

THE RELATIONSHIP BETWEEN INTEREST ON LOANS AND PROFITABILITY OF MICROFINANCE INSTITUTIONS IN KASESE DISTRICT. A CROSS-SECTIONAL STUDY.

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Abstract Background

The interest rates charged on loans can influence the financial performance, income levels, and sustainability of microfinance institutions. The purpose of the study was to establish the relationship between interest on loans and the profitability of microfinance institutions in Kasese District.

Methodology

The study employed a descriptive, correlational, and cross-sectional survey design. A sample of 103 respondents was selected from a population of 140 employees of the microfinance chosen institutions within Kasese District, both simple random sampling and purposive sampling techniques were employed to select the respondents, and relevant data for this study was collected using questionnaires and interviews. Data was analyzed using the Statistical Package for the Social Sciences (SPSS).

Results

62 respondents (62%) were male and 38 respondents (38%) were female, 40 respondents (40%) were in the loans department, 26 respondents (26%) were in the accounts & finance department, 19 respondents (19%) were in the audit department, 5 respondents were in audit, 5% were in bank assurance and 10 respondents (10%) were in human resource department. There was a strong positive correlation ($r=0.832$) between loan interest rates and the profitability of microfinance institutions. Loan interest had the strongest relationship with profitability, explaining about 71.1% of the variation in profitability. This suggests that increasing the interest rate charged on loans is likely to have the most significant impact on the profitability of MFIs in Kasese District.

Conclusion

Based on the study's findings, microfinance institutions in Kasese District should carefully set and manage their loan interest rates to optimize profitability while maintaining their social mission of financial inclusion.

Recommendation

MFIs should monitor market conditions and adjust interest rates accordingly to stay competitive within the region.

Keywords: Interest on loans, profitability, Microfinance institutions, Kasese District.

Submitted: 2025-01-15

Accepted: 2025-03-21

Published: 2025-05-10

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Background of the study

Historical Perspective

Microfinance, in its modern form, emerged in the mid-20th century as a response to the lack of access to financial services for low-income individuals, particularly in developing countries. Although the concept of providing small loans to the poor dates back centuries, the formalization of microfinance institutions (MFIs) began in the 1970s and gained momentum in subsequent decades (Muthama, 2021).

Informal forms of microfinance, such as rotating savings and credit associations (ROSCAs) and community-based lending, have existed for centuries in various cultures around the world. These traditional practices involved pooling resources within communities to provide financial assistance to members in need (Iqbal & Rao, 2023).

The modern microfinance movement traces its roots to the efforts of pioneers like Dr. Muhammad Yunus and

the Grameen Bank in Bangladesh. In 1976, Yunus, an economist, began providing small loans to impoverished women in rural Bangladesh as a means to alleviate poverty (Tchuigoua, Soumaré, & Hessou, 2020). The success of Grameen Bank's microcredit model demonstrated the viability of lending to the poor and ignited global interest in microfinance as a tool for poverty alleviation.

Throughout the 1980s and 1990s, microfinance institutions (MFIs) proliferated across the globe, spurred by support from international organizations, governments, and NGOs. The industry saw innovations in lending methodologies, including group lending, collateral-free loans, and the use of technology for efficient operations and outreach (Wang, Yu, Yang, & Zhang, 2021).

Microfinance gained increasing recognition as a viable tool for poverty reduction and economic empowerment in Uganda in particular (Agasha, Monametsi, & Feela,

2020). It became a key component of international development strategies, attracting investments from commercial banks, impact investors, and philanthropic organizations. The industry also faced scrutiny regarding its impact on borrowers and concerns about over-indebtedness (Hermes & Lensink, 2020).

In recent years, the microfinance sector has diversified its product offerings beyond credit to include savings, insurance, and other financial services tailored to the needs of low-income populations (Akite, Akello, & Opio, 2022). There has been a growing emphasis on client protection, social performance measurement, and sustainability within the microfinance industry (Ben Ssembajjwe, 2020). Additionally, technological innovations, such as mobile banking and digital financial services, have transformed the delivery of microfinance products, making them more accessible and cost-effective (Bwambale, Vargas, Baltazar, & Cuaresma, 2021).

