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Assessing the Impact of Retained Profit on Corporate Performance: Empirical Evidence from Niger Mills Company, Calabar-Nigeria

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Abstract:

This study examined the impact of retained profit on corporate performance of Niger Mills Company Ltd Calabar-Nigeria. The research evaluated the Importance of retained profits as an alternative source of financing the activities of a corporation. Data were collected from the annual report of Niger Mills Company Ltd. Calabar and the statistical model used for data analysis was Karl Pearson product moment correlation coefficient. Findings revealed that the future earnings capacity of Niger Mills Ltd. Calabar depends on its retained profit. It was also discovered that accumulated profit, retained in the business has the potential of boosting future earnings. It was therefore concluded that, corporate bodies should always retain profits in their business rather than distribute all of it to shareholders. To this end, it was recommended that corporate entities should always retained profit in their business if they have to achieve a competitive edge over their rivals. Also that policies should be instituted by corporate bodies whereby a high percentage of net profit is retained in the business.

Keywords: Retain profit, corporate performance, future earnings, shareholders

1. Introduction

Corporate bodies like other entities are always in constant need of funds to finance their operations. These funds, which are either internally or externally generated have their various implication on the overall performance of the corporation.

Essentially, an entrepreneur or a manager considering raising external funds must realize that the lender will place considerable demands on him. The high cost of raising external finance such as interest payment on loans, debentures and leases, dividends payment on shares, rent and royalty payment, repayment of loan sums, redemption of redeemable debentures, redemption of redeemable preference shares, etc. serves as a bane for raising funds through this medium. Also, the additional disclosure requirements conferred on the corporation equally militates against raising external funds (Scott, 2003).

It is on the above background that the researchers intend to critically examine and appraise the impact of retained profit as an alternative method of financing a firm. Internal financing which involves a firm using its retained profit does not confer any obligation on the firm as the firm does not have to pay transactional cost and other cost associated with raising external funds, however, assuming the corporation has no profit during the year of operations, then it has to source for funds (short term capital) by way of overdraft, commercial papers, trade credits, debt factoring, etc. in order to provide a cash flow cushion. To this end, the following hypotheses were formulated:

- H_01 : There is no significant relationship between retained profits and corporate performance.
- H_02 : There is no significant relationship between retained profits and future earning capacity of the company.

2. Theoretical Framework

In the theory of capital structure, internal financing is the name of a firm using its sources as a source of capital for new investments rather than distribute it to the firm's owners or other investors and obtain capital elsewhere. Internal financing is generally seen as less expensive for the firm, than external financing because the firm does not have to incur any expenses in the process of carrying out transactions, it (firm) does not have to also pay the taxes associated with paying dividends.

Most economists debate that neither the availability of internal finance is an important determinant of a firm's performance or not. A related controversy is neither the fact that internal financing (using retained profit) is empirically correlated with investment implies that firms are credit constrained and therefore depends on internal funding through retained profit for investment.

Net income retained in the business can be used to acquire additional income earning assets that result in increased income in future years. The size of this income indicates to the public how big a company's war-chest is.

Also known as statement of stakeholders' equity, a report on retained earnings indicates whether the firm has 'adopted resources' (Scott, 2003). Smaller and faster growing companies tend to have a high earned surplus ratio to fuel research and development; it also fuels new products expansion. Mature firms on the other hand, tend to pay out a high percentage of their profits as dividends (Falex, 2009).

The retained earnings formula given as;

$RE = \text{Beginning RE} + \text{Net income}$.

Dividends have economic implications on the firm, 'net assets are increased and the accounting earnings are increased to the balanced sheet crediting the retained earnings account.

Also, when a company operates at a 'loss, the loss reduces net assets and is carried to the balanced sheet by debiting the retained earnings. This reduces shareholders equity. These economic activities affect the position of retained earnings. The onus is therefore on corporate management to take appropriate decision to control these variables - an efficient and effective corporate performance.

2.1. Pecking Order Theory

Pecking order theory tries to capture the cost of asymmetric information. It states the companies; prioritize their sources of financing from internal financing to equity, according to the law of last resort, or least resistance, preferring to raise equity as a financing means of "last resort." Hence, internal financing is used first; when that is depleted, then debt is issued; and when it is no longer sensible to issue any more debt, equity is issued.

