Sustainability Reporting and Retained Earnings Growth of Quoted Companies in Nigeria

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Abstract. This study examined the effect of sustainability reporting on retained earnings growth of quoted companies in Nigeria. A sample size of 28 quoted firms was selected from the population of 167 quoted companies on Nigerian Stock Exchange as at 31st December, 2018. *Ex-post facto* research design was adopted with the tool of content analysis. Company age and financial leverage were used as control variables. Correlation statistics and panel regression analysis were adopted for the study. The Prob. (F-stat.) of pooled OLS is 0.7105 which is greater than the 5% level of significant adopted for the study. This implies that sustainability reporting has no significant effect on retained earnings growth of quoted companies in Nigeria. Therefore, the study recommends that sustainability reporting should be integrated into companies` value chain to enhance profitability and boost future earnings which can results in continuous growth in retained earnings, all things been equal.

Keywords: Sustainability reporting, retained earnings growth, company age, financial leverage

Introduction

The growth of businesses worldwide has been alarming to manager and policy makers as some businesses grow faster than others (Yoo & Kim, 2015). The decline has also attracted the attention of various stakeholders based on the resultant effects of low returns on investment, increase in the level of unemployment, increase in poverty level and decrease in government earnings. The aim of a business entity is to make profit, maximize the shareholders` wealth and enjoy going concern. However, to remain sustainable, companies to keep reviewing their strategies (Obure, 2016).

The growth of firms can be a quantitative growth or a qualitative growth (Ülgen & Mirze, 2004). Retained earnings growth (REG) is a quantitative growth of companies. Retained earnings are profit of businesses set aside after the deduction of expenses and dividend paid to shareholders (Dinayak, 2014). Retained earnings are for the purpose of firms` growth and expansion (Javed, & Shah, 2015). According to Burgstahler and Dichev (2011), organizations are opened to only few options to finance their activities, as such; entities usually prefer funds from their operations to enhance firm growth. Therefore, some companies prefer to have high retained earnings for reinvestment, which might not pleasing to investors as dividend payout will be affected (Abdullahi, Zechariah & Emmanuel, 2020).

The importance of growth in retained earnings cannot be overemphasized as it drive future growth of firms. Therefore, companies require strategies to sustain growth in their retained earnings. Sustainability reporting has been the trend of global discussion. It is a reporting system that complements the traditional financial reporting system. Sustainability reporting is a reporting system that involves the disclosure of non-financial information of firms` activities from the dimensions of economic sustainability, environmental sustainability, social sustainability and governance sustainability (Muhammad, 2014). The disclosure of non-financial information to stakeholders is expected to improve firm-stakeholder relationship and boost firms revenue, profitability and retained earnings, all things been equal.

The various corporate scandals coupled with the economic meltdown around the globe have led to loss of confidence in the traditional financial reporting system. These have led to challenges on growth of organizations as stakeholders will prefer to associate with firms where growth is assured. These challenges on growth is evidenced in the parabolic and decline trend in the retained earnings growth of some listed firms as observed by this study. Thus, his study investigated the effect of sustainability reporting on retained earnings growth of quoted companies in Nigeria.

Research Hypothesis

Ho: Sustainability reporting does not have significant effect on retained earnings growth of quoted companies in Nigeria.

Literature Review

Sustainability Reporting

Wang (2017) defined sustainability reporting to include disclosure of non-financial information as regards social aspect and environmental aspect. The disclosure of non-financial information increases transparency and have positive effect on companies. Orazalin and Mahmood (2019) opined that sustainability reporting gives stakeholders the opportunity to have access to wide range of information on firms social, economic and environmental performance. herefore, sustainability reporting is one of the means through which managers communicate their sustainability practices to stakeholders. Sustainability reporting is also seen as a strategy to manage firm`s risks and improve sustainability (Md Zaini et al., 2018).

Sustainability reports of organizations are usually prepared in accordance with globally accepted standards of Global Reporting Initiatives (GRI) guidelines. The GRI sustainability guidelines provides requirements for reporting the elements of sustainability reporting to ensure comparability of corporate reports globally (Kuzey & Uyar, 2017). The adoption of GRI guideline is still voluntary in most emerging countries. The GRI framework provides guidelines for the disclosure of non-financial information on economic sustainability practices (economic performance, market presence, indirect economic impacts, and procument practices), social sustainability practices (diversity in work place, labour practices and decent work, occupational health and safety, society, product responsibility, and human rights), environmental sustainability practices (waste management and efficient, water, emissions, energy, compliance, product/service responsibility, and environmental grievance mechanism), and governance sustainability practices (governance structure and composition, role of highest governance body in evaluating economic, environmental and social practices, role of highest governance body in risk management, role of highest governance body in sustainability reporting, and role of highest governance body in seeking value and strategy) (GRI 4, 2015).

