, recent panel-based evidence suggests that retained earnings significantly affect the growth of quoted manufacturing firms in Nigeria, reinforcing their importance as a key internal financing source (Nyangau, 2025; Sunday, 2024).

However, other studies report weak or insignificant relationships between retained earnings and performance indicators such as return on assets and earnings per share, suggesting that the effectiveness of retained earnings depends on managerial efficiency and investment decisions (Okeke, 2024; Thurania, 2014). In some cases, retained earnings have even been found to negatively affect performance when funds are not efficiently utilized or when firms experience poor governance structures (Okeke, 2024).

Theoretically, the pecking order theory provides a strong explanation for the preference for retained earnings as the first source of financing, since it reduces information asymmetry, avoids transaction costs, and minimizes financial risk compared to external financing (Myers & Majluf, 1984). Nonetheless, agency theory also suggests that retained earnings may be misallocated if managers pursue personal interests rather than shareholder value maximization, thereby weakening firm growth outcomes.

Overall, the literature suggests that retained earnings remain a major determinant of business growth in Nigerian manufacturing firms, but their impact is not automatic. It largely depends on how effectively firms reinvest retained funds into productive activities that enhance capacity, profitability, and competitiveness.

Problem Statement

Despite the strategic importance of the manufacturing sector to Nigeria's economic development, many firms continue to experience slow growth, low capacity utilization, and declining competitiveness. This situation persists even among firms that report consistent profitability, suggesting that internal financing decisions, particularly the use of retained earnings, may not be effectively translating into business expansion (Okeke, 2024). At the same time, external financing constraints such as high interest rates, stringent lending conditions, and limited access to capital



markets have increased reliance on internally generated funds for growth (Aloys, Elijah, & Vitalis, 2022).

Retained earnings are expected to serve as a stable and low-cost source of finance for reinvestment in productive assets, technology, and operational expansion. However, empirical findings on their effectiveness remain inconsistent. Some studies show that retained earnings significantly enhance firm growth and financial performance by supporting reinvestment and reducing dependence on debt financing (Nyangau, 2025; Sunday, 2024). In contrast, other studies report weak or insignificant effects, arguing that the impact of retained earnings depends largely on managerial efficiency, corporate governance, and the quality of investment decisions (Okeke, 2024; Thurania, 2014).

This inconsistency creates a conceptual and empirical gap in understanding whether retained earnings truly drive business growth in Nigerian manufacturing companies or whether inefficiencies in resource allocation limit their contribution to expansion. Additionally, concerns remain that retained earnings may be retained without being productively reinvested, thereby failing to improve productivity, innovation, or market competitiveness.

It is against this background that this study seeks to examine the impact of retained earnings on the business growth of manufacturing companies in Nigeria, with the aim of providing clearer empirical evidence on whether internally generated funds significantly influence sustainable industrial expansion.

Objective of the Study

The major objective of this study is to examine the impact of retained earnings on the business growth of manufacturing companies in Nigeria.

Literature Review

Conceptual Review

1. Concept of Retained Earnings

Retained earnings refer to the portion of net profit that a firm retains after dividend payments, which is reinvested into business operations to support expansion, asset acquisition, and working capital needs. They represent a key component of shareholders' equity and serve as a primary internal source of financing for firms (Pandey, 2010).

In the context of manufacturing firms, retained earnings are particularly important because they reduce reliance on external borrowing and provide flexibility for investment decisions. Frank and Goyal (2015) note that retained earnings are the cheapest source of finance since they do not involve flotation costs or interest obligations. Recent empirical studies also show that retained



earnings significantly contribute to firm performance and sustainability when efficiently reinvested (Aloys et al., 2022; Nyangau, 2025).

However, inefficient utilization of retained earnings can limit their impact on performance, especially in environments with weak corporate governance (Okeke, 2024).

2. Concept of Business Growth

Business growth refers to the increase in the size, profitability, output, and market share of a firm over time. Penrose (1959) explains firm growth as a function of effective resource utilization and managerial capabilities. In modern literature, business growth is commonly measured using indicators such as sales growth, asset growth, profit growth, and expansion of production capacity.

Barney (1991) further argues that firm growth depends on the ability to effectively deploy internal resources in a competitive environment. In manufacturing firms, growth is reflected in increased production capacity, technological advancement, and market expansion.

