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# Retained Earnings and Financial Performance of Commercial State Corporations in Kenya

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**Abstract**

Kenyan commercial state corporations have seen a decline in their profitability as indicated by their return on assets. As a result, different commercial state enterprises have been funding their operations through retained earnings, debt, and equity. However, despite receiving funding from these sources, Kenyan commercial state enterprises have been underperforming as seen by declining profitability and losses over the past five years. This study, therefore, sought to examine the effect of retained earnings on the financial performance of commercial state corporations in Kenya for the period between 2013 and 2022. The study was anchored on the agency theory. The target population was 26 commercial state corporations distributed in different parts of Kenya. Given the small size of the target population, the study employed a census approach and hence the whole population was included in the study. This research used secondary panel data. Secondary data on total assets, return on assets, and retained earnings was collected from the Office of Auditor General's website and individual companies' annual reports. Inferential and descriptive statistics were utilized in data analysis, and STATA version 14 was used for all statistical analysis. Descriptive statistics included frequency distributions, percentages, means, variances and standard deviation. On the other hand, panel regression analysis was used to perform inferential statistics. The results of the study were presented in tables and figures such as line graphs. The study established that retained earnings, measured in terms of the ratio of retained earnings to net income, have a positive and significant effect on the financial performance of commercial state corporations in Kenya. The study recommends that commercial state corporations retain more profits, implement cost management strategies, and reinvest retained earnings into strategic growth initiatives to enhance financial performance through increased returns on assets.

**Keywords:** *Retained Earnings, Financial Performance, Financial Structure*

## INTRODUCTION

Commercial state corporations play a critical role in national development by enhancing public service delivery, creating job opportunities, and strengthening a country's technical capacities (Arani & Mwangi, 2021). Unlike other state entities, they operate in a profit-driven environment alongside private sector competitors. However, challenges persist globally. Brumby and Gokgur (2021) note that many commercial state corporations have suffered losses, with some collapsing due to declining profitability. Brigitta (2017) also highlights that in the United States, state-

owned enterprises are often less efficient and profitable than private firms. Similarly, Nguyet (2019) found that Japanese state-owned businesses tend to be less profitable and more reliant on loans. In Africa, although a few commercial state corporations perform well, the World Bank (2015) reports that most face financial strain, adding pressure to limited public budgets.

Financing structures encompass debt (short term and long term), equity and retained earnings. Retained earnings represent the portion of net income not distributed as dividends but kept within the company for reinvestment or debt repayment (Kasozi, 2018). These earnings accumulate over time, providing a reliable internal capital source for funding business growth, expansion, or acquisitions. In countries like Chile and Costa Rica, state-owned enterprises use retained earnings to finance investments (OECD, 2020). While offering flexibility, retained earnings also pose challenges. Companies that forgo dividend payments may face shareholder dissatisfaction, particularly if they have historically paid regular dividends (Hoang, Thong & Scott, 2020). Moreover, retained earnings are not immediately accessible to income-seeking investors relying on dividends for income (Mburu, Macheru & Ngahu, 2022). Despite these limitations, retained earnings enhance financial stability and growth potential.

In Pakistan, internal financing, such as retained earnings, has a substantial impact on financial performance, with a significant positive relationship observed between return on assets and total debt ratio (Riaz, 2019). In Nigeria, state-owned enterprises (SOEs) can generate funds internally through their operations, with profits earned from business activities often reinvested to support expansion, system upgrades, or debt repayment (Okoye, Osakwe & Anugwu, 2022). This reinvestment of retained earnings plays a crucial role in strengthening the financial performance of commercial SOEs by reducing dependence on external financing and improving operational efficiency. Internal financing through retained earnings allows SOEs to manage resources more sustainably and respond swiftly to investment opportunities. Similarly, in Ghana, although many SOEs have faced financial challenges, reforms such as restructuring and partial privatization aim to boost efficiency (Usman, 2019). Reinvesting internally generated funds, rather than relying heavily on debt, can contribute to long-term financial sustainability and reduce the financial burden on the government.