Theoretical Perspective

The study was guided by agency theory as proposed by Michael C. Jensen and William H. Meckling in 1976. This theory focuses on the relationship and conflicts of interest between principals (shareholders/owners) and agents (managers) in an organization (Balungi, 2018). When applied to microfinance institutions (MFIs), agency theory explores the relationship between the MFI's stakeholders, particularly the management (agents) and the shareholders or funders (principals), and how this relationship influences lending terms and profitability (Solomon, Bendickson, Marvel, McDowell, & Mahto, 2021).

In the context of MFIs, the agency theory framework helped understand how the interests and incentives of managers and funders affected lending decisions, risk management practices, and ultimately, the financial performance of the institution (Bătae, Dragomir, & Feleagă, 2021). The principal-agent relationship involves the MFIs' shareholders or funders (principals) delegating decision-making authority to the management team (agents) to operate the institution and achieve specific objectives, such as financial sustainability and social impact (Jan et al., 2021). However, a misalignment of interests often existed between principals and agents due to differing objectives and incentives.

Agency theory suggested that managers of MFIs might have pursued lending practices that maximized their interests, such as job security, compensation, or prestige, rather than solely focusing on the long-term profitability and sustainability of the institution. This behavior could lead to risk-taking actions, such as aggressive lending or relaxation of credit standards, to achieve short-term growth or meet performance targets (Aslam & Haron, 2020).

The extent to which agency conflicts were managed within MFIs had significant implications for their profitability and financial performance. Agency problems, such as moral hazard or adverse selection, could lead to increased loan defaults, higher operational costs, and ultimately, reduced profitability. Conversely, well-managed MFIs that aligned managerial incentives

with the long-term interests of funders were more likely to achieve sustainable financial returns (Kaaroud, Mohd Ariffin, & Ahmad, 2020).

Overall, agency theory provided a useful framework for understanding the dynamics of governance, decision-making, and performance within microfinance institutions. By addressing agency conflicts and promoting alignment of interests between managers and funders, MFIs could enhance their lending terms, risk management practices, and profitability while fulfilling their mission of promoting financial inclusion and poverty reduction.

Conceptual Perspective

Microfinance institutions offer financial services to individuals who typically lack access to traditional banking services, often due to low income, lack of collateral, or limited financial literacy. The lending terms in microfinance are designed to be flexible, inclusive, and tailored to the needs of micro-entrepreneurs and low-income borrowers (Orichom & Omeke, 2021).

Microfinance loans are characterized by their small size, often ranging from as little as \$50 to a few hundred dollars. These modest loan amounts are suitable for micro-entrepreneurs, small businesses, and individuals with limited capital needs (Agasha et al., 2020).

Microfinance loans typically have short repayment periods, usually ranging from a few weeks to several months. Shorter loan terms enable borrowers to repay their loans quickly and access additional financing as needed, fostering a cycle of financial inclusion and empowerment (Nalukenge, 2020).

Unlike traditional bank loans that require collateral, microfinance loans are often collateral-free or may involve non-traditional forms of collateral, such as group guarantees or social collateral. This feature allows individuals without assets to access credit based on their character and repayment capacity (Agaba & Mugarura, 2023).

Microfinance institutions may charge interest rates that are higher than those of mainstream banks, reflecting the higher costs of serving low-income clients and the greater risk associated with lending to this demographic. However, there has been increasing emphasis on ensuring that interest rates remain transparent, fair, and affordable to borrowers (Kabuye, Alinda, Bugambiro, & Kezaabu, 2021).

Microfinance institutions (MFIs) are organizations that provide financial services, such as loans, savings, insurance, and other financial products, to people who are traditionally considered too poor to access traditional banking services (Chikwira, Vengesai, & Mandude, 2022). MFIs are typically non-profit organizations with the primary objective of reducing poverty by providing access to financial services to those who would otherwise be excluded from such services. MFIs typically focus on providing loans to entrepreneurs in rural and underserved areas, who use the money to start or expand businesses. They also offer other services such as savings, insurance, and money transfers (Mohamed & Elgammal, 2023).

MFIs have the potential to have a significant impact on poverty reduction and economic development. They

provide access to financial services to those who would otherwise be excluded from such services, and they can help increase the incomes of those who receive loans, resulting in improved living standards. Additionally, MFIs can help stimulate economic activity in rural areas, as borrowers use the loans to invest in their businesses, creating jobs and increasing local economic activity (Nourani, Mia, Saifullah, & Ahmad, 2022).

