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RETAINED EARNINGS AND FINANCIAL PERFORMANCE OF SAVINGS AND CREDIT COOPERATIVE SOCIETIES IN GARISSA COUNTY, KENYA

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ABSTRACT
The main objective of the study was to establish the influence of retained earnings on financial performance of SACCOs in Garissa County, Kenya. The study was anchored on Pecking Order Theory. The study used a descriptive design and targeted ten registered SACCOs active in Garissa County. The units of observation comprised all board members for each SACCO. A purposive sampling approach was employed in selecting 90 participants. Primary data was gathered through a 4-point-Likert-scale questionnaire. Secondary data was collected through a panel data collection sheet. The collected data was analysed using both descriptive statistics and inferential statistics. The statistics were generated using the Statistical Package for Social Scientist V24 program. A multiple regression analysis that linked dependent and independent variables was used. The results were presented using tables and figures. The study established existence of a moderately high relationship between retained earnings and financial performance of SACCOs. The study further established that retained earnings positively and significantly affected financial performance of SACCOs in Garissa County. The study concluded that retained earnings positively and significantly affect financial performance of SACCOs. The study recommends SACCOs to improve management of retained earnings and re-invest retained earnings prudently to support investments and liquidity purposes.
KEYWORDS: *Retained Earnings, Financial Performance and Garissa County*

BACKGROUND OF THE STUDY

The microfinance industry in Kenya has grown significantly in recent years, especially the Savings and Credit Cooperative Societies (SACCOS) as noted by Kamurar and Mbuva (2025). SACCOs are crucial especially when it comes to offering financial services to people and small enterprises, particularly in underserved areas that traditional financial institutions inclusive of banking institutions might not be able to reach (Ndiege et al, 2021). However, the institution's financial performance suffers from three main factors which include inadequate capitalization, bad management techniques, and general economic instability. Retained earnings refer to the portion of net profits a firm retains after distributing dividends to its shareholders Pibowei et al (2021). In SACCOs, retained earnings are crucial as they form a vital internal source of capital that contributes to financial performance. These funds are often reinvested into the SACCO for expansion, improving services, or covering unforeseen losses. SACCOs achieve better financial stability through their ability to generate retained earnings which decreases their need for external loans. SACCOs choose to keep their profits which shows their dedication to achieving sustainable growth through their maintained funding. The retention policy must be strictly followed to determine how retained earnings get spent.

The retained earnings stability according to Oganda et al (2022) serves as a vital element for SACCOs which want to reach their financial objectives. The company experiences periodic profit fluctuations which result in unpredictable retained earnings patterns that obstruct its ability to carry out its long-term investment plans. The SACCOs build their reserves through stable retained earnings which protect them from economic uncertainties and operational challenges. SACCOs in unpredictable environments require income stabilization strategies that produce dependable income streams which they can use for reinvestment. The financial stability of an organization enables stakeholders to determine its financial health which results in increased organizational credibility.

The value of retained earnings reflects the cumulative reinvestments made over time and serves as an indicator of financial strength Ngozi and Francica (2021). The SACCOs which show retained earnings capacity work to fund their operational needs and growth requirements without turning to outside funding sources. The organization improves its financial performance by reducing borrowing costs and minimizing its vulnerability to outside economic impacts. The SACCOs need to reach high retained earnings value which

enables them to meet member requirements and develop their services while adapting to market demands. The process requires effective financial management which drive strategic use of retained earnings to achieve the greatest benefits

STATEMENT OF THE PROBLEM

The Savings and Credit Cooperative Societies (SACCOs) in Kenya play a significant role in promoting financial inclusion and economic development by mobilizing savings and providing affordable credit facilities to members who are underserved by commercial banks. Their financial performance partly depends on their ability to generate and retain earnings to strengthen their capital base, finance investments, support credit expansion, and cushion against financial losses. However, SACCOs operate in a financial environment characterized by non-performing loans, liquidity constraints, and unexpected withdrawals, which may limit their ability to generate and accumulate retained earnings. Inadequate retained earnings may consequently restrict investment opportunities, reduce internally generated funds, and weaken the capacity of SACCOs to sustain profitable operations.