Retained earnings play a significant role in the financial structure of commercial state corporations in Kenya, as observed by Nzeki (2017) and Mburu, Macheru, & Ngahu (2022). These corporations, often government-owned, rely on retained earnings alongside other sources of financing such as debt, government grants, and shares from other institutions. Nduati & Wepukhulu (2020) note that these earnings can contribute to the financial stability and growth of these entities, offering a self-financing option that reduces reliance on external debt. By reinvesting profits, commercial state corporations can finance new projects, strengthen their balance sheets, and potentially improve their long-term financial performance. However, the effectiveness of retained earnings in enhancing financial performance depends on how well these funds are managed and allocated to generate sustainable returns.

**Statement of the Problem**

Commercial state corporations in Kenya have been experiencing a reduction in their profitability as indicated by profit after tax and return on assets (Public Service Commission, 2022). To improve their financial performance, commercial state corporations need to expand geographically and increase their number of products or services, which requires capital. As such, various commercial state corporations have been collecting money through equity financing, financing for loans, and internal sources, such as retained earnings (Vătavu, 2019). However, even after receiving money from these sources, commercial state corporations in

Kenya have been exhibiting low performance, as shown by decreasing profitability and losses in the last five years.

The return on assets among commercial state corporations in Kenya decreased from 4.53% in 2015 to 14.32% in 2016, which decreased again to 1.60% in 2017. While the return on assets increased to 3.07% in 2018, it decreased to 2.66% in 2019 and 0.69% in 2020 (Public Service Commission, 2022). Kenya Safari Lodges and Hotels Limited encountered a reduction in its profitability, as determined by return on assets, which reduced by 22.28% (Office of the Auditor General, 2020). Between the year 2018 and 2019, New Kenya Cooperative Creameries experienced a decline in profitability, as indicated by the return on assets, by 16.89%. Between 2018 and 2019, the profitability of Kenya Electricity Transmission Company, as determined by the return on assets, decreased by 65%, while between the year 2019 and 2020, it decreased by 69%. Nzoia Sugar Company experienced a decrease in its return on assets between the years 2019 and 2020 by 26%. In addition, Kenya Power and Lighting Company experienced a decrease in its return on assets by 17% for the period between 2019 and 2020.

Several studies have been conducted in Kenya on the relationship between retained earnings and financial performance. Nduati and Wepukhulu (2020) focused on Deposit Taking SACCOs in Nairobi County, Oganda, Museve, and Mogwambo (2020) examined manufacturing and allied firms, while Motanya (2020) looked at petroleum companies. However, these studies primarily focused on specific sectors such as SACCOs, manufacturing, and petroleum enterprises, excluding other industries, including commercial state corporations. In addition, there is a lack of consensus on how retained earnings are conceptualized and measured. While some studies measured retained earnings using ratios such as retained earnings to net income, others did not specify the ratios used, creating a gap in how this concept is defined across different studies. Furthermore, the studies differ in the time frames they cover, with no unified period of analysis, making it difficult to compare results across sectors or assess trends over time. This research, therefore, seeks to focus on the effect of retained earnings on the financial performance of commercial state corporations in Kenya for the period between 2013 and 2022.

The study sought to test the following null hypothesis;

**$H_{01}$:** Retained earnings have no statistically significant effect on the financial performance of commercial state corporations in Kenya

## LITERATURE REVIEW

### Theoretical Review

The study was anchored on the agency theory, which was propagated by Meckling and Jensen (1976). Because many decisions that have a financial impact on the principal are made by the agents, agency theory views managers as agents and stakeholders as principals. The agency argument is predicated on the idea that managers won't always behave in the shareholders' best interests. The theory makes this claim by pointing out two key disputes that arise between the many parties involved in a corporation: the first is between the shareholders and management, and the second is between the creditors and shareholders. To overcome their diverse preferences for economic activity and disparate views regarding risk exposure, the interests of principals and agents must be balanced (Chen, Wang & Wang, 2021).

Managers are initially tempted to maximize the earnings of the companies they oversee for their own benefit at the cost of the shareholders. In the latter case, debt gives stockholders an incentive to make less-than-ideal investments. The benefits of an investment that provides returns higher than the face value of the debt flow to the owners, according to Fayezi, O'Loughlin and Zutshi

(2018). In contrast, the shareholders limit their exposure if the business fails by exercising their right to withdraw. The business that the debt holders are left with as a result has a market value that is below the whole of outstanding debt. Another possible agency cost of debt is the lack of incentive for shareholders to increase equity investments in near-bankrupt companies, even when there are projects with positive Net Present Values (NPV). This is because the value of the projects will mostly benefit the holders of the loans. The conclusion is that excessive debt levels may cause projects with higher value to be rejected.