Retained Earnings Growth

Ugwu, Obasuyi and Mbah (2019) refer to retained earnings as the internal equity of an organization which forms part of firm distributable reserves and reinvests back into the firm. Dugguh, Aki and Isaac (2018) defined retained earnings as the surplus profit after the dividend for the period is paid to the owners. According to Kim and Suh (2010), retained earnings are the accumulated net income that is reserved by a firm rather than distributed to its shareholders as dividends which is one of the critical retentions created by companies. In assessing the fundamentals of companies, investors pay attention to how much profit is held from shareholders and not just the amount of profit paid as dividend to shareholders because retained earnings are important financial values to investors. Investors are interested in how firms put the retained earnings to use and generate returns on them. Retained earnings are majorly for reinvestment or settlement of debts. It can also be used for research and development or developing a new product line. Retained earning is also known as retained surplus or retention ratio, which equals the beginning retained earnings plus net income less dividends. Retained earnings is a crucial item in shareholders' equity.

In the theory of capital structure, retained earnings are used as internal finance while sourcing for capital to finance new investments instead of distributing it to the owners of the firm as a dividend. Internal financing is seen to be less expensive than external funding since the firm will not have to incur additional expenses in obtaining it. Stakeholders view retained earnings as an essential means of assessing management effectiveness. According to Ghosh, Gu and Jain (2010) retained earnings growth is the increase in retained revenue of firm over time. Growth in retained earnings can be used to measure how much value has been added to a company through the retention of capital over time (Falak & Faiza, 2015). Before investors invest in a company, they are interested in how much growth in profit the management can achieve and not just making profit alone (Akinkoye & Akinadewo, 2018). For this study, retained earnings growth is calculated as current retained earnings less previous retained earnings to previous retained earnings, which is stated below as:

$$\frac{\text{Current retained earnings} - \text{previous retained earnings}}{\text{Previous retained earnings}} \times 100$$

Mathematically:

$$REG = \frac{RE_t - RE_{t-1}}{RE_{t-1}}$$

Theoretical Framework

Legitimacy theory. Legitimacy theory was developed by Davis (1973). The theory assumes that a company has no right to exist unless its values are being perceived as matching with that of the society at large where it operates. Accordingly, the idea of the legitimacy theory resembles a social contract between the company and the community (Magness, 2006). Legitimacy theory has been integrated into accounting studies as a means of explaining what, why, when and how certain items are addressed by corporate management in their communication with stakeholders (Magness, 2006). This is because the primary objective of accounting/reporting is providing users with information that help in decision-making (i.e., satisfying social interests).

According to Loh, Thomas and Wang (2017) sustainability reporting is a means of providing information to stakeholders that will justify the firm's behaviour to influence their perceptions about the firm which will result to increase in the market value of the firm. In accordance with the legitimacy theory, managers need to ensure that their firms continually conform to social contracts by operating within societal expectations. Therefore, companies use sustainability reporting as an incentive to voluntarily disclose its strategies put in place to ensure sustainable future as a good citizen that wants to maintain its survival and ensure continuous growth (Asuquo, Dada & Onyeogaziri, 2018). Legitimisation involves changes in internal decision making which result in changes in perception of the stakeholders and accountability on the part of the companies.

Empirical Review

Akinkoye and Akinadewo (2018) adopted descriptive and inferential statistics to assess the impact of retained earnings on firm value of listed firms in Nigeria. Financial leverage, earnings per share and dividend pay-out were controlled for in the study. Data from secondary sources were collected from 2003 to 2014. The study revealed that retained earnings have positive significant effect on market value of quoted companies in Nigeria.

Asuquo, Dada and Onyeogaziri (2018) identified that the dimensions of sustainability reporting does not have significant effect corporate performance (return on asset (ROA)) of listed firms in Nigeria. Data for five years (2012-2016) were collected from annual reports and sustainability reports of three sampled brewery frims studied.

Similarly, Nireshi and Silva (2018) carried out a study on the relationship between corporate social responsibility disclosure (CSRD) and financial performance of listed banks, finance and insurance companies in Sri Lanka. The objective of the study was to address the issue of causality between corporate social responsibility disclosure and financial performance of listed banks and other financial institutions. Content analysis was adopted in developing the disclosure index. The dimension of the CSRD considered were community, education, environment, customers, health and safety of employees. Financial performance was measure through return on equity and return on asset. The control variables were size and leverage. The study tested two multi-regression models and findings show that a significant correlation between CSRD and financial performance, implying that banks and other financial institutions should increase their CSRD disclosure.