Although retained earnings are an important source of internally generated capital, their contribution to the financial performance of SACCOs in Garissa County remains insufficiently established. Wanjala et al. (2023) investigated challenges associated with financial instability, including non-performing loans, liquidity challenges, and unexpected withdrawals. However, these challenges do not adequately explain how the accumulation and utilization of retained earnings influence the financial performance of SACCOs in Garissa County. This presents a contextual and empirical research gap concerning whether retaining a greater proportion of earnings strengthens financial performance or whether inadequate accumulation and ineffective utilization of retained earnings constrain profitability and financial sustainability.

The limited county-specific empirical evidence on the relationship between retained earnings and financial performance presents a practical challenge for SACCO managers and other stakeholders responsible for making decisions regarding the allocation of surpluses, reinvestment, and capital development. Without such evidence, it may be difficult to determine the extent to which retained earnings contribute to improved financial performance and sustainable service delivery to members. This study therefore sought to address the identified research gap by examining the effect of retained earnings on the financial performance of SACCOs in Garissa County, Kenya. The findings were expected to provide evidence to inform decisions on earnings retention and utilization, thereby contributing to improved financial performance and sustainability of SACCOs in the county.

OBJECTIVE OF THE STUDY

To assess the relationship between retained earnings and financial performance of SACCOS in Garissa County, Kenya.

THEORETICAL REVIEW

Pecking Order Theory

Myers and Majluf (1984) proposed the theory. According to the theory, firms prefer internal financing over external financing due to asymmetric information between managers and external investors (Bagley et al, 1998). The process of raising funds for a business begins with using retained earnings and proceeds to debt financing before finally turning to equity financing. The notion exists because company managers possess better knowledge about their operational risks and business value than external investors do. A company can signal to investors that it has overvalued itself by issuing new stock which results in a decline of its share price. Companies prefer to use retained earnings as their primary funding source because this method protects them from the harmful effects that external borrowing triggers when it comes to signalling to others.

The theory proposed that managers possess superior knowledge about a company's essential value and its operational risks than outside investors do. According to the theory, businesses select internal funding methods before choosing debt financing and only then consider equity financing because this sequence helps them reduce their funding expenses. The preference for this particular funding method occurs because investors perceive outside funding as having signaling expenses, which they associate with stock issuance that they interpret as a sign of company overvaluation. The theory maintains that businesses use financial hierarchy rules to achieve fiscal stability while reducing the harmful effects which market sentiment brings to (Myers, 2019).

However, the theory is criticized for ignoring other factors that influence a firm's choice of financing, like the tax benefit of debt financing or the costs of the financial disturbance that arises when a firm borrows too much, causing it to venture too far into debt (Frank & Goyal, 2023). Another flaw is that the theory is not universally valid as it is not able to explain how state markets and industries influence firms' choice of capital structure. The second problem is the fact that the theory's framework could not demonstrate why companies elect to issue equity instead of utilize their internal resources and debt markets. The assumption is that all businesses are similar in behavior, as it does not take into account how various factors influence their decision-making procedures during operation.The

Pecking Order Theory clarifies the reasoning behind financing decisions, but its application to reality is limited due to basic assumptions and conditional limitations in the theory.

SACCOs rely on retained earnings as their primary internal funding source. The resource constraints they encounter significantly limit the options available to SACCOs to access external funding given the environment which they are functioning. SACCOs are likely to have to borrow internally generated funds due to limited resources available since that could help them business operations to sustain their financial soundness according to Pecking Order Theory (Sheikh et al., 2012). The theory proved that retained earnings could also be utilized by SACCOs for more improved financial performance.According to Pecking Order Theory, retained earnings serve as a vital resource which supports SACCOs in achieving their financial objectives while it explains their behavioral finance patterns. SACCOs establish a foundation which helps them navigate challenges during economic downturns by prioritizing retained earnings as their primary funding source.