This theory maintains that businesses adhere to a hierarchy of financing sources and prefers internal financing.

2.2. Theory of Corporate Financing

One of the theories that is fundamental to corporate performance is the theory of corporate financing. This theory describes how the activities of a corporate body are financed right from the birth of the corporation through various policy decisions to its death (Liquidation).

Corporate finance is the area of finance dealing with monetary decision that business enterprises make and the tools and analysis used to make these decisions. The primary goal of corporate finance is to maximize shareholders value.

Although, it is in principle different from managerial finance, which studies the financial decisions of all firms, rather than corporations alone, the main concept in corporate finance are applicable to the financial problems of all kinds of firms.

Corporate finance theory prior to the 1950s was riddled with logical inconsistencies, and was almost normatively oriented, the major concern being optimal investment; financing and dividend policies. The past twenty years have seen great theoretical and empirical advances in the field of corporate finance, whereas once, are financed right from the birth of the corporation through various policy decisions to its death (Liquidation).

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Pandy (2005) opines that to choose among alternative financial structures, a manager must know how each cause affects the cash flows, their risk level and therefore How they affect a firm's value. Achieving the goals of corporations' finance requires that ay corporate investment be financed appropriately. The sources of financing are generally capital self-generated by the firm and capital form external funders which is obtained by issuing new debt and equity by hybrid or convertible securities, (Njoku and Jumbo, 2003). The financial means chosen will impact the valuation of the firm as well as other long, term financial management decisions. There are two interrelated decisions here:

1. Management must identify the "optimal mix" of financing the capital structure that result in maximum value. Financing a firm through debts results in liability and obligations that must be serviced, thus entailing cash follows implications independent of the project's degree of success. Equity financing is less risky with respect to cash flow commitments, but results in a dilution of share ownership, control and earnings. Therefore retained profit is most readily used. This correlates to the hierarchical order of the pecking order theory as seen in 2.2.1.

2. Management must attempt to streamline the long-term financial mix to the assets being financed, in terms of timing and cash flows. Managing any potential asset - liability mismatch or duration gap entails matching the assets and liabilities according to maturity pattern (cash flow matching). Managing this relationship is in the short term a major function of working capital management, the working capital being provided mainly from retained earnings (Tiroles, 1956). Those two interrelated decisions of corporate finance, if silently made, have the tendency to boost profitability, earnings per share and therefore corporate performance.

2.3. *Theory of Corporate Performance Management*

The theory of corporate performance also known as business performance consists of a set of management and analytical processes, supported by technology that enables business to define strategic goals. It involves maintaining and managing organization's performance, 'according "to key performance indicators such as revenues, return on investments, overhead and operational cost. Corporate performance management is contained - within approaches to business process management, which is a holistic management approach focused on' aligning all aspects of an organization with the wants and needs of clients, (Agulana and Madu, 2003). It promotes business effectiveness and efficiency.

Since going to business is synonymous with going to war, reference could be made to non-business performance management, which occurs in Sun Tzu's "The Art of War;" Sun Tzu's claims that, to succeed one should have full knowledge of one's own strength and weakness as well as those of one's enemies (rivals). Lack of either sets of knowledge might result in defeat. The corporate performance management theory helps to achieve this function in business through financial planning, operational planning, consolidation and reporting, analysis and monitoring of key performance indicators linked to strategy (Inyang, 2006).

2.4. *Theory of Company Growth*

The theory of company growth emphasizes the growth or decline of a company as a result of decisions made by corporate management that impinge on growth variables such as financing decisions, investing decisions, dividend policy and corporate governance.

Business grows for number of reasons, including to take advantage of a gap in the market, to gain a competitive advantage over others and to win increased market shares. The theory opines that there are two there are two types of business growth:

1. Internal or organic growth
2. External growth involving merger and acquisition.

According to the theory, internal growth is typically a slower process and can be defined by asking shareholders to contribute more capital or by ploughing back profits into the business. The main disadvantage of such an approach is that it takes time and rivals may be expanding and gaining competitive advantage. However, the main advantage is that the business is able to a healthy gearing position, because it is not building up external debts (requiring interest repayments), it is placed to maintain solvent growth. In addition, ownership and control of the business is more likely to be retained by existing shareholders.