The study used the agency theory to explain the impact of equity financing on the financial performance of commercial state corporations in Kenya. In commercial state corporations, the government or state typically acts as the principal (owner) while the appointed managers and executives serve as agents responsible for day-to-day operations. The challenge is that the interests of the government (as the principal) and the interests of managers might not always align perfectly. While equity financing can be effective in aligning interests, it's not the only source of financing available to commercial state corporations. They must consider a balanced financial structure that includes equity as well as debt. Excessive equity financing might dilute government ownership and lead to loss of control, while excessive debt financing can bring its own set of challenges.

**Conceptual Framework**

Conceptual framework is a graphic depiction of connection between independent variables and dependent variable (Devi, 2019). Figure 1 shows the link between independent and dependent variables. The independent variable in this research was retained earnings and the dependent variable was the financial performance of commercial state corporations.

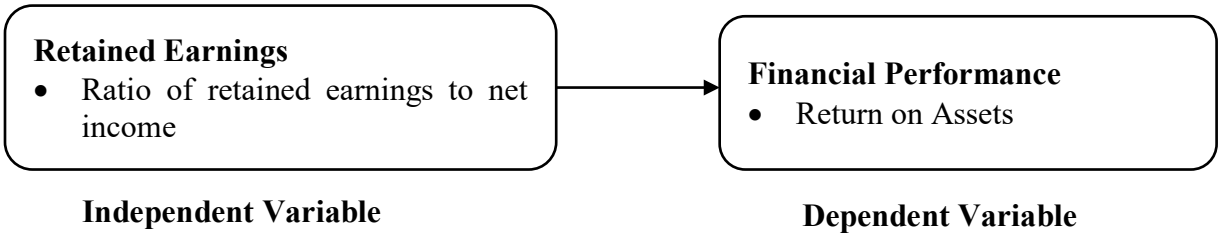


**Figure 1: Conceptual Framework**

**Empirical Review**

In Vietnam, Hoang, Scott and Thong (2020) conducted a study on the inter link between retained earnings and firm performance. The research employed a descriptive research methodology. The results show that retained earnings have a positive impact on firm performance. Retained earnings provide a source of internal financing that can be used for capital expenditures, research and development, and other investments that can drive company growth. This allows firms to expand their operations and potentially increase revenue and profitability. Retained earnings can act as a financial cushion during economic downturns or periods of uncertainty. Companies with healthy retained earnings are better positioned to weather financial challenges without resorting to external borrowing or equity issuance.

In Nigeria, Pibowei, Odong, and Jimoh (2021) conducted a study examining the impact of retained earnings specifically the ratio of retained earnings to net income—on the financial performance of selected breweries during periods of crisis. The research adopted ex-post-facto study design. The findings revealed that there is no significant inter link between retention index and the return on assets, return on equity and earnings per share. This implies that changes in the amount or proportion of retained earnings in the financial structure did not have a

statistically significant impact on ROA, ROE, or EPS. The study suggests that relying on retained earnings as a significant component of the financial structure did not lead to improvements in ROA, ROE, or EPS. This implies that simply accumulating retained earnings may not be an effective strategy for enhancing these financial performance measures in the specific context of the study.

A study on the impact of retained, assessed in terms of retained earnings ratio to net income, on the financial performance of SACCOs in Nairobi County was done in Kenya by Nduati and Wepukhulu (2020). The research approach employed in the research was a descriptive survey. 29 Deposit Taking SACCOs that were registered were the study's target population. Secondary data from financial reports in Deposit Taking SACCOs were employed in the study. The findings revealed that retained earnings predict a significant and positive effect on Deposit Taking SACCOs' financial performance. Retained earnings are having a positive impact on the financial performance of Deposit Taking SACCOs. This means that as these SACCOs retain earnings over time, they are likely experiencing benefits such as increased profitability, higher returns on assets and equity, or improved overall financial health.