Empirical Review

Retained earnings as a form of self-finance, where organizations plough back their retained profits back into the organization rather than dividing it completely to the shareholders or members. Previous research have studied the issue of retained earnings and their impact on a firm's performance in various industries and institutional settings, in different countries, performance measures and research models with different results depending on the situation, measure of performance, and methodology. Pibowei et al. (2021) examined the impact of retained earnings (measured with retention index) on the financial performance of breweries in Nigeria during crisis period. Ex-post facto research design was adopted, secondary data collected from four listed breweries between 2012-2020 and analysed through OLS regression. Return on assets, return on equity and earnings per share were used as measures of financial performance. The study reported that retention index was not significantly related to the three measures of performance.

Additionally, Ngozi and Francica (2021) studied how retained earnings affected the performance of four Nigerian Stock Exchange Listed Companies in the oil and gas industry using data from 2009- 2018. Data was collected from financial statements and annual reports which were secondary data sources, and simple linear regression was used to analyze the data. Performance was calculated using ROA and ROE and it was discovered that retained earnings had a significant positive impact on ROE for Mobil Nigeria Plc, but ROA and ROE performance results were inconsistent from one company to another. Both studies explored retained earnings as a source of internal financing, but did not yield similar results in the strength of the relationship between retained earnings and financial performance. These variations imply that the contribution of retained earnings may be related to how internal resources are efficiently invested and the nature of the environmental context, but since the studies were carried out in Nigeria and used public enterprises as research subjects, they may not be directly relevant to the situation of member-owned financial institutions in Garissa County, Kenya.
There is more relevant institutional evidence from Kenya, but results are limited due to differences in research design and units of analysis. Oganda et al. (2022) studied nine listed manufacturing and related firms in Kenya in a panel of nine firms over the period 2010-2019 to understand the association between retained earnings financing and firm financial performance. A panel data design was employed, and secondary financial statement data were gathered to analyze the relationship, Pearson correlation and panel data analysis were used, in which the relationship was studied using Tobin's Q and the natural logarithm of economic value added as measures of performance while considering earnings volatility and economic growth.

The results showed a moderate positive correlation with Tobin's Q and a very high positive correlation with natural logarithm of economic value added in the relationship of the retention ratio. The regression results further showed that the relationship was positive and significant. These results are contrary to the insignificant relationship found in the study by Pibowei et al. (2021) implying that retained earnings may be more persistent performance predictor within some organization and economic circumstances. However, Oganda et al. (2022) concentrated on listed manufacturing companies and did the data analysis through panel data method which does not represent the financial and operational conditions of SACCOs.

More specifically, Waithira and Wepukhulu (2020) analyzed the influence of retained earnings on the financial performance of regulated deposit-taking (DT) SACCOs operating within Nairobi County, Kenya. This descriptive survey-based research engaged all 29 registered DT SACCOs, utilizing secondary financial documents to collect data. The statistical tools of descriptive analysis (frequencies, means, standard deviations, and modes) as well as univariate linear regression were employed to analyze retained earnings' influence on financial performance. The authors established a positive and statistically significant influence of retained earnings on DT SACCOs' financial performance. Unlike their other research investigations on Nigerian breweries and oil and gas corporations, their analysis of SACCOs directly addresses the present research inquiry. Moreover, its finding lends support to the hypothesis that SACCOs' retained earnings serve as internal sources of financing to bolster their operational needs and growth. Nevertheless, the authors' analysis of DT SACCOs in Nairobi County was constrained to the extent of their scope and excluded the fact of examining retained earnings as a sole source of financing, thus its results may not be applicable to SACCOs in Garissa County.