Also, Thuranira (2014) conducted a study to examined the stock return of firms quoted on Nairobi Securities Exchange as influenced by retained earnings. Regression analysis and descriptive statistics were adopted to analyse the secondary data. The study revealed statistical insignificant effect on stock returns with existence of no relationship between retained earnings and stock returns.

Ghosh, Gu and Jain (2010) investigated the effect of sustained earnings and revenue growth on earnings quality and earnings response coefficients. The study observed that firms reporting sustained increases in both revenues and profits have higher quality earnings and more significant earnings response coefficients (ERCs) in comparison to firms reporting sustained increases in earnings alone. For earnings quality, firms with revenue-supported increases in revenues have more persistent earnings, exhibit less susceptibility to earnings management, and have higher future operating performance. Concerning response coefficients, firms with revenue-supported increases in earnings have both higher ERCs and lower book value response coefficients, consistent with the implications of the Ohlson (1995) model

Furthermore, Bassey, Edom and Aganyi (2016) assessed the effect of retained earnings on performance of firm (A case study of Niger Mills Company Ltd). The annual report of the company served as the secondary source of data and correlation statistics was carried out. The study revealed that retained earnings have significant effect on corporate performance of Niger Mills Company Ltd, Calabar-Nigeria. The study concluded that firms should leverage on their retained earnings to enhance performance.

Falak and Faiza (2015) explored the stock returns of firms of Karachi Stock Exchange by examining the retained earnings of food and personal care goods industry. The study adopted correlation statistics and linear regression analysis. Secondary data were collected from 2009 to 2014 and the result revealed that retained earnings has insignificant effect on stock returns of the sampled firms.

Likewise, Erhinyoja and Marcella (2019) expressed that social sustainability reporting exerts a negative effect on return on assets, return on equity and return on capital employed but only statistically significant with return on equity. The study examined corporate social sustainability reporting and financial performance of the Oil and Gas Industry in Nigeria. Ten oil and gas companies were sampled for the study. Ex post facto research design was adopted, and descriptive statistics and regression analysis technique were also used. The study utilized secondary data collected via financial ratios and accounts of the individual companies and content analysis.

Furthermore, Abdullahi, Zechariah and Emmanuel (2020) established that retained earnings has positive and significant effect on financial performance of deposit money banks in Nigeria. The study selected 14 sampled deposit money banks conveniently from population of 25 deposit money banks listed on Nigerian Stock Exchange. Regression analysis and correlation statistics were carried out.

From the empirical review, the study observed that various studies have been carried out to examine the effect of retained earnings on other variable. The effect of factors (internal variables e.g. sustainability reporting) that can drive retained earnings growth have been neglected. Thus, the study examined the effect of sustainability reporting on retained earnings growth of quoted companies in Nigeria.

Methodology

Ex-post facto research design was adopted for the study with a sample size of 28 quoted firms purposively selected from a population of 167 companies on Nigerian Stock Exchange as at 31st December, 2018. The criteria used for the sample selection was that the fims must have their annual reports and sustainability reports available from 2009 to 2018. Sustainability reporting was measured with economic sustainability reporting, social sustainability reporting, environmental sustainability reporting and governance sustainability reporting. With the use of content analysis tool, the approach of Ching, Gerab and Toste (2017) was adopted to develop disclosure index for the elements of sustainability reporting in accordance with Global Reporting Initiative (GRI) guidelines. Retained earnings growth was measured with current retained earnings less previous retained earnings to previous retained earnings, which is stated below as:

$$\frac{\text{Current retained earnings – previous retained earnings}}{\text{Previous retained earnings}} \times 100$$

Mathematically:

$$REG = \frac{RE_t - RE_{t-1}}{RE_{t-1}}$$

Company age and financial leverage were used as the control variable for the study. Company age is the absolute number of years of existence since start-up while financial leverage is total debt divided by total equity. Correlation statics and regression analysis were used to analyze the panel data obtained. F-test and adjusted R-square were used to evaluate the model. The model for the study is specified below:

$$REG_{it} = \beta_0 + \beta_1 ECSR_{it} + \beta_2 SOSR_{it} + \beta_3 EVSR_{it} + \beta_4 GOSR_{it} + \beta_5 CAG_{it} + \beta_6 FL_{it} + \varepsilon_{it}$$

Where: REG = Retained Earnings Growth
ECSR = Economic Sustainability Reporting
SOSR = Social Sustainability Reporting
EVSR = Environmental Sustainability Reporting
GOSR = Governance Sustainability Reporting
CAG = Company Age
FL = Financial Leverage
ε_{it} = Error Term
β_0 = regression intercept which is constant
β_1 …….. β_4 = represent the coefficient of explanatory variables
β_5 and β_6 represent the coefficient of control variables

Data Analysis, Results and Discussion of Findings

This section presents and discusses the results of the data analyzed to examine the effect of sustainability reporting on retained earnings growth of quoted companies in Nigeria. Correlations statistics was carried out to confirm that heteroskedasticity does not exist among the data. Also, inferential statics through panel regression was carried out.

