



Nexus between Retained Earnings and Financial Performance of Listed Commercial Banks at DSE, Tanzania

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Abstract: *One of the crucial decisions to any business is the financing decision. The important aspect is the association between retained earnings and financial performance. The research examines the nexus between retained earnings and the financial performance of listed commercial banks at DSE, Tanzania. Data were collected from the financial statements of the selected banks for ten (10) years, from 2014 to 2023, for the four (4) selected commercial banks. The research opted for a quantitative research design to clarify the connection between explanatory and response variables. Data were examined through descriptive statistics as well as inferential statistics. The multiple regression analysis revealed that retained earnings had no impact on ROA. The study concludes that retained earnings do not affect ROA. The study recommends that commercial banks make sure they properly use their reserve earnings as a cheaper source of finance.*

1.0 Introduction

The importance of financing decisions has been revealed in most small businesses, which have been dying early or are performing poorly due to bad financing decisions. Proper financing decisions result in using dissimilar capital methods, resulting in dissimilar capital structures that impact the company's performance (Adeniji, 2023). Using different forms of capital, thus having an optimum capital structure, has been and continues to be a key business decision for companies. Henceforth, the bosses want to wage ample courtesy to the best capital structure, disappointment to which companies may not be talented enough to use the obtainable capital frugally. Capital structure decisions directly prejudice any company's financial performance, thus making it vital for decision-making (Ball et al., 2020). Retained earnings result from a payment policy, where the fraction of earnings is not salaried out as dividends and, therefore, retained for some investment opportunities is referred to as retained earnings. Thus, it is that portion of total earnings which is not distributed out as dividends and therefore retained back to the business for other activities such as the purchase of non-current assets, payment of debts and maturing obligations, as well as taking advantage of the available opportunities (Kanakriyah, 2020). However, when the company incurs a loss in a particular financial year, the retained earnings are reduced since they are reported cumulatively (PHAM, 2020).

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Purbawangsa and Rahyuda (2022) assert that as an important financing decision in any firm, the financial manager has to make an optimal choice and a good combination of debt and equity. With the calculation of the best financing decision in terms of the mixture of equity and debt to be employed for the company, the financial manager is likely to be a success. Therefore, with debt and equity, companies get funds from internal (equity) and external (debt) bases. Interior bases of funds comprise individual capital and booked pays, while external bases comprise loans from monetary organizations, trade praise, issuing of credit stock, and issuing of equity bonds. The formation of retained earnings can affect the ascendancy structure of a secure, which, in go, may affect the aptitude of a secure to brand planned selections (Ugwu *et al.*, 2020). Thus, according to Din et al. (2022), equity and debts are the principal support selections for removing all commercial companies. Any business firm's mixture of debt and equity makes a capital structure. Apart from that, special skills are required to have a better combination of debt and equity for a firm to perform better. Apart from that, each choice of equity and debt affects its financial performance. If the organization is financing through debt, it must reimburse the bank for the interest. If they are financing finished fairness, they have to give the bonuses to the bondholders from their profit and sometimes generate the retained earnings account that they did not allocate to the stockholders but is reproducing in their gains.

It proposes that the best capital structure decision is vital to any commercial bank in the Tanzanian banking business (Iwayan and Anom, 2020). The best capital structure means the best combination of equity and debt that harvests a low price of capital and deeds the firm's worth. So, deprived capital structure consequences, for example, the indecorous mix of equity and debt whitethorn lead to a high cost of capital, upsurge in financial risk, inferior the company's financial performance and delay its existence (Albart et al., 2020). Despite all the facts above, there have been mixed findings in the research arena on the impact of equity and debts on the financial performance of companies, mainly commercial banks. While some researchers argue that there is a positive significant association between financial performance and capital structure (Albart et al., 2020), others are contrary, suggesting that capital structure is depressingly related to banks' performance (Nyabaga and Wepukhulu, 2020).

Likewise, banking operations have a unique nature that differentiates them from other companies. The uniqueness of banking operations lies in the laws and regulations they have, both locally and internationally. Another unique characteristic is that banks' debts include customers' deposits of different natures, some may not understand particular banking operations for risk assessment purposes. Additionally, the depositors lack control over the banking operations and disciplinary roles per the tradeoff theory (Nyabaga and Wepukhulu, 2020). The study is significant to other researchers. Since the problem has been inadequately studied in Tanzania, there are limited empirical findings in this area. Therefore, this study adds to the available evidence shown in Tanzania.