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A comparison of the findings of the reviewed studies shows that the nature of the relationship between retained earnings and financial performance as achieved in the reviewed environments is not definitive. Pibowei et al. (2021) found no significant relationship, Ngozi and Francica (2021) reported mixed effects for each of the companies and performance indicators, while Oganda et al. (2022) and Waithira and Wepukhulu (2020) established positive effects for the listed firms and regulated SACCOs respectively. Such disparities could partly stem from differences in industry, sample size, study period, performance indicators and analytical techniques. As noted earlier, the reviewed studies used various indices of financial performance, such as, ROA, ROE, EPS, Tobin's Q and economic value added, which makes comparison difficult. Also, most of the studies relied on secondary financial data while the results may not be sufficient to reveal distinctions in capitalization strategies and financial management among SACCOs in specific local context.

Conceptual Framework

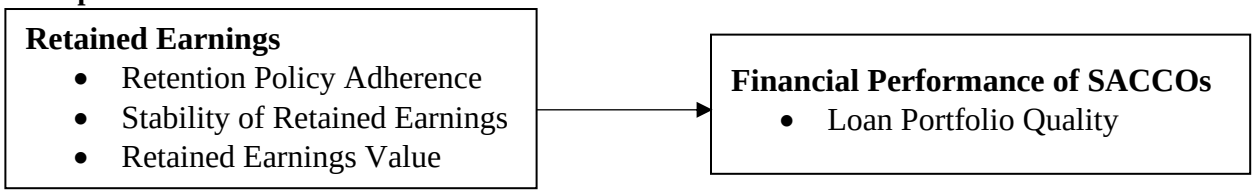

Figure 1 Conceptual Framework

RESEARCH METHODOLOGY

The research design was a descriptive design. The study 10 targeted Savings and Credit Cooperative Societies operating in Garissa County. The unit of observation comprised of nine managers per institution making a total of 90 respondents. Purposive sampling was used. The study utilized both primary and secondary data. For the purposes of collecting primary data, a 4-point Likert scale questionnaire was used in the study. Secondary data was collected from the respective SACCOs financial publications and reports through a panel data collection sheet. The study employed both descriptive statistics (mean and std.dev) and inferential statistics (regression and correlation) to examine the data. The Statistical Package for Social Sciences (SPSS) V24 software was used to analyze the statistics. The study utilized a multiple regression analysis to assess how the dependent variable changes when the independent variable is changed. When a study seeks to determine if one variable (independent) predicts another variable (dependent), regression analysis is used (Uyanık & Güler, 2023). The model for this study is as illustrated below:

$$Y = \beta_0 + \beta_1 X_1 + \varepsilon$$

Where; Y = Financial performance of Saccos, β_0= Regression Constant or Intercept, β_1=Coefficient of Retained Earnings X_1 = Retained Earnings and ε = Error term.

RESULTS

The study aimed at collecting data from 90 respondents. The number of fully filled questionnaires was 76 accounting for a response rate of 84.4%. Marshall and Rossman (2021) states that a response rate of more than 70% is appropriate for analysis and drawing conclusions, hence the response rate was deemed adequate for analysis.

DESCRIPTIVE RESULTS

Retained Earnings

Table 1 presents the descriptive statistics on retained earning

Table 1: Descriptive Statistics on Retained Earnings

Statement	N	Mean	Std.Dev
Retention policies are clearly communicated to members	76	3.132	1.269
The current value of retained earnings is adequate for supporting strategic investments.	76	3.039	1.301
The SACCO has mechanisms to ensure the stability of retained earnings.	76	3.000	1.337
The SACCO strictly adheres to its retention policy.	76	2.974	1.316
The SACCO regularly reviews its retention policy	76	2.974	1.336
Retained earnings are sufficient to cover unexpected financial challenges.	76	2.961	1.351
Members' contributions positively impact the value of retained earnings.	76	2.921	1.294
Overall Mean and SD	**76**	**3.000**	**1.315**