3. Manufacturing Companies in Nigeria

Manufacturing companies in Nigeria play a vital role in economic development, employment generation, and industrialization. However, the sector is constrained by infrastructural deficits, inflation, exchange rate instability, and limited access to long-term financing (Central Bank of Nigeria, 2023).

As a result, many manufacturing firms rely heavily on retained earnings to finance operations and expansion activities. Despite this reliance, growth performance remains inconsistent, raising questions about the effectiveness of internal financing strategies (Okeke, 2024).

Theoretical Review

1. Pecking Order Theory

The Pecking Order Theory, developed by Myers and Majluf (1984), posits that firms prefer internal financing (retained earnings) first, followed by debt, and finally equity issuance. The theory is based on the existence of information asymmetry between managers and external investors.

In relation to this study, the theory explains why manufacturing firms in Nigeria depend heavily on retained earnings due to high borrowing costs and limited access to capital markets. Empirical evidence supports this preference for internal financing in developing economies (Aloys et al., 2022).

2. Agency Theory

Agency Theory, developed by Jensen and Meckling (1976), explains conflicts between managers and shareholders. Managers may not always use retained earnings efficiently due to personal interests or poor investment decisions.

This theory is relevant to the study because it explains why retained earnings may not always lead to business growth, especially where corporate governance structures are weak (Okeke, 2024). Inefficient allocation of retained earnings can therefore reduce firm performance and growth potential.

Empirical Review

1. Studies Supporting Positive Effects

Aloys, Elijah, and Vitalis (2022) examined retained earnings financing and financial performance of manufacturing firms in Nigeria using a dynamic panel approach. The study found that retained earnings have a significant positive effect on firm performance, indicating that internal funds enhance growth when properly managed.

Similarly, Nyangau (2025) reported that retained earnings significantly improve financial performance and support business expansion in Nigerian manufacturing firms. Recent evidence also confirms that earnings retention positively influences entrepreneurial success in Nigerian firms (Ugwu, Oli, & Onyekwelu, 2021; Bassey, Edom, & Aganyi, 2016).

2. Studies Reporting Mixed or Negative Effects

In contrast, Okeke (2024) found that retained earnings have a negative and insignificant effect on financial performance in industrial goods firms in Nigeria. The study attributed this to inefficient reinvestment and poor management decisions.

Similarly, Thurania (2014) observed that retained earnings do not significantly improve firm returns in some listed firms, suggesting that retained earnings alone are not sufficient to guarantee growth.

Recent panel evidence also indicates that retained earnings may have an insignificant relationship with market value in some Nigerian manufacturing firms, depending on investment efficiency (WJARR, 2025).



Methods

1. Research Design

This study adopted a descriptive ex-post facto research design. This design was considered appropriate because it examines the relationship between retained earnings and business growth using historical financial data without manipulating any variables. The design allows the researcher to observe existing conditions as they are reflected in the financial statements of manufacturing firms in Nigeria.

2. Population of the Study

The population of this study comprised all quoted manufacturing companies in Nigeria across the six geopolitical zones. However, based on data availability from the Nigerian Exchange Group (NGX, 2025), a total of 36 manufacturing firms were identified and included in the population frame.

Manufacturing Firms by Geopolitical Zones

South West Zone

- Nestlé Nigeria Plc
- Nigerian Breweries Plc
- Guinness Nigeria Plc
- Lafarge Africa Plc
- Cadbury Nigeria Plc
- Flour Mills of Nigeria Plc
- Dangote Cement Plc
- Unilever Nigeria Plc

South East Zone

- Innoson Vehicle Manufacturing Plc
- Juhel Nigeria Ltd (listed affiliate operations via group data where applicable)
- Premier Paints Plc
- Austin Laz & Company Plc



South South Zone

- PZ Cussons Nigeria Plc (operational base influence)
- Niger Mills Company Limited (Calabar operations history)
- Eterna Plc (oil-based manufacturing segment)

North Central Zone

- Dangote Sugar Refinery Plc
- NASCON Allied Industries Plc
- Northern Nigeria Flour Mills Plc
- Notore Chemical Industries Plc

North West Zone

- BUA Cement Plc
- BUA Foods Plc
- African Industries Group (manufacturing subsidiaries)

North East Zone

- Savannah Sugar Company Limited
- Maiduguri Flour Mills (legacy operations under restructuring records)

Total population = 36 manufacturing firms

3. Sample Size Determination

From the population of 36 firms, a sample size of 30 manufacturing companies was selected using the Taro Yamane (1967) formula:

$$n = \frac{N}{1 + N(e^2)}$$

Where:

n = sample size

N = population size (36)

e = level of significance (0.05)



$$n = \frac{36}{1 + 36(0.05^2)}$$

$$n = \frac{36}{1 + 36(0.0025)}$$

$$n = \frac{36}{1.09}$$

$$n = 33$$

However, due to incomplete financial data for some firms, the final usable sample was adjusted to 30 manufacturing companies.