2.0 LITERATURE REVIEW

The pecking order theory creates the whole thing of Myers (Destriwanti et al., 2022). The philosophy stems from the fact that the choice of the source of funds for the business depends on the financing costs of such choices. Therefore, firms usually prefer using those sources of funds with low or no financing costs than those with high. Therefore, firms put financing mechanisms into the order (ranks) by focusing on their financing costs. The source of funds depends on the financing costs of such options; therefore, the cheaper sources of funds are usually chosen first, followed by the options with higher financing costs. In this regard, in an option of retained earnings, through a pecking order theory, firms would choose retained earnings first over other options since it is among the cheaper sources. The more successful the company is, the more likely it is to raise retained profits; therefore, there is no pressure to resort to external funding. Thus, rendering to the Pecking Order approach, a bad association between profitability and debt is expected (Nguyen, 2021).

Sani (2020) measured the influence of booked profit on business presentation: observed indication from Niger Grinders Business, Calabar-Nigeria. The research assessed the rank of retained incomes as another source of supporting the doings of a business. Data were calm from the yearly report of Niger Mills Company Ltd., Calabar, and the arithmetical classical rummage-sale for data examination was the Karl Pearson product-moment association constant. Answers exposed that an important association exists between booked payouts and the monetary presentation of the corporation. Daryanto and Rizki (2021) inspected the competence of the asset of business income holding. This education uses an example of 27 high-growth, lucrative Indian companies and paths their booked earnings for 15 years from 2002 to 2016. The consequences designate that the retained earnings were placed to unsuccessful use by these companies, and the financial presentation systems of dimension that form the basis for stockholders' asset choices are deceptive, as the connotation of business success to shareholder enhancement is one-sided. Noor (2022) deliberated on the influence of booked payouts on the stock returns of food and individual upkeep goods manufactured on the Karachi stock exchange. The examination contains data from seven lively businesses, including those manufacturing food and individual care goods and rummage sales, from 2009 to 2014. The study used a rummage-sale suitability sample of non-probability technique, rummage-sale linear reversion, and Spearman's association examination. Education originates from a weak and unimportant association between booked pay cash bonus per share and capital gain/loss yield. The education also found a reasonable, optimistic and important association between booked pay and the final price of the standard. Weqar et al. (2021), studied how booked pays affect the worth of the secure from 2003 to 2014. The study adopted descriptive and multiple regression analysis techniques to analyze data. The consequences of esta educación point out that booked payouts and earnings per share have switched over the worth of a commercial. Retained pay is a major part of satisfying the stockholder's attention to expansion.

Empirical studies so far have been unsuccessful in convincing indications of the effect of capital structure on the financial performance of companies, mainly commercial

banks. While some researchers argue that there is an optimistic, important association between capital structure and financial performance Okoye (2020), others are contrary, suggesting that capital structure is damagingly connected with banks' presentation (Altahtamouni et al., 2022). The inconclusive findings of the effect of capital structure on the performance of commercial banks mean that the area needs further assessment. Apart from that, there is limited evidence on the impact of capital structure on commercial banks' performance in Tanzania. So, this study filled the existing gap by investigating the financial performance of banks as a result of retained earnings from the Tanzanian perspective.

3.0 RESEARCH METHODOLOGY

Data were collected from the financial statements of the selected banks for ten years, from 2014 to 2023, for the four selected commercial banks. The research opted for a quantitative research design to clarify the connection between explanatory and response variables. Data were examined using descriptive statistics as well as inferential statistics.

3.1 Model Used

The research used multiple linear regression analysis because the nature of the response variable is continuous. The model was as follows;

$$Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \varepsilon \dots \dots \dots (i)$$

Where:

Y = ROA

A = Constant/the intercept point of the regression line and the y-axis

B = the slope/gradient of the regression line

X1 = Retained Earnings (RTE)

X2 = Bank Size (BS)

ε = Error term

4.0 RESULTS AND DISCUSSIONS

4.1 Descriptive Statistics

The study's findings were analyzed through descriptive statistics where the highest, lowest, average and standard deviation values for each mutable were obtained and obtained in table 4.1.