Oganda, Museve and Mogwambo (2020) conducted a study on retained earnings financing, measured in terms of ratio of retained earnings to net income, and listed manufacturing and allied firms' financial performance in Kenya. The study utilized a descriptive research design. The findings indicated that retained earnings have a statistically significant effect on financial performance. Having a robust base of retained earnings provides financial flexibility. Firms can use retained earnings to seize growth opportunities, weather economic downturns, or make strategic investments without taking on additional debt or diluting ownership through equity issuance. By relying on retained earnings, manufacturing and allied firms can reduce their dependence on external debt financing. This can lead to lower interest expenses and, in turn, higher profitability. Reducing debt levels can also mitigate financial risk and enhance creditworthiness.

A study on the impact of retained earned finance on the profitability of Kenyan petroleum enterprises (ROA) was undertaken by Motanya (2020). Positivist philosophy was adopted in this study. The results showed that retained earnings financing had an inverse and insignificant effect on the profitability of petroleum companies in Kenya. There seems to be a negative relationship between the use of retained earnings for financing and profitability. The term insignificant effect implies that the observed relationship between retained earnings finance and profitability is not strong enough to be considered statistically significant. In statistical analysis, an insignificant effect suggests that any observed correlation may be due to chance rather than a true cause-and-effect relationship.

## RESEARCH METHODOLOGY

The study employed an explanatory research design, with the target population consisting of commercial state corporations in Kenya. According to the Public Service Commission (2022), there are 26 commercial state corporations in Kenya. Therefore, the target population for this study included all 26 commercial state corporations, which are distributed across various regions of the country. Additionally, the target population is spread across 10 industry categories, with the highest representation in the energy sector (6 firms), followed by manufacturing (4), agriculture (4), telecommunications (3), food and beverage (2), hotel services (2), and finance (2). The least represented sectors include consultancy (1), publishing (1), and transport (1),

totaling 26 firms. Since the target population was relatively small, the study adopted a census approach and included the entire population.

This study utilized secondary panel data. Data on total debt, total assets, return on assets, and retained earnings were collected from the Office of the Auditor General's website and individual companies' annual reports. Additionally, a data extraction tool was used to facilitate the collection of secondary data. The study covered a 10-year period and involved all 26 commercial state corporations in Kenya. By combining descriptive and inferential statistics, the research aimed to provide a comprehensive understanding of the relationship between variables and support informed conclusions. All analyses were conducted using STATA version 14. Descriptive statistics included means, percentages, frequencies, standard deviations, as well as minimum and maximum values. Inferential statistics, such as regression analysis, were used to draw conclusions and make predictions about the population based on the panel data. Data were presented using tables and figures, including line graphs. The panel regression model was as follows;

$$FP_{it} = \beta_0 + \beta_1 RE_{it} + \varepsilon$$

Where; $FP$ is the Dependent variable (Financial Performance (Return on Assets)); $\beta_0$ symbolizes Y intercept; $\beta_1$ is the coefficient of determination; $RE$is the independent variable (Retained earnings); $\varepsilon$ is the error term; $t$ subscript represents time; $i$ subscript represents number of commercial state corporations

To ensure the validity and reliability of the regression model, several diagnostic tests were conducted. These included the linearity test using scatter plots to confirm a linear relationship between variables, and the Shapiro-Wilk test to assess normality of data distribution. Multicollinearity was tested using the Variance Inflation Factor (VIF), with thresholds guiding further investigation or correction. Autocorrelation was examined using the Breusch-Godfrey test, while heteroscedasticity was checked through the Breusch-Pagan/Cook-Weisberg test to confirm constant error variance. The Im, Pesaran, and Shin (IPS) panel unit root test was used to determine stationarity in the panel data, and the Hausman specification test helped decide between fixed or random effects models by identifying potential endogeneity in the regression coefficients.

## RESEARCH FINDINGS AND DISCUSSIONS

### Descriptive Statistics

Data was collected from 25 commercial state corporations in Kenya out of the targeted 26. One commercial state corporation did not have data from the year 2013 to 2018. As such, there were 250 observations covering the period between 2013 and 2022. The results were presented in Table 1. There were 250 observations from 25 commercial state corporations covering a 10-year period (2013 to 2022). The average return on assets (ROA) among the 25 commercial state corporations during this period was 9.351228%, with a standard deviation of 4.752692. The minimum ROA was 2.927%, and the maximum was 33.396%. The average ROA of 9.351228% indicates the typical return these corporations are generating from their assets, helping to set performance standards. The minimum and maximum ROA values highlight the range of financial performance within the sector, suggesting significant disparities in how different corporations utilize their assets to generate returns.