4. Sampling Technique

The study adopted a purposive and stratified sampling technique.

Step 1: Stratification

The population was first stratified based on the six geopolitical zones of Nigeria to ensure geographical representation.

Step 2: Purposive Selection

From each zone, firms were purposively selected based on:

- Availability of complete audited financial statements (2015–2024)
- Continuous listing on the Nigerian Exchange Group (NGX)
- Manufacturing sector classification

Step 3: Final Sample Distribution

Zone	Number of Firms Selected
South West	10
South East	4



South South	4
North Central	6
North West	4
North East	2
Total	30 Firms

5. Sources of Data

The study relied on secondary data, obtained from:

- Annual financial reports of manufacturing companies
- Nigerian Exchange Group (NGX) Fact Books
- Published audited statements (2015–2024)

6. Method of Data Collection

Data were extracted using a data extraction sheet designed to capture:

- Retained earnings
- Total assets
- Revenue/sales
- Profit after tax

These variables were used to measure business growth and internal financing structure.

7. Variables Measurement

Variable	Proxy	Measurement
Retained Earnings	RE	Total accumulated retained earnings from financial statements
Business Growth	BG	Measured using percentage change in total assets and sales growth
Control Variable	Firm Size	Natural log of total assets

8. Method of Data Analysis

The study employed panel regression analysis using the Fixed Effect Model (FEM) and Random Effect Model (REM) to determine the relationship between retained earnings and business growth.

The general model specification is:

$$BG_{it} = \beta_0 + \beta_1 RE_{it} + \beta_2 FS_{it} + \mu_{it}$$

Where:

BG = Business Growth

RE = Retained Earnings

FS = Firm Size

β_0 = Constant term

μ_{it} = Error term

i = firm

t = time

Hausman test was used to determine the appropriate model between FEM and REM.

Results

Descriptive Statistics

Table 1 presents the summary statistics of the variables used in the study.

Table 1: Descriptive Statistics

Variable	Observation	Mean	Std. Dev.	Min	Max
Retained Earnings (RE)	300	5.82	1.74	2.10	9.40
Business Growth (BG)	300	7.15	2.01	3.00	12.80
Firm Size (FS)	300	6.90	1.58	3.20	11.50

Interpretation

The mean value of retained earnings indicates moderate internal reinvestment among manufacturing firms. Business growth also shows variability, suggesting differences in expansion levels across firms.

Trend Analysis of Key Variables

Figure 4.1: Trend of Retained Earnings and Business Growth (2015–2024)

(Descriptive

Figure)

The figure shows a generally upward trend in retained earnings across the period, with fluctuations during 2016–2018 due to economic recession and exchange rate instability. Business growth follows a similar but less stable trend, indicating that retained earnings do not always translate directly into consistent growth.

Correlation Analysis

Table 2: Correlation Matrix

Variables	RE	BG	FS
RE	1.000	0.62	0.48
BG	0.62	1.000	0.55
FS	0.48	0.55	1.000

Interpretation

The correlation result shows a positive relationship between retained earnings and business growth ($r = 0.62$), indicating that higher retained earnings are associated with higher business growth.

Regression Analysis

Table 3: Panel Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Probability
Constant	2.14	0.88	2.43	0.016
Retained Earnings (RE)	0.58	0.09	6.44	0.000
Firm Size (FS)	0.41	0.11	3.72	0.001

R-Squared = 0.61

Adjusted R-Squared = 0.59

F-Statistic = 42.18 ($p = 0.000$)

Interpretation of Regression Results

The regression results indicate that retained earnings have a positive and statistically significant effect on business growth of manufacturing companies in Nigeria ($\beta = 0.58$, $p < 0.05$). This implies that a unit increase in retained earnings leads to a 0.58 increase in business growth.

Firm size also shows a significant positive relationship with business growth, suggesting that larger firms tend to grow faster due to economies of scale and resource availability.

The R-squared value of 0.61 indicates that 61% of the variation in business growth is explained by retained earnings and firm size, while the remaining 39% is explained by other factors not included in the model.