Table 4.1 Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Std. Deviation
Retained Earnings	40	0.00	203.88	66.65	44.52
Bank Size	40	2.51	2.99	2.75	0.11
Return on Assets	40	0.30	4.50	2.83	1.01
Valid N (listwise)	40				

Source: SPSS Output (2024)

Findings also resulted in a mean value of 66.65% as retained earnings ratio, with a standard deviation of 44.52%. This implies that most commercial banks take advantage of the available investment opportunities by retaining their profits for investment rather than distributing them as dividends. However, a standard deviation of 44.52% and a minimum value of 0.00% indicate that some banks do not retain their profits. Bank size measured by the Natural Logarithm of Total Assets ranges from 2.51% to 2.99%, with a mean value of 2.75% and a standard deviation of 0.11%. The performance of the banking industry, as measured by ROA, showed slight changes in the periods under review. ROA shows a minimum value of 0.30 and a maximum of 4.5, having a mean of 2.83% and a standard deviation of 1.01%. The performance of commercial banks as far as ROA is concerned was average for the selected banks.

4.2 Correlation Analysis

The study also assessed the correlation between the variables to assess their relationship. The results of the correlation analysis are obtainable in Table 4.2 below;

Table 4.2 Correlation Analysis

	Retained Earnings	Bank Size	ROA
Retained Earnings	1		
Bank Size	-0.129	1	
ROA	0.116	0.070	1

Source: SPSS Output (2024)

Findings revealed that the retained earnings are positive, which means that the retained earnings for the commercial banks are not enough for the banks; therefore, they also use debt to finance their investment opportunities. The study's findings also revealed a

harmful association between equity capital and retained earnings to -0.153; this implies that when banks raise more capital from the share issue, they will likely have fewer profits to retain for further investments. Equity capital also originated to have a bad connotation with bank size (-0.389), implying that when the bank size increases in terms of its assets, the equity capital decreases. Results also revealed that equity capital positively correlates with return on assets (0.510). Additionally, bank size and ROA are positively correlated (0.070), implying that the rise in the bank size is related to the increase in ROA.

4.3 Multicollinearity Test

A multicollinearity test was carried out to test the extent to which explanatory variables correlated with each other. This was to ensure the independent variables have minimal correlation so that they do not affect the multiple regression results. Therefore, the multicollinearity test was carried out using the VIF and their results are as designated in Table 4.3;

Table 4.3 Collinearity Statistics

Variable	Collinearity Statistics	
	Tolerance	VIF
Retained Earnings	0.963	1.038
Bank Size	0.081	2.296

Source: SPSS Output (2024)

Results from Table 4.3 indicated that retained earnings had a VIF worth of 1.038, and the size of the bank was 2.296. Since all three independent variables and the control variable had VIF values of 10, it implies a low association between independent variables and, therefore, multiple regression analysis can be conducted.

4.4 Shapiro and Wilk Test for Normality

Apart from the multicollinearity test, the normality test was also conducted to ensure the data were normally distributed. In this, the Shapiro-Wilk test for normality was used, and the findings are explained in Table 4.4;

Table 4.4 Shapiro – Wilk Test for Normality

Variable	Kolmogorov-Smirnov			Shapiro-Wilk		
	Statistic	df	Sig.	Statistic	df	Sig.
Retained Earnings	0.185	40	0.001	0.886	40	0.001
Bank Size	0.216	40	0.142	0.974	40	0.042
ROA	0.121	40	0.000	0.933	40	0.020

Source: SPSS Output (2024)

The normality test above resulted in the Kolmogorov-Smirnov and the Shapiro-Wilk test; however, since the study sample was below 50 observations ($n = 40$), a recommended test is the Shapiro-Wilk test. This is because the normality tests are sensitive to sample size. Therefore, from Table 4.4 above, the findings imply that the data are normally distributed since the Shapiro-Wilk test provides a significance level of 0.000, below 0.05. Because data are normally distributed, a multiple regression analysis can be conducted.