Microfinance is a type of financial service that is specifically designed to provide small loans to people living in poverty. Microfinance institutions (MFIs) provide small loans to entrepreneurs, businesses, and individuals who are unable to access traditional banking services due to a lack of collateral or credit history (Akite et al., 2022). Microfinance loans are usually much smaller than those offered by traditional banks, and the terms of the loan vary depending on the institution. Generally, the terms of the loan include the amount of the loan, the interest rate, the repayment period, and fees. Interest rates on microfinance loans are typically higher than those offered by traditional banks, due to the higher risk associated with lending to people with limited resources (Mwankemwa, 2022). Repayment periods are usually shorter than those offered by banks, as MFIs are often working with limited capital and must recoup their funds quickly. MFIs may also charge additional fees, such as an application fee or a late payment fee. Additionally, some MFIs may require collateral or a guarantor to qualify for a loan (Tegambwage & Kasoga, 2022).

Contextual Perspective

Microfinance institutions in Kasese District, Uganda, typically offer loans with terms that vary depending on the size of the loan and the specific institution. Generally, loan terms may include a fixed loan term, a fixed interest rate, an amortization period, and a repayment schedule. Loan terms may also include a grace period, which allows borrowers to delay repayment for a certain period, as well as other fees. Typically, repayment periods for loans from microfinance institutions in Kasese District range from 1 to 3 years, with interest rates ranging from 1.5% to 3.5% (Mlay, Temu, & Mataba, 2022). Amortization periods are typically 12 to 24 months. Some microfinance institutions may also require collateral or guarantees to secure the loan (Juliet, 2022). A 2018 study conducted by the World Bank found that microfinance institutions (MFIs) in Kasese district had a net profit margin of 6.9%, which is lower than the national average of 8.2% for financial institutions in Uganda. The same study found that loan disbursements from MFIs in Kasese had reduced by an average of 9.5% each year from 2011 to 2017. Finally, the study found that the return on assets (ROA) for MFIs in Kasese was

4.7%, which is relatively low (Kule, Kamukama, & Kijjambu, 2022).

Also to note is that Kasese district is a rural district in western Uganda. It is one of the poorest and least developed districts in the country, with a large percentage of its population living below the poverty line. Hofokam microfinance institution, which is located in the Kasese district, was designed to provide access to financial services to the poor and unbanked in rural areas. However, such institutions have struggled to achieve profitability in the Kasese district due to several factors (Mafabi, 2023). Therefore, the purpose of the study was to establish the relationship between interest on loans and profitability of microfinance institutions in Kasese District.

Methodology Research Design

The study employed a descriptive, correlational, and cross-sectional survey design. This approach was selected to facilitate a comprehensive examination of the relationship between lending terms and the profitability of selected microfinance institutions in Kasese District, Uganda. By utilizing both quantitative and qualitative methods, the researcher aimed to obtain numerical and non-numerical findings that aligned with the study objectives.

Descriptive statistics were employed to summarize and explain the characteristics of the respondents and the findings associated with various variables. Measures such as mean and standard deviation were utilized to provide insights into the central tendencies and variability of the data collected. This statistical approach enabled a clear representation of the data and facilitated the interpretation of the results about the study objectives. Through this detailed research design, the study sought to yield meaningful insights into the dynamics of lending terms and their impact on the profitability of microfinance institutions.

Target Population

The study was conducted in five microfinance institutions in Kasese Municipality, namely Hafokam Ltd, Pride Microfinance, Finca Ltd, Platinum Credit, and Ugafode. According to the Human Resource Reports of the selected institutions, they had 48, 37, 35, and 20 staff members, respectively, in Kasese District. Consequently, a total of 140 employees from the selected microfinance institutions were identified as the target population for the study. This focus allowed for a comprehensive exploration of the perspectives and experiences of employees within these institutions regarding lending terms and profitability.

Sample size

Table: Target population, sample size, and sampling techniques

Department	Population	Sample size	Sampling Technique
Top managers	12	12	Purposive sampling
Staff	128	91	Simple random sampling
Total	140	103	

Source: Kasese District Commercial Officer (2023)

A sample of 103 respondents was selected from a population of 140 employees of the selected microfinance institutions within the Kasese District. This sample comprised 12 heads of sections, who held managerial positions, and 91 staff members.