Correlation Statistics

The correlation statistics indicate the degree of relationship among the independt variables. Variance Inflation Factor (VIF) was carried in addition to correlation statistics to ensre that unhealthy association does not exist among the explanatory and control variables; Economic sustainability reporting (EOSR), social sustainability reporting (SOSR), environmental sustainability reporting (EVSR) and governance sustainability reporting (GOSR) as well as the control variables; company age (CAG) and financial leverage (FL).

Table 1. Result of Correlation Matrix and Variance Inflation Factor (VIF)

Variable	ECSR	SOSR	EVSR	GOSR	CAG	FL	VIF
ECSR	1						3.65
SOSR	**0.3869**	1					3.35
EVSR	**0.2643**	**0.7300**	1				2.69
GOSR	**0.4239**	**0.7038**	**0.7993**	1			1.35
CAG	0.0202	**0.1191**	**-0.1132**	**-0.0444**	1		1.12
FL	0.1790	0.0142	-0.0776	-0.0406	-0.0198	1	1.06

Source: Researcher`s computation (2020)

Table 1 shows the Pearson pair wise correlation matrix. The independent variables are economic sustainability reporting (ECSR), social sustainability reporting (SOSR), environmental sustainability reporting (EVSR) and governance sustainability reporting (GOSR). The control variables are company age (CAG) and financial leverage (FL) for selected quoted companies in Nigeria. The VIF is the variance inflation factor which is a test for multicollinearity. The correlations are below the major diagonal and the bold coefficients denotes statistical significant at either1, 5 or 10 percent. All the values were calculated from 280 firm-year observations from twenty-eight listed firms in Nigeria.

From the correlation matrix, the minimum and maximum values of -0.1 and 0.79 are below the threshold of 0.8. This indicate the absence of multicollinearity among the independent variables. The result of the correlation matrix is inline with the VIF values of he explanatory variables. the VIF values are below the threshold of 10 which indicate that unhealthy associations does not exist among the series.

Regression Analysis

Table 2. Test of hypothesis

	Pooled OLS			
Variable	Coefficient	SE	t-test	Prob.
Constant	1.5197	1.2090	1.26	0.210
ECSR	-0.1022	0.4864	-0.21	0.834
SOSR	-0.8424	1.0035	-0.84	0.402

EVSR	5.1020	4.8101	1.06	0.290
GOSR	-4.1301	3.9718	-1.04	0.299
CAG	-0.0278	0.0240	-1.16	0.249
FL	0.0454	0.0863	0.53	0.599
Adj. R^2; Prob.(F-Stat)	0.0583; 0.7105			
Diagnostics Test	**Statistics**		**Prob.**	
Hausman Test	5.33		0.5026	
Breusch-Pagan LM test	0.00		1.0000	
Testparm Test	-		-	
Heteroskedasticity Test	1917.96		0.0000	
Wooldridge test for autocorrelation	1.224		0.2784	

Source: Researcher`s computation (2020)

Note: Table 2 reports pooled OLS results of the effect of sustainability reporting on retained earnings growth. The dependent variable is retained earnings growth. The independent variables are: economic sustainability reporting (ECSR), social sustainability reporting (SOSR), environmental sustainability reporting (EVSR) and governance sustainability reporting (GOSR). The control variables are company age (CAG) and financial Leverage (FL).