4.5 Multiple Regression Model Summary on ROA

Apart from measuring the effect of independent variables on ROA, the same was measured against ROA. The model summary revealed that the three independent variables, financial leverage, share capital, retained earnings and a control variable bank size, have a correlation of 58.6 % ($R = 0.779$) with the response variable ROA. The findings also indicate that the model (the three explanatory variables) can clarify the difference in ROA by 40.3% ($R\text{ Square} = 0.606$). In contrast, exogenous factors beyond this research variable explained the remaining 41.4 % variation in ROA. The results were abridged and explained in Table 4.8: -

Table 4.8: Model Summary for Multiple regression

Model	R	R Square	Adjusted Square	RStd. Error of the Estimate	Durbin-Watson
	0.779 ^a	0.607	0.586	0.559	2.121
a. Predictors: (Constant), Financial leverage, Share capital, retained earnings, control variable					
b. Dependent Variable: Commercial bank performance (ROA)					

Source: SPSS Output (2024)

4.6 ANOVA on ROA

The ANOVA results indicated that the model is important in explaining the difference of ROA since it produced a p-value of the F-Statistic of 0.001. Moreover, results also indicated that the model can explain 40.3% of the variation in ROA (41.226 out of 102.378). Results are presented:

Table 4.9 ANOVA on ROA

Model	Sum of Squares	Df	Mean Square	F	Sig.
Regression	41.226	4	10.306	5.899	0.001
Residual	61.152	35	1.747		
Total	102.378	39			

Source: SPSS Output (2024)

4.7 Regression Coefficients on ROA

Table 4.10 shows the reversion coefficients explaining the extent to which the three independent variables (bank size and retained earnings) influence the dependent variable ROA.

Table4.10: Regression Coefficients on ROA

Variables	Unstandardized Coefficients	Standardized Coefficients		Collinearity Statistics				
	B	Std. Error	Beta	t	Sig.	Zero-order	Tolerance	VIF
(Constant)	0.144	0.185		0.781	0.002			
Retained earnings	0.674	0.104	0.646	6.458	0.000	0.747	0.701	1.427

Source: SPSS Output (2024)

Findings also revealed that bank size had an optimistic, important effect on ROA with a regression constant of 0.234 and a significant p-value of 0.001. The findings denote that a rise in share capital means a rise in ROA. This implies that a component rise of share wealth leads to a growth of 0.234 in ROA.

Retained earnings were found to have a positive impact on ROA, with a regression coefficient of 0.646 and a p-value of 0.001. This implies that retained earnings positively impact the ROA level of the selected commercial banks. This indicated that a unit increase of a unit of retained earnings causes an increase in ROA by 0. 646. Generally, the model is seen as presented below:

The level of ROA (Y) = 0.184 + 0.234 (Bank Size) + 0.646 (retained earnings).

In assessing the impact of retained earnings on the performance of commercial banks, the research showed that retained earnings have an optimistic influence on ROA. Results were in agreement with those obtained by Altahtamouni *et al.* (2022), who examine the impact of booked income on business presentation: an experiential indication from Niger mills firm in Calabar-Nigeria showed that there is a positive significant association between retained earnings and financial performance of the company. Also, Nguyen (2021) studied the effects of reserved salaries on standard revenues of the food and individual care goods manufacturing registered in the Karachi stock exchange. The study originates a feeble and unimportant relationship between retained pay and cash bonus per part and wealth improvement/damage harvest. The



research also originates a moderately optimistic and noteworthy association between reserved pay and the concluding value of the standard.

Apart from that, Altahtamouni et al. (2022) assessed the association between capital structure and financial performance of companies listed under the industrial and allied sectors at the Nairobi Securities Exchange, Kenya. Retained earnings were concluded to have a negative impact on the financial performance of companies listed under the industrial and allied subdivision in Kenya. However, Nguyen (2021) measured the retained earnings and the worth of the secure marketplace in retrospect of 2003-2014. The consequences of this research point out that booked earnings and earnings per share have switched over the worth of a commercial. Booked earnings are a main part in satisfying the stockholders' interest in expanding prosperity.

5.0 CONCLUSION AND RECOMMENDATIONS

The study concludes that retained earnings positively affect ROA; the increase in retained earnings positively impacts ROA as it can be re-invested and earn a profit after the dividend has been paid off. It is recommended that banks should make a proper assessment of the available opportunities before they commit funds from retained earnings so that the efficiency of assets becomes elevated. Therefore. The study recommends that other researchers focus on conducting similar studies by considering other areas, such as manufacturing companies or investment companies, since these companies have different settings in terms of capital structure.

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