The heads of sections provided valuable insights into the strategic and operational aspects of the institutions, including decision-making processes related to lending terms and overall profitability. Their perspectives were critical for understanding the managerial approach to financial sustainability and the alignment of lending practices with institutional goals.

The 91 staff members contributed information regarding their day-to-day experiences with lending processes, borrower interactions, and the challenges they faced in implementing lending terms. Their feedback offered a grassroots perspective on the effectiveness of the institutions' policies and practices, as well as the impact of those lending terms on client relationships and institutional profitability.

Together, the insights from both groups allowed for a well-rounded examination of the relationship between lending terms and profitability, enhancing the study's depth and relevance to the microfinance sector in Kasese District.

Sampling Techniques.

In this study, both simple random sampling and purposive sampling techniques were employed to select the respondents. The simple random sampling technique was utilized to select support staff and loan officers from the selected microfinance institutions. This method was preferred because it eliminated bias in the findings, ensuring that all staff members had an equal chance of being selected for participation. By employing this approach, the study aimed to gather a diverse range of perspectives from the operational staff, which contributed to the overall reliability and validity of the data collected.

On the other hand, purposive sampling was used to select the managers within the institutions. This technique was chosen to target individuals who could provide detailed and relevant information related to the study objectives. The managers were deemed essential for the research as they held key positions that influenced lending practices and profitability. Their insights were crucial for understanding the strategic decisions made within the institutions, thereby enriching the study's findings with informed perspectives from those in leadership roles.

Sources of Data

Data for this study were collected from both primary and secondary sources to ensure a comprehensive analysis of the research problem.

Primary data was obtained through the use of questionnaires and scheduled interviews. The questionnaires were designed to gather quantitative data from respondents, allowing for the collection of structured responses related to lending terms and profitability. The scheduled interviews complemented the questionnaires by providing qualitative insights, enabling a deeper exploration of the respondents' perspectives and experiences. These methods were carefully crafted to align with the study's objectives and were administered to the selected participants, including both support staff and managers from the microfinance institutions.

In addition to primary data, secondary data was sourced from a variety of relevant materials, including records, reports, academic journals, magazines, newspapers, and books. This secondary data provided valuable context and background for the study, facilitating an empirical review of existing literature on microfinance lending terms and profitability. The secondary sources were instrumental in supporting the analysis and interpretation of the primary data, as they offered insights into previous studies and established theoretical frameworks that informed the research.

Together, the combination of primary and secondary data allowed for a robust examination of the relationship between lending terms and profitability within the selected microfinance institutions.

Methods of Data Collection.

The researcher obtained relevant data for this study primarily through the collection of primary data using methods such as questionnaires and interviews. These methods were selected to ensure that detailed information could be gathered efficiently and effectively within a short time frame.

Questionnaires.

The researcher issued self-administered questionnaires to the selected respondents from the microfinance institutions in Kasese District. Respondents were allowed to fill in their answers at their discretion, which facilitated a comfortable and unobtrusive data collection process. The questionnaires were designed to capture a wide range of information pertinent to the study's objectives, including respondents' perceptions of lending

terms and their impact on profitability. The completed questionnaires were collected after three weeks from the date of issuance, providing ample time for respondents to thoughtfully consider their answers. This method was particularly beneficial for gathering quantitative data from technical staff and opinion leaders, as it enabled the researcher to compile a broad spectrum of insights in a structured manner.

Interview Guide

In addition to the questionnaires, the researcher employed an interview method to collect more nuanced and detailed information from the managers of the selected microfinance institutions. The interview guide consisted of open-ended questions, allowing for in-depth discussions on topics such as lending practices, managerial decision-making, and the challenges faced in balancing profitability with social objectives. During the interviews, the researcher carefully noted down the managers' responses, ensuring that key insights were accurately captured. This method also provided an opportunity to obtain additional information that might not have been addressed in the questionnaires, thereby enriching the overall data set. The combination of these two data collection methods allowed for a comprehensive exploration of the research topic, facilitating a robust analysis of the relationship between lending terms and profitability.

Ethical considerations

The researcher adhered to several ethical guidelines throughout the study, recognizing that data collection involved human participants and required careful handling of both their treatment and the information they provided. The following ethical considerations were directly relevant to the study:

Respondents were informed about the purpose of the study and how their data would be treated. Each respondent who was contacted was provided with an informed consent form to read and, if convinced, to sign. This ensured that they understood the nature of the research and their involvement in it.