External growth can be carried out by seeking external finance or by merger and acquisition. This approach tends to rely on bringing external finance into the business in order to find expansion and therefore can lead to a deteriorating gearing position. External growth enables fast expansion of a business, but there are a number of problems. Where two companies come together, the cultures may be quite different and difficult to match up. Additionally, there may be disagreement between managers who are used to working with different practices and systems. Therefore the business change needs to be handled carefully from the human resource management perspective (www.wikipedia.com/company)

In order to be successful in today's economy, a business must have knowledge of the current market. This includes information regarding the relationship it has with existing and potential clients and customers. A company should have knowledge of its market changing needs and opportunities, how it will identify and reach out to new customers and clients, the quality of its products or services, its productivity, its marketing and advertising and the skill its management possesses. All of these factors together shows where exactly a company stands as an entity within the competition for its particular sector of business:

The entire organization must be considered a whole in order to properly grow (Agulana and Madu, 2003). Growth depends on an organization in its entirety. This includes the structures, policies, systems, procedures, activities, how authority is exercised, how decisions are made, coordination, integrations and most of all, communication. These factors are very crucial to achieving 'optimal growth successfully. The people's component of a company's' growth in business also plays a significant role in business success. Hence, the manpower should be well managed, as it serves a as a recipe for success in any business plan.

3. **Research Methodology**

The study adopted the ex-post facto research design and the population of the study constitute the retained earnings of Niger Mills Limited, Calabar from the year of incorporation to date which is from 1967 to 2013. The sample size for the study constituted ten (10) years retained earnings of the company. The ten (10) years ranges from 2001 to 2010, this period was chosen for consistency and more so, it falls within the latest annual records of the company. Therefore, the researcher used only secondary data for the study. The Karl Pearson product movement correlation Coefficient and t-test were used to analyze the data collected as well as the test of hypotheses respectively.

4. Research Result and Finding

Years	Retained profits/Loss	Turnover	Net Assets	Earnings/Loss Per share
2001	(10812000)	1302658000	113996000	-
2002	(8148000)	1406228000	122144000	-
2003	(123658000)	1250438000	(1514000)	-
2004	-	-	-	-
2005	(53469000)	2768637000	(54983000)	(11.1)
2006	61588000	264843000	6605000	12.83
2007	306230000	2971626000	459907000	14
2008	138468000	3923868000	6660096000	55
2009	(107739000)	62801630000	558357000	(43)
2010	493572000	7816227000	105192900	197
Total	420,425,000	-	2922537000	224.7

Table 1: Retained profit/loss, turnover, net assets and earnings (Loss) per share of Niger Mills Ltd between 2001-2010
Source: Annual report of Niger Mills, 2005 and 2010

The data above, contains information about the retained profits/losses, turnover, net assets and the earnings per share of Niger Mills Ltd Calabar, from 2001-2010. From the data, Niger Mills Ltd had retained losses in the year 2001, 2002, 2003, 2005 and 2009. This was due to poor operating results from the activities- of the company in these respective years. From 2006-2008, the company had retained profits of ₦61588000, ₦30623000 and ₦138468000 respectively. These retained profits are as a result of positive returns from the company's operations. 2010 equally had positive performance as disclosed by the retained profits of ₦493572000. Annual accounts were not prepared for 2004.

Turnover of the company has been very encouraging and has been increasing consistently except for a slight decline by ₦155,980,000 between 2002 and 2003; and ₦120,200,000 between 2005 and 2006. Perhaps, this decline in turnover of ₦155,790,000 between 2002 and 2003 inform the retained loss of (₦123,658,000) incurred in 2003. The high turnover incurred in 2005 and its consistency in subsequent years after a slight decline in 2006 shows efficiency in the operating performance of Niger Mills Ltd.