The average retained earnings for all 250 observations from commercial state corporations between 2013 and 2022, measured using the ratio of retained earnings (retained earnings to net income) to total assets, was 0.2652, with a standard deviation of 0.2329579. The minimum

retained earnings ratio was 0.04, and the maximum was 0.94. Retained earnings represent the portion of net income that is reinvested back into the company rather than distributed to shareholders as dividends. A higher average ratio of retained earnings to total assets (0.2652) indicates that, on average, these corporations retain a significant portion of their earnings for reinvestment in the business. This suggests financial stability and a commitment to long-term growth, as retained earnings can be used to fund expansion, research and development, and other strategic initiatives without relying on external financing.

**Table 1: Descriptive Statistics**

| Variable | Description | Mean | Std. Dev. | Min | Max |
|---|---|---|---|---|---|
| ROA | Return on Assets (%) | 9.3512 | 4.7527 | 2.927 | 33.396 |
| RE | Retained Earnings to Net Income | 1.5981 | 0.5020 | 0.703 | 2.758 |

In descriptive analysis, kurtosis and skewness are statistical measures used to understand the shape and distribution of a dataset. The results were as presented in Table 2. The skewness statistics for return on assets and retained earnings were 1.337 and 1.183, respectively, while their corresponding kurtosis values were 1.119 and 0.727. These skewness and kurtosis values fall within the acceptable range of ±2, suggesting that the distribution of these variables does not significantly deviate from normality. Therefore, the data for return on assets and retained earnings can be considered approximately normally distributed.

**Table 2: Skewness and Kurtosis**

| | Skewness | | Kurtosis | |
|---|---|---|---|---|
| | **Statistic** | **Std. Error** | **Statistic** | **Std. Error** |
| Return on Assets | 1.337 | .154 | 1.119 | .307 |
| Retained earnings | 1.183 | .154 | .727 | .307 |

**Diagnostic Tests**

Diagnostic tests included autocorrelation, normality, heteroscedasticity, linearity, multicollinearity, Hausman and unit root tests. As shown in Figure 2, retained earnings exhibit a positive linear relationship with the financial performance (return on assets) of commercial state corporations in Kenya. The findings suggest that an increase in retained earnings is likely to enhance financial performance. Furthermore, the results indicate that retained earnings explain 93.1% of the variation in financial performance (return on assets), demonstrating a strong positive association between the two variables among commercial state corporations in Kenya.

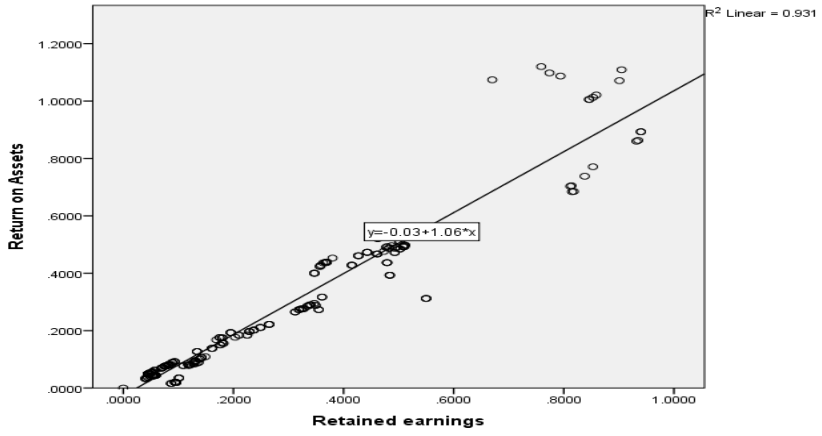


**Figure 2: Scatter plot for the Retained Earnings and Return on Assets**

The Shapiro-Wilk test is a statistical method used to assess whether a dataset follows a normal distribution, with a p-value above 0.05 indicating normality. As shown in Table 3, return on assets (0.111) and retained earnings (0.960) were found to be normally distributed. This suggests that the dependent variable as well as all independent variables had a normal distribution.