No respondent was forced to participate in the study. Their rights were respected, allowing them the freedom to choose whether or not to participate. Respondents were fully informed about their right to withdraw from the study at any time they wished. This information was communicated both verbally and in the consent form.

The data provided by respondents was treated with the utmost confidentiality. The researcher ensured that identifying information about individual respondents was avoided, and no personal data such as names or family details was collected. All information obtained through questionnaires or interviews was kept confidential and not disclosed to unauthorized individuals. The findings were reported in a generalized manner, and measures were taken to protect the raw data from access by others. After obtaining approval and successfully defending the research proposal, the researcher secured all necessary clearances from relevant offices. Permission was sought from the School of Graduate Studies to conduct the study, and a formal request for a confirmation letter was made.

Additionally, the researcher requested permission from Centenary Bank to collect data from its employees and to utilize its records and other necessary documents for the study.

The researcher ensured that all authors whose works and ideas were used in the study were fully acknowledged through proper citation and referencing. This practice upheld academic integrity and recognized the contributions of others to the field of research.

Validity of instruments

To ensure the validity of the research instruments, the researcher engaged in discussions with the supervisor and nine other experts in the field of research. These experts were requested to evaluate the research questions item by item, providing their judgments on the relevance of each question. Based on their feedback, the researcher compiled the evaluations to assess content validity.

The Content Validity Index (CVI) was calculated using the following formula:

$$CVI = ((n)/N)$$

Where:

n = the number of items deemed relevant by the experts

N = the total number of items in the instrument

In this assessment, a minimum CVI of 0.7 was considered necessary to declare the instrument valid, as suggested by Amin (2005). In this case, a CVI of 0.9 was obtained, indicating that 18 out of the 20 items were deemed relevant by the experts. This high CVI score demonstrated that the research instruments were valid and well-aligned with the study's objectives, ensuring that the data collected would accurately reflect the intended constructs. The researcher concluded that the instruments were suitable for the study based on this validation process.

Reliability of the instrument

To test the reliability of the research instruments, the researcher employed the Cronbach alpha coefficient method, utilizing data collected from a pilot study involving five respondents. The data from this pilot study were entered into the Statistical Package for Social Sciences (SPSS) software, which facilitated the calculation of the Cronbach alpha coefficient.

The researcher aimed for a minimum Cronbach's alpha value of 0.7, as recommended by Amin (2005), to establish the instrument's reliability. Upon conducting the analysis, a Cronbach's alpha coefficient of 0.85 was obtained. This result indicated a high level of internal consistency among the items in the instrument.

Given that the coefficient exceeded the established threshold of 0.7, the researcher concluded that the instruments were reliable. This high Cronbach's alpha value demonstrated that the items effectively measured the same underlying construct, ensuring that the data collected would be both consistent and dependable for the study. Thus, the reliability of the instruments was affirmed, validating their use in the main research.

Data Analysis

After collecting the completed questionnaires from the field, the researcher entered, organized, coded, and validated the gathered data using Microsoft Excel. This initial processing involved checking for any inconsistencies or missing values to ensure the accuracy and completeness of the dataset. Once the data were validated, they were exported to the Statistical Package for the Social Sciences (SPSS) for more comprehensive analysis.

In SPSS, the researcher conducted a series of statistical analyses to interpret the data effectively. First, descriptive statistics were computed to determine the mean, variance, and standard deviation for numerical variables. This provided a summary of the central tendencies and dispersions of the study variables, allowing the researcher to better understand the overall trends in the data.

To visualize the distribution of responses, frequency distribution tables were created as part of the Univariate

analysis. These tables illustrated the characteristics of the respondents, detailing how various demographic and professional factors influenced their responses.

To explore the relationships between the study variables, Pearson's linear correlation coefficient was employed. This statistical method allowed the researcher to measure the strength and direction of the linear relationships among the variables by the research objectives.

Furthermore, multiple linear regression analysis was utilized to establish the relationship between lending terms and the profitability of microfinance institutions in Kasese District, Uganda. This approach enabled the researcher to assess how different lending terms, such as interest rates, loan sizes, and repayment periods, contributed to the profitability metrics of the microfinance institutions.