The Net Assets of the company as disclosed by the table shows a negative net assets of (1514000) and (₦54983000) in 2003 and 2005 respectively. These negative could be attributed to the high retained loss incurred in these years. Other years had positive net assets, the net asset of ₦558,357,000 in 2009 was after offsetting the retained loss of (₦107,739,000) incurred in 2000.

Data relating to earnings per share were not disclosed in the report for 2001-2004. These negative earnings per share was a direct consequence of the retrained loss sustained in these years. The year 2006, 2007, 2008 and 2010 had positive earnings per share owing to favourable operating results.

4.1. Test of Hypotheses

- H_{01} : There is no significant relationship between retained profits and corporate performance.
- H_{a1} : There is a significant relationship between retained profits and corporate performance.

Variables	Σx Σy	Σ^2 Σy^2	Σxy	R	T
Retained profit (x)	420425000	2974587723750000000	3503688521296000500	0.681	3.410
Turnover (y)	27984688000	137734635884608000000		0.681	3.410

Table 2: Pearson's product moment correlation coefficient and independent t-test of the relationship between retained profits and turnover ($n=10$)

- Significant at 5% level, $df=8$, critical $r=0.681$, critical $t=3.410$

The result of the analysis in table 2 shows that the calculated value of 0.681 implies a significant relationship between retained profit and turnover of Niger Mills Ltd, Calabar. Further analysis using the t-test revealed a t-value of 3.410 greater than the table value of 2.31 at 5% significant level and degree of freedom. This equally confirms that there is a significant relationship between retained profit and turnover. Therefore, the null hypothesis is rejected and the alternative hypothesis accepted. That is, the more profits been retained, the better the corporate performance of Niger Mills Ltd.

- H_{02} : There is no significant relationship between retained profit and future earning capacity of a company.
- H_{a2} : There is a significant relationship between retained profits and future earnings capacity of a company.

Variables	Σx Σy	Σ^2 Σy^2	Σxy	R	T
Retained profit (x)	420425000	297458772375000000	111296741700	0.969	15.57
Earnings per share (y)	224.7	44168			

Table 3: Pearson's product moment correlation coefficient and independent t-test of the relationship between retained profits and earnings per share (n=10)

- Significant at 5% level, df=8, critical r=0.969, critical t=15.57

Results of the analysis in table 3 show that the calculated r-value of 0.696 at 0.05 level of significance and 8 degrees of freedom is greater than the table value of 0.186. A further analysis using t-test revealed a calculated t-value of 15.57 greater than the table value of 2.31. As such, the null hypothesis is rejected and the alternative hypothesis is accepted. We therefore conclude that there is a significant relationship between retained profit and future earnings capacity of a company, i.e. the more retained profits, the more future earnings capacity of Niger Mills Ltd, Calabar.

5. Summary of Findings, Conclusion and Recommendations

The fulcrum of this study was to assess the impact of retained profit on corporate performance.

The findings of hypothesis one, using Karl Pearson's Product Moment Correlation Coefficient and independent t-test shows that there is indeed a significant relationship between retained profits and corporate performance of Niger Mills Ltd. By this result, one can aptly say with 95% confidence that Tiroles (1956) who submit's that the contributions by retained earnings help to increase the turnover, assets and capital base of a corporation thereby enhancing the effect corporate performance. In line with the findings, Weygandt (2007) contended that companies that perform better are those that have a high capital base much of which comes from contributions by retained profits, in his view, those companies are obliged to perform better because profits retained in a business help's to reduce the spectrum of interested parties. As such, this profits will be ploughed back into the activities of the corporation, and used to diversity the portfolio of the company without any bureaucratic consideration of third parties who hitherto would have risen, if the funds were raised externally. It is therefore concluded from the findings of the study that corporations retain much of their profits for re-investment. This will make funds readily available to them and avoid the problem of working capital shortages. This will equally enhance efficiency and productivity, expansion and diversification and even automation and modernization. Therefore, corporate bodies are encouraged to always retain profits in their business rather than distribute all of it to shareholders. On the basis of the findings of this study, the following recommendations have been made:

1. Corporation should always retain profits in their businesses if they have to achieve a competitive edge over their rivals.
2. Internal financing should always be used by financial managers before other options may be resorted to.
3. A policy or policies should be instituted by corporate bodies whereby a high percentage of net profit is retained in the business.
4. Since the price-earnings and the earnings yield depends on the capitalization of present earnings. Earnings should therefore be retained and re-invested immediately into the business.