**Table 3: Shapiro-Wilk Test**

| Variables | Statistic | df | Sig. |
|---|---|---|---|
| Return on Assets | 0.961 | 250 | .111 |
| Retained earnings | 0.960 | 250 | .640 |

a. Lilliefors Significance Correction

The Durbin-Watson statistic was used to test for autocorrelation in the regression residuals, with values between 1.5 and 2.5 indicating no significant autocorrelation, as shown in Table 4. The Durbin-Watson statistic was 2.261, which falls within the acceptable range of 1.5 to 2.5, indicating no presence of autocorrelation or serial correlation in the data.

**Table 4: Autocorrelation Test**

| Model | Durbin-Watson |
|---|---|
| 1 | 2.261 |

The Breusch-Pagan/Cook-Weisberg test was utilized to assess heteroscedasticity. As shown in Table 5, the p-value of 0.2607 was greater than the significance level of 0.05, which implies that there was homoscedasticity in the dataset. This is a favorable result for linear regression analysis because it means that one of the assumptions of classical linear regression (homoscedasticity) is met, and hence we can proceed with the analysis without the concern of heteroscedasticity affecting the validity of the results. Homoscedasticity indicates that the variability of the residuals is consistent and does not depend on the values of the independent variables.

**Table 5: Breusch-Pagan Test for Heteroskedasticity**

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Breusch-Pagan / Cook-Weisberg test for heteroskedasticity
         Ho: Constant variance
         Variables: fitted values of ROA