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The results in table 1 show that respondents were in agreement with the statements that the SACCO strictly adhered to its retention policy (mean=2.974, std.dev=1.316), that retention policies were clearly communicated to members (mean=3.132, std.dev=1.269) and that the SACCO regularly reviewed its retention policy (mean=2.974, std.dev=1.336). Similarly, respondents were in agreement with the statements that retained earnings were sufficient to cover unexpected financial challenges (mean=2.961, std.dev=1.351), that the SACCO had mechanisms to ensure the stability of retained earnings (mean=3.000, std.dev=1.337), that the current value of retained earnings was adequate for supporting strategic investments (mean=3.039, std.dev=1.301) and that members' contributions positively impacted the value of retained earnings (mean=2.921, std.dev=1.294).

The composite mean of 3.000 and std.dev of 1.315 implied that respondents were in agreement with the statements on retained earnings. The results were consistent with Pibowei et al (2021) who noted that in SACCOs, retained earnings are crucial as they form a vital internal source of capital that contributes to financial performance. The result concurs with the Pecking Order Theory, which advocates that organizations resort to internal sources of finance (Retained earnings) before exploring other sources of funds. The consensus by respondents that retained earnings helped increase financial stability and strategic investments indicates that Garissa County SACCOs depend on internal earnings to fuel operations and financial returns.

Financial Performance

Table 2 presents the descriptive results on financial performance

Table 2: Descriptive Statistics on Financial Performance

Statement	N	Mean	Std.Dev
The SACCO's ability to generate income from its assets is sufficient to cover its operating costs	76	3.526	0.791
The percentage of non-performing loans within the SACCO is kept at a minimum	76	3.474	0.871
The SACCO consistently generates positive returns on its assets	76	3.461	0.886
The SACCO have managed to stabilize loan default rates	76	3.447	0.944
The SACCO's revenue sources are diversified enough to support long-term sustainability	76	3.395	0.865
The SACCO maintains a high quality of assets that ensure financial stability	76	3.342	0.946
The SACCO has sufficient reserves to handle financial shocks or economic downturns	76	3.211	1.011
Overall Mean and SD	**76**	**3.408**	**0.902**

The results outlined in table 2 established that respondents strongly agreed with the statement that the SACCO's ability to generate income from its assets was sufficient to cover its operating costs (mean=3.526, std.dev=0.791). There was further an agree stance with the statements that the SACCO consistently generated positive returns on its assets (mean=3.461, std.dev=0.886) and that the percentage of non-performing loans within the SACCO was kept at a minimum (mean=3.474, std.dev=0.871). respondents further had an agree stand with the statements that the SACCO had managed to stabilize loan default rates (mean=3.447, std.dev=0.944) and that the SACCO maintained a high quality of assets that ensured financial stability (mean=3.342, std.dev=0.946).

Similarly, the statements on whether the SACCO had sufficient reserves to handle financial shocks or economic downturns and whether the SACCO's revenue sources were diversified enough to support long-term sustainability further had an agree stance as depicted by composite means of 3.211 and 3.395 and std.dev of 1.011 and 0.865 respectively. All the statements on financial performance attained an agree stance as shown by a composite mean of 3.408 and std.dev of 0.902. According to Haris et al. (2020), SACCOs which implement strong capitalization methods maintains their ability to provide loans for member needs which forms the basis of their operational system.

Inferential Statistics

Correlation Analysis

Table 3 presents results on correlation analysis.

Table 3 : Correlation Results

		Retained Earnings	Financial Performance
Retained Earnings	Pearson Correlation	1	
	Sig. (2-tailed)		
Financial Performance	Pearson Correlation	0.584	1

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	Sig. (2-tailed)	0.000	
	N	76	76

The results presented in table 3 revealed that retained earnings and financial performance of SACCOs in Garissa County, Kenya positively and significantly strongly correlates. This was depicted by a correlation value of 0.584 and a p-value of 0.000 which was less than 0.05. The results imply that enhancing aspects of retained earnings in the operation of SACCOs enhances the levels of financial performance. The results tallied with Waithira and Wepukhulu (2020) who showed that retained earnings had a significant positive impact on SACCOs financial performance.