Hausman Test was carried out to determine the most appropriate method of estimation among the fixed effect, random effect and pooled OLS. Table 2 shows that random effect is most appropriate with the p-value of 0.5026. The result of Breusch-Pagan Lagrangian Multiplier (LM) test as a confirmatory test shows a p-value of 1.0000 which is greater than the 5% level of significance chosen for the study. Therefore, pooled OLS was found to be most appropriate for the model. For the diagnostic test, Breusch-Pagan/Cook-Weisberg test for heteroskedasticity was carried out and the result revealed a p-value of 0.0000 for the model. This indicates that the model is not heteroskedastic. Likewise, Wooldridge test for serial auto-correlation was carried out to test for autocorrelation. The p-values of 0.2784 is insignificant at 5 per cent level of significance, which indicates that there is no presence of the first-order autocorrelation among the series.

$$REG_{it} = \beta_0 + \beta_1 ECSR_{it} + \beta_2 SOSR_{it} + \beta_3 EVSR_{it} + \beta_4 GOSR_{it} + \beta_5 CAG_{it} + \beta_6 FL_{it} + \varepsilon_{it}$$

$$REG_{it} = 1.5197 - 0.1022 ECSR_{it} - 0.8424 SOSR_{it} + 5.1020 EVSR_{it} - 4.1301 GOSR_{it} - 0.0278 CAG_{it} + 0.0454 FL_{it} + \varepsilon_{it}$$

According to regression model, environmental sustainability reporting (EVSR) and financial leverage (FL) are positively related with retained earnings growth with coefficients of 5.1020 and 0.0454 respectively while economic sustainability reporting (ECSR), social sustainability reporting (SOSR), governance sustainability reporting (GGOSR) and company age (CAG) are negatively related with retained earnings growth with coefficients of -0.1022, -0.8424, -4.1301 and -0.0278 respectively. However, Table 2 indicates that individually, ECSR, SOSR, EVSR, GOSR, CAG and FL has an insignificant effect on retained earnings growth (REG) with the p-values of 0.834, 0.299, 0.402, 0.290, 0.299, 0.249 and 0.599>0.05 respectively.

This implies that an increase in reporting environmental sustainability practices and financial leverage (FL) will increase the growth in retained earnings of companies. A positive change in reporting environmental sustainability and financial leverage will yield 510% and 4% increase in retained earnings growth (REG) respectively. Also, an increase in economic sustainability reporting, social sustainability reporting, governance sustainability reporting and company age (CAG) will decrease the growth in retained earnings of firms. Thus, a positive change in economic sustainability reporting, social sustainability reporting, governance sustainability reporting and company age will yield 10%, 84%,413% and 2% decrease in retained earnings growth, respectively.

Probability of F-statistics was used to evaluate the overall significance of the explanatory variables on the dependent variable. From Table 2, the Prob. (F-Stat) is 0.7105, which is insignificant at 5% level of significance. This provides evidence to infer that the explanatory variables (ECSR, SOSR, EVSR, GOSR, CAG and FL) are not linearly related to the dependent variable (REG). Therefore, the study does not reject the null hypothesis, which implies that sustainability reporting has no significant effect on retained earnings growth of quoted companies in Nigeria.

Discussion of Findings

Retained earnings are the residual of a company`s profit after taking care of the due interests of all stakeholders. It involves ploughing back a portion of the profit of an organisation. It can also be seen as the first point of call in the financing option of an organisation. According to Kim and Suh (2010), retained earnings are the accumulated net income that is reserved by a firm rather than distributed to its shareholders as dividends which is one of the key retentions created by companies. In assessing the fundamentals of companies, investors pay attention to how much profit is held from shareholders and not just the amount of profit paid as dividends to shareholders because retained earnings are important financial values to investors. Investors are interested in how firms put the retained earnings to use and generate returns on them.

Based on the result presented in Table 2, sustainability reporting does not have a significant effect on retained earnings growth. This implies that sustainability reporting does not significantly explain changes that happen to retained earnings.

This is because retained earnings are internal variables to firms while sustainability reporting system of an organisation affects external stakeholders. Therefore, effective sustainability practices and reporting does not guarantee continuous growth in retained earnings of firms but can only serve as a medium for building a firm`s reputation and attracting stakeholders. From literature, there is the paucity of studies that considered the effect of sustainability reporting on business growth, but Bassey, Edom and Aganyi (2016) found that accumulated retained earnings in the business has the potential of boosting future earnings. This is supported by the studies of Nireshi and Silva (2018), Nnamani, Onyekwelu and Ugwu (2017) and Al Ahbabi and Nobanee (2019) who opined that sustainability reporting is a source of competitiveness and companies need it to ensure sustainable financial growth and meeting financial decisions.

Conclusion and Recommendation

The study examined the effect of sustainability reporting on retained earnings growth of quoted companies in Nigeria. Based on the results of the correlation statistics and the regression analysis (Prob. (F-stat.)), the study concludes that sustainability reporting does not have significant effect on retained earnings growth of quoted companies in Nigeria. Therefore, the study recommends that sustainability reporting should be integrated into companies` value chain to enhance profitability and boost future earnings which can results in continuous growth in retained earnings, all things been equal.

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