         chi2(1)      =     1.27
         Prob > chi2  =   0.2607
```

The IPS (Im, Pesaran, and Shin) unit root test is used to determine whether a time series is stationary or non-stationary, with the null hypothesis suggesting the presence of a stochastic trend and non-stationarity. The null hypothesis for financial performance, measured by return on assets (ROA), posits that all panels (25 commercial state corporations) contain a unit root. Since the p-value (0.0096) is below the significance level of 0.05, we reject the null hypothesis, indicating that financial performance, as measured by ROA, does not contain a unit root. In relation to retained earnings, the null hypothesis is that retained earnings, measured using the ratio of retained earnings to net income, in the panels (25 commercial state corporations) has a unit root. Since the p-value (0.0368) is below 0.05, we also reject the null hypothesis, suggesting that retained earnings does not exhibit a unit root.

**Table 6: IPS Unit-Root Test**

| Variable | t.statistic | p-value | Fixed-N exact critical - values | | |
|---|---|---|---|---|---|
| ROA | 0.9335 | 0.0096 | -2.010 | -1.850 | -1.770 |
| RE | -1.7492 | 0.0368 | -2.010 | -1.850 | -1.770 |

The Hausman test is used to determine whether the random effects model is appropriate by testing if its estimates significantly differ from those of the fixed effects model, which would indicate potential bias. As shown in Table 7, the p-value from the Hausman specification test (0.0757) was greater than the alpha value of 0.05 (at a 95% confidence interval). This indicates that the null hypothesis was not rejected, suggesting that the study should utilize the random effects model.

**Table 7: Hausman Test**

| | Coefficients | | | |
|---|---|---|---|---|
| | (b) fixed | (B) random | (b-B) Difference | sqrt(diag(V_b-V_B)) S.E. |
| RE | 11.0901 | 10.69161 | .3984929 | .2243659 |

b = consistent under Ho and Ha; obtained from xtreg
B = inconsistent under Ha, efficient under Ho; obtained from xtreg

Test: Ho: difference in coefficients not systematic

chi2(1) = (b-B)'[(V_b-V_B)^(-1)](b-B)
= 3.15
Prob>chi2 = 0.0757

**Panel Regression Model**

Panel regression models are statistical techniques used to analyse data where the same entities (firms) are observed repeatedly over time. The regression model was as shown below;

$$FP_{it} = \beta_0 + \beta_1 RE_{it} + \varepsilon$$

Where; $FP$ is the Dependent variable (Financial Performance (Return on Assets)); $\beta_0$ symbolizes Y intercept; $\beta_1$ is the coefficient of determination; $RE$is the independent variable (Retained earnings); $\varepsilon$ is the error term; $t$ subscript represents time; $i$ subscript represents number of commercial state corporations.

**Table 8: Regression Results**

Random-effects GLS regression — Number of obs = 250
Group variable: State_Corp~s — Number of groups = 25

R-sq: within = 0.3437 — Obs per group: min = 10
between = 0.0337 — avg = 10.0
overall = 0.0669 — max = 10

Wald chi2(1) = 114.51
corr(u_i, X) = 0 (assumed) — Prob > chi2 = 0.0000

| ROA | Coef. | Std. Err. | z | P>\|z\| | [95% Conf. | Interval] |
|---|---|---|---|---|---|---|
| RE | 10.69161 | .9991088 | 10.70 | 0.000 | 8.733394 | 12.64983 |
| _cons | 6.515813 | .9257989 | 7.04 | 0.000 | 4.70128 | 8.330345 |
| sigma_u | 4.3872085 | | | | | |
| sigma_e | 1.6902996 | | | | | |
| rho | .87074644 | (fraction of variance due to u_i) | | | | |

In the random-effects GLS regression analysis, the R-squared value within the groups indicates that 34.37% of the variation in the financial performance of commercial state corporations can be attributed to the retained earnings (RE) included in the model. This suggests a moderate level of explanatory power, indicating that this financial metric has a meaningful impact on predicting financial performance across different state corporations. The overall R-squared was 0.669, which indicates that 66.9% of the financial performance of commercial state corporations can be explained by retained earnings. The Wald chi-square test statistic, with a value of 115.51 and a corresponding p-value of 0.000, suggests that the overall model is a good fit for the data. The p-value being significantly less than the conventional significance level of 0.05 indicates that RE significantly contributes to explaining the variation in Return on Assets (ROA) among commercial state corporations.

Retained earnings exhibit a significant positive effect on state corporations' financial performance ($\beta_4 = 10.69161$, p-value $< 0.001$). This indicates that an increase in retained earnings leads to an increase in state corporations' financial performance by approximately 26.56943 units. The relationship is statistically significant, with a p-value of less than 0.001, underscoring the beneficial impact of higher retained earnings on financial performance. The findings agree with those of Nduati and Wepukhulu (2020), who found that retained earnings have a significant and positive effect on the financial performance of Deposit-Taking SACCOs. In addition, the findings are consistent with Oganda, Museve, and Mogwambo's (2020) argument that retained earnings have a positive and statistically significant effect on financial performance. However, the findings contradict Motanya's (2020) conclusion that retained earnings financing had an inverse and insignificant impact on the profitability of petroleum companies in Kenya.

**Conclusion and Recommendations**

The study concludes that retained earnings, measured in terms of the ratio of retained earnings to net income, have a positive effect on the financial performance (return on assets) of commercial state corporations in Kenya. The study shows that an increase in the ratio of retained earnings to net income leads to an increase in return on assets. Therefore, commercial state corporations in Kenya should consider strategies to maximize their retained earnings, as this is likely to improve their financial performance. This could involve reinvesting profits into the business rather than distributing them as dividends, thereby boosting their overall return on assets.

Accordingly, the study recommends that commercial state corporations should place greater emphasis on retaining a higher portion of profits within the corporation rather than distributing them as dividends. This increases retained earnings, which in turn enhances financial performance. They should also implement effective cost management strategies to improve profitability, thereby generating higher net income available for retention. Furthermore, commercial state corporations should use retained earnings to fund strategic investments and growth initiatives that yield positive returns on assets. These may include expansions, innovations, and improvements in operational efficiency.

**Suggestions for Further Studies**

The study focused on commercial state corporations in Kenya; therefore, the results are not generalizable to the private sector. Consequently, further studies should be conducted to examine the influence of retained earnings on the financial performance of firms within the private sector in Kenya. These studies could focus on sectors such as banking, insurance, manufacturing, and others. The study found that financial structure accounts for 34.37% of the financial performance of commercial state corporations in Kenya. Therefore, the study recommends further research to

examine other factors that affect the financial performance of commercial state corporations in Kenya. Moreover, Return on Assets was used to measure financial performance in this study. It is thus recommended that future research examine how retained earnings affect financial performance in terms of Return on Investment and Return on Equity.

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