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APPENDIX

Correlations

/VARIABLES=retained profit turnover/PRINT=TWOTAIL
NOSIG/STATISTICS DESCRIPTIVES/MISSING=PAIRWISE.

Correlations

[DataSet1] C:\Users\BENISON\Documents\elvisUntitled2.sav Descriptive

Statistics			
	Mean	Std. Deviation	N
Retained profit	76440909.09	2.025E8	11
Turnover	5.09E9	7.976E9.	11

Table 4

Correlations			
		retained profit	Turnover
retained profit	Pearson Correlation	1	.681
	Sig. (2-tailed)		.021
	N	11	11
Turnover	Pearson Correlation	.681	1
	Sig. (2-tailed)	.021	
	N	11	11

Table 5

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

Correlations

/VARIABLES=retained profit net asset /PRINT=TWOTAIL
NOSIG /STATISTICS DESCRIPTIVES /MISSING=PAIRWISE.

Correlations

[Data Set 1] C:\Users\BENISON\Documents\elvisUntitled2.sav Descriptive

Statistics			
	Mean	Std. Deviation	N
retained profit	76440909.09	2.025E8	11
set asset	531370363.64	8.683E8	11

Table 6

Correlations			
		retained profit	net asset
retained profit	Pearson Correlation	1	.767
	Sig. (2-tailed)		.006
	N	11	11
net asset	Pearson Correlation	.767	1
	Sig. (2-tailed)	.006	
	N	11	11

Table 7

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

/VARIABLES=retained profit earning per share /PRINT=TWOTAIL NOSIG /STATISTICS DESCRIPTIVES
/MISSING=PAIRWISE.

Correlations

[Data Set 1] C:\Users\BENISON\Documents\elvisUntitled2.sav

Descriptive Statistics			
	Mean	Std. Deviation	N
retained profit	76440909.09	2.025E8	11
earning per share	40.85	87.347	11

Table 8

Correlations			
		retained profit	Earning Per share
retained profit	Pearson Correlation	1	.969
	Sig. (2-tailed)		.000
	N	11	11
earnings per share	Pearson Correlation	.969	1
	Sig. (2-tailed)	.000	
	N	11	11

Table 9

Elvis Untitled 2.sav

etoisUntitled2.sav Correlation is significant attie 0,01 level (2-tailed).

Elvis untitled 2.sav						
S/N	Years	Retained Profit	Turnover	Net Asset	Earning Pershare	R2
1	2001	-10812000	1302658000	113996000	0	116899344000000
2	2002	-8148000	1406228000	122144000	0	66389904000000
3	2003	-E+088	1250438000	-1514000	0	15391300964000000
4	2004	0	0	0	0	0
5	2005	-53469000	2768637000	-54983000	-11	2858933961000000
6	2006	61588000	264843000	6605000	13	3793081744000000
7	2007	30623000	2971626000	459907000	14	937768129000000
8	2008	138468000	3923868000	666096000	55	19173387024000000
9	2009	-1E+008	6280163000	558357000	-43	11607692121000000
10	2010	493572000	7816227000	1051929000	197	243613319184000000
	TOTAL	420425000	27984688000	2922537000	225	2974587723775000000

Table 10

Elvis untitled 2.sav				
	t2	n2	e2	Rt
1	1696917864964000000	1299508816000000	0	-14084338296000000
2	1977477187984000000	1491915673600000	0	-11457945744000000
3	1563595191844000000	2292196000000	0	-154626662204000000
4	0	0	0	0
5	3023130289000000	3023130289000000	124	-148036251753000000
6	43626025000000	43626025000000	165	16311150684000000
7	211514448649000000	211154448649000000	196	91000102998000000
8	44368388121600000	443683881216000000	3025	543330154224000000
9	311762539449000000	311762539449000000	1849	-676618481456999940
10	1106554621040999940	1106554621040999940	38809	3857870792844000300
11	2104498783616999940	2014498783616999940	44168	3503688521296000500

Table 11