Regression Analysis

The nature of relationships between the study variables was assessed through regression analysis. The analysis was conducted at 95% confident level. The analysis resulted into 3 outputs: Model Summary, Analysis of Variance and Model Coefficient. The model summary results presented in table 4 show that the R-Value was 0.763 implying that retained earnings and financial performance of SACCOs in Garissa County bear a strong relationship. The R-Square value representing the coefficient of determination was 0.582 implying that 58.2% of variations in the levels of financial performance of SACCOs can be attributed to retained earnings.

Table 4: Model Summary

R	R Square	Adjusted R Square	Std. Error of the Estimate
.763[a]	.582	.565	.326
	a. Predictors:(Constant), Retained Earnings		

The results on Analysis of Variance presented in table 5 show that the p-value was 0.000 which was less than 0.05. This implied that the model linking the dependent variable with the independent variables was statistically significant. It was therefore considered a good fit for the study.

Table 5: ANOVA

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	10.69	1	10.69	103.41	.000[b]
	Residual	7.65	74	0.10		
	Total	18.35	75			
Dependent Variable: Financial Performance Predictors: (Constant), Retained Earnings						

The results on the regression coefficient were presented in table 5.

Table 5: Regression Coefficients

	Unstandardized Coefficients		Standardized Coefficients		
Predictors	**B**	**Std.Error**	**Beta**	**t**	**sig.**
(Constant)	1.935	0.162	11.959		0.000
Retained Earnings	0.189	0.036	5.249	0.440	0.000
Dependent Variable: Financial Performance					

According to the results presented in table 5, retained earnings positively and significantly impact financial performance of SACCOs in Garissa County, Kenya. This was shown by beta value 0.189 and significant value of 0.000<0.05. The result bear the implication that increasing aspects of retained earnings with one unit results into 0.189 units increase in the levels of financial performance. The results were consistent with Pibowei et al (2021) who noted that in SACCOs, retained earnings are crucial as they form a vital internal source of capital that contributes to financial performance.

The optimal regression model of the study was thus:

Financial Performance = 1.935 + 0.189 (Retained Earnings)

Hypothesis Testing

Table 6 presents the hypothesis testing results. The decision rule was to reject the null hypothesis if the p-value was less than the 0.05 significance level and fail to reject it if the p-value was greater than 0.05.

Table 6 Hypothesis testing

Hypothesis	Method and Criteria	Remark
H_{01}: There is no statistically significant impact of retained earnings on financial performance of SACCOS in Garissa County, Kenya	Multivariate regression analysis ($p=0.000< 0.05$)	Reject **H_{01}**

CONCLUSION

Based on these findings, the study therefore concludes that sound retention of the retained earnings was vital for strengthening the financial performance of the SACCOs in Garissa County. Having the right level of retention, ensuring the retention was well understood, controlling retention, and the responsible use of retained earnings contributed to the increased availability of earned capital to the SACCOs which contributed to liquidity, financial stability and investments. The positive and significant impact identified in the analysis implied that those SACCOs that strengthened their retained earnings were more likely to have their financial performance strengthened.

Recommendations

Based on the findings, the study recommends the SACCO management in Garissa County to strengthen policies and procedures of retention and the application of retained earnings. SACCOs should have specific retention of earnings targets, review retention of earnings policies regularly, and the members should be educated on the benefits of retained earnings to the SACCO's financial health. The management should also focus more on the prudent utilization of retained earnings towards investment of properties, liquidity support, not excessive distribution of earnings to members that will threaten the internal capital for the SACCO. Such a move will improve the capacity of the SACCO to cater for their financial needs internally and cater for its creditors and counter the financial and operational pressures.

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