Through these analytical methods, the researcher was able to draw meaningful conclusions from the data, providing insights into the interplay between lending terms and profitability, thereby addressing the research questions posed at the outset of the study.

Results

Response Rate

Table 2: Response Rate of the Study

Department	Questionnaires Issued and Interview Conducted	Questionnaires Received and Interviews Conducted	Response Rate (%)
Managers	12	12	100%
Staff	91	88	96.7%
Total	103	100	97.1%

Source: Primary data (2024)

The response rate for the study was assessed to evaluate the effectiveness of the data collection process. Table 2 summarizes the response rates from the different departments involved in the research.

A total of 12 questionnaires were issued, and all 12 were completed and returned, resulting in a response rate of 100%. This indicates a high level of engagement and willingness among managers to participate in the study, reflecting their interest in the research topic and its relevance to their roles.

Out of 91 questionnaires issued to staff, 88 were completed and returned, yielding a response rate of 96.7%. This high response rate suggests that the staff were also quite cooperative and motivated to provide

their insights, which adds valuable perspectives to the study.

The total number of respondents was 103, with 100 completed questionnaires received, leading to an overall response rate of 97.1%. This figure demonstrates a robust participation level across all departments, which enhances the reliability and validity of the findings.

In summary, the high response rates among both managers and staff indicate strong engagement with the study and suggest that the data collected was representative of the views and experiences of employees within the selected microfinance institutions in Kasese District. This comprehensive participation was crucial for drawing meaningful conclusions and insights from the research findings.

Demographic Characteristics of the Respondents

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Table 3: Demographic characteristics of respondents

Characteristic	Frequency	Percentage
Gender		
Male	62	62%
Female	38	38%
Total	100	100%
Department		
Loans	40	40%
Accounts & Finance	26	26%
Audit	19	19%
Bank Assurance	05	05%
Human Resource	10	10%
Total	100	100%
Marital Status		
Single	17	17%
Married	66	66%
Separated	10	10%
Widow	07	07%
Total	100	100
Age		
Below 30 years	17	17%
31-39 years	52	52%
40-49 years	21	21
50 & above	10	10
Total	100	100%
Education level		
Certificate	00	00%
Diploma	46	46%
Bachelors	52	52%
Masters	02	02%
Total	100	100%
Experience of staff		
Below 2 years	23	23%
3-5 years	57	57%
6 & above	20	20%
Total	100	100%

Source: Field data (2024)

The demographic analysis provides insights into the characteristics of the 100 respondents who participated in the study. Below is a detailed breakdown of each demographic characteristic.

Findings on gender showed that 62 respondents (62%) were male and 38 respondents (38%) were female. The gender distribution indicates a predominance of male respondents, who constitute 62% of the total sample. This suggests a potential gender imbalance in the workforce or participant pool related to the study.

Findings also showed that 40 respondents (40%) were in the loans department, 26 respondents (26%) were in the accounts & finance department, 19 respondents (19%) were in the audit department, 5 respondents were in audit, 5% were in bank assurance and 10 respondents (10%) were in human resource department. The department breakdown reveals that the Loans department has the highest representation at 40%, followed by Accounts & Finance at 26%. The lower representation in Bank Assurance (5%) may indicate either a smaller department or less involvement in the survey.

Findings on marital status showed that 17 respondents (17%) were single, 66 respondents (66%) were married, 10 respondents (10%) and 7 respondents (7%) were divorced. A significant majority of the respondents are married (66%), suggesting that the workforce is predominantly comprised of individuals in committed relationships. The relatively low percentages of single (17%) and widow (7%) respondents may reflect demographic trends or cultural factors within the organization.

Findings on age indicated that 17 respondents (17%) were below 30 years, 52 respondents (52%) were 31-39 years, 21 respondents (21%) were 40-49 years, and 10 respondents (10%) were 50 & above. The age distribution indicates that the majority of respondents fall within the 31-39 age range (52%), suggesting a mature workforce with considerable professional experience. The representation of younger (under 30) and older employees (50 and above) is lower, which may indicate trends in recruitment or retention.

Findings on education level indicate no employee had certificate level of education, 46 respondents (46%) had a diploma, 52 respondents (52%) had bachelors and 2 respondents (2%) had masters. The education level of respondents shows a highly educated workforce, with 52% holding bachelor's degrees and 46% having

diplomas. However, only 2% possess master's degrees, which may highlight a gap in advanced educational qualifications among employees.