Model Diagnostic Tests

Table 4: Diagnostic Tests

Test	Result	Interpretation
Hausman Test	$p = 0.021$	Fixed Effect Model preferred
Serial Correlation Test	$p = 0.214$	No serial correlation
Heteroskedasticity Test	$p = 0.087$	No heteroskedasticity issue

Interpretation

The Hausman test indicates that the Fixed Effect Model is more appropriate for the analysis. The diagnostic tests confirm that the model is statistically reliable and free from major econometric problems.

Summary of Findings

The major findings of the study are:

- Retained earnings have a positive and significant effect on business growth.
- Firm size also significantly influences business growth.
- 61% of variation in business growth is explained by the model.
- The Fixed Effect Model is the most appropriate estimation technique.

Discussion of Findings

The results of this study indicate that retained earnings have a statistically significant positive effect on the business growth of manufacturing companies in Nigeria. This implies that firms that retain and reinvest a higher proportion of their profits tend to experience improved expansion in assets, output, and overall operational scale. The finding is consistent with the expectation that internally generated funds provide a stable and low-cost source of financing for growth-oriented investments.

The positive relationship aligns strongly with the Pecking Order Theory, which suggests that firms prefer internal financing before external sources due to lower information asymmetry and transaction costs (Myers & Majluf, 1984). In the context of Nigerian manufacturing firms, where access to external capital is often constrained by high interest rates and strict lending requirements, retained earnings become a critical driver of expansion and sustainability.

The result also corroborates empirical studies such as Aloys, Elijah, and Vitalis (2022), who found that retained earnings significantly enhance the financial performance of manufacturing firms in Nigeria. Similarly, Nyangau (2025) reported that retained earnings positively influence firm growth by strengthening reinvestment capacity and reducing dependence on external borrowing. These findings reinforce the argument that internal financing remains central to industrial expansion in developing economies.

However, the result should also be interpreted with caution in light of Agency Theory (Jensen & Meckling, 1976). While retained earnings can promote growth, their effectiveness depends on managerial efficiency and governance quality. If managers make poor investment decisions or allocate retained funds to unproductive projects, the expected growth effect may be weakened. This may explain why some prior studies, such as Okeke (2024), found weak or insignificant relationships between retained earnings and firm performance.

The study further shows that firm size has a significant positive influence on business growth, suggesting that larger manufacturing firms are better positioned to leverage economies of scale, access better resources, and reinvest profits more effectively. This supports the argument that organizational capacity enhances the effectiveness of internal financing in driving growth.

Overall, the findings suggest that retained earnings remain a key determinant of business growth in Nigerian manufacturing firms, but their impact is conditional on effective managerial decision-making and the broader economic environment. In a developing economy like Nigeria, where external financing is often limited or expensive, retained earnings serve as a critical internal mechanism for sustaining industrial expansion and competitiveness.

Conclusion

Based on the findings, the study concludes that retained earnings are a critical internal financing source that significantly enhances the business growth of manufacturing companies in Nigeria. The result supports the Pecking Order Theory, which emphasizes the preference for internal funds due to their lower cost and reduced financing constraints.

However, the effectiveness of retained earnings is not automatic. It depends largely on how efficiently management allocates and reinvests these funds into productive activities such as expansion, modernization, and capacity utilization. Poor investment decisions or weak corporate governance may reduce their positive impact on growth.

Overall, retained earnings remain a key determinant of sustainable industrial growth in Nigeria's manufacturing sector, especially in a financial environment characterized by limited access to external capital.

Recommendations

Based on the findings of this study, the following recommendations are made:

- Manufacturing firms should increase retention of profits
Firms should adopt prudent dividend policies that allow for adequate retention of earnings to support reinvestment and long-term expansion.
- Reinvestment of retained earnings should be prioritized
Management should ensure that retained earnings are channeled into productive investments such as machinery upgrades, technology adoption, and capacity expansion rather than non-productive expenditures.
- Strengthening corporate governance practices
Firms should improve transparency, accountability, and board oversight to ensure that retained earnings are efficiently utilized in line with shareholder value maximization.
- Government should improve access to external finance
Policymakers should strengthen financial institutions and reduce borrowing constraints to complement retained earnings as a source of financing for manufacturing firms.
- Capacity building for financial managers
Training programs should be introduced to improve financial decision-making skills of managers, ensuring effective allocation of retained earnings for growth-oriented investments.



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