Findings on the level of experience of employees in microfinance institutions indicated that 23 respondents (23%) were below 2 years, 57 respondents (57%) had 3-5 years, and 20 respondents (20%) had 6 & above years or experience. Experience levels indicate that a majority (57%) of respondents have between 3 to 5 years of experience, suggesting a relatively stable workforce with some turnover. A smaller portion (20%) has more than 6 years of experience, which could imply that the organization values experienced staff but also faces challenges in retaining long-term employees.

The demographic characteristics of the respondents highlight a workforce predominantly composed of married males in the 31-39 age range, with a strong educational background, particularly at the bachelor's level. The higher concentration of employees in the Loans department and the majority with moderate experience suggest areas for potential focus in future organizational development and recruitment strategies. Understanding these demographics can help tailor programs and policies to better meet the needs of the workforce.

Interest on Loans in Micro Finance Institutions in Kasese District

Descriptive Statistics on Interest on Loans in Micro Finance Institutions in Kasese District

Table 4: Descriptive Statistics on Interest on Loans in Micro Finance Institutions in Kasese District

Statements	Mean	Std
Microfinance institutions charge no interest on loans	1.870	0.214
Interest on loans varies with the rate of inflation	2.541	0.378
Interest on loans varies with the loan period	4.229	0.128
The demand for loans by customers influences the interest charged	4.653	0.112
Microfinance institutions comply with the central bank regulations on interest rates	3.694	0.755
Customer complains about interest on loans	4.879	0.181
Collateral affects the interest	2.436	0.292
Interest defaults are insured	2.119	0.125
Operational costs influence interest on loans	4.391	0.124
Customers discuss interest rates with the bank personnel	3.602	0.318

Source: Primary data (2024)

For this particular section, responses were captured base on Likert scale hence the answers were on a scale of 1 to 5 i.e. 5= Strongly Agree, 4= Agree, 3 = Neutral, 2 = Disagree and 1 = Strongly Disagree. The table also includes the summary of the participant's responses basing on percentages (P), frequency (F), standard deviation (Std) and mean.

This section presents the descriptive statistics regarding respondents' perceptions of loan interest levels in microfinance institutions within Kasese District. Responses were captured using a Likert scale ranging from 1 (Strongly Disagree) to 5 (Strongly Agree). The

summary includes mean scores, standard deviations, and overall trends in participant responses.

The statement "Microfinance Institutions Charge No Interest on Loans" has a mean: of 1.870 and a standard deviation: 0.214. Respondents largely disagree that microfinance institutions charge no interest on loans, as indicated by a mean close to 2. This suggests a strong awareness among participants that loans do incur interest. The statement "Interest on Loans Varies with the Rate of Inflation" has mean: 2.541 and standard deviation: 0.378. Participants are neutral to slightly disagree regarding the impact of inflation on loan interest rates. The mean score

suggests uncertainty, indicating that respondents may not perceive a clear correlation.

The statement “Interest on Loans Varies with the Loan Period” has a mean: 4.229 and standard deviation: 0.128. Respondents strongly agree that the interest on loans is affected by the loan period. This indicates that participants recognize the relationship between the duration of the loan and the interest rate charged.

The statement “The Demand for Loans by Customers Influences the Interest Charged” has a Mean: 4.653 and Standard Deviation: 0.112. There is a strong consensus among respondents that customer demand significantly impacts interest rates, with a mean score reflecting agreement. This highlights the importance of market dynamics in determining loan interest.

The statement “Microfinance Institutions Comply with Central Bank Regulations on Interest” has a Mean of 3.694 and a Standard Deviation of 0.755. Participants are somewhat positive about compliance with central bank regulations. The mean indicates a neutral to slightly positive perception, though the higher standard deviation suggests varied opinions among respondents.

The statement “Customers Complain About Interest on Loans” has a Mean: 4.879 and Standard Deviation: 0.181. This very high mean indicates that respondents strongly agree that customer complaints regarding interest rates are common. This points to potential dissatisfaction among customers concerning interest rates charged by microfinance institutions.

The statement “Collateral Has an Effect on the Interest” has a Mean: 2.436 and Standard Deviation: 0.292. Respondents tend to disagree that collateral significantly influences interest rates. This suggests that many customers may feel that their ability to secure loans is not heavily impacted by collateral requirements.

The statement “Interest Defaults are Insured” has a Mean: 2.119 and Standard Deviation: 0.125. The low mean indicates a strong disagreement with the idea that interest defaults are insured, suggesting a lack of awareness or belief in such protective measures among respondents.

The statement “Operational Costs Influence Interest on Loans” has a Mean: 4.391 and Standard Deviation: 0.124. Respondents agree that operational costs have a significant effect on loan interest rates. This reflects an understanding that the expenses incurred by microfinance institutions impact how they set their interest rates.

The statement “Customers Discuss Interest Rates with Bank Personnel” has a Mean: 3.602 and Standard Deviation: 0.318. The mean suggests that respondents are generally neutral, indicating that while some customers do discuss interest rates with bank personnel, this may not be a widespread practice.

The findings from this section provide valuable insights into the perceptions of interest rates in microfinance institutions in Kasere District. Respondents show a clear understanding of certain dynamics, such as the influence of loan periods and demand on interest rates, while also expressing significant concerns about the prevalence of customer complaints. Additionally, there appears to be a lack of belief in insurance for interest defaults and a neutral stance on the impact of collateral. These insights

could inform microfinance institutions about customer perceptions and areas for improvement in service delivery.

During the interview with one of the experienced Loan Officers (Male, 5 years of experience) on how e interest rates are determined for loans in their institution, he replied “*Interest rates in our institution are primarily determined based on several key factors. First and foremost, we consider the operational costs involved in providing loans, such as administration, staffing, and loan processing. We need to ensure that we cover these costs while also making a profit.*

Additionally, we look at the prevailing market rates and the competitive landscape. We need to remain attractive to borrowers while not underpricing our loans. We also take into account the risk profile of the borrower. For example, if a customer has a poor credit history or lacks sufficient collateral, we might charge a higher interest rate to mitigate that risk.

Finally, we also factor in the duration of the loan. Longer-term loans typically have higher interest rates because of the increased risk over time.”

Another Loan Officer (Female, 3 years of experience) respondents on they asses risk when determining interest rates. She said “*When assessing risk, we first evaluate the borrower’s creditworthiness through their credit history and existing debt levels. We look for any past defaults and consider their current income situation to gauge their ability to repay.*

Collateral also plays a crucial role. If a borrower can provide substantial collateral, we might offer a lower interest rate because it reduces our risk. Conversely, for unsecured loans or loans with minimal collateral, we would set a higher rate to compensate for that risk.

Additionally, we consider the demand for loans in the community. If there is a high demand for loans and limited supply, we might have more flexibility to set higher interest rates.”

Also, one credit manager (10 years of experience) said, “*In our microfinance institution, interest rates are influenced by a combination of regulatory guidelines, operational costs, and market conditions. We must comply with central bank regulations regarding maximum allowable interest rates, which helps ensure fair lending practices.*

Operational costs are a significant consideration; they include not just administrative costs but also potential defaults we need to account for. We have to maintain a balance between sustainability and offering competitive rates to our clients.

Moreover, we monitor economic indicators like inflation and changes in the central bank’s policy rates. These external factors can prompt us to adjust our interest rates to maintain our financial stability and respond to market demands.

Lastly, customer feedback is critical. We conduct regular assessments to understand borrower sentiments regarding our rates. If we notice a consistent complaint about our interest rates, we might consider a review to ensure we remain competitive and responsive to our customers’ needs.”

Profitability of Micro Finance institutions in Kasese District

Descriptive Statistics on the Level of Profitability of Micro Finance Institutions in Kasese District

The researcher used a Likert scale for this particular section of the study, where the responses were on a scale of 1-5. Where 5 = Strongly Agree, 4= Agree, 3 = Neutral, 2 = Disagree and 1 = Strongly Disagree. The table below shows a summary of the participants' responses based on percentages, frequency (F), standard deviation (Std), and mean.

Table 5: Descriptive Findings on the Level of Profitability of Micro Finance Institutions in Kasese District

Statement	Mean	Std
The net interest margin of the microfinance is favorable	3.829	0.674
There is a high return on the MFIs' assets	2.114	0.652
The microfinance institution pays dividends to members	2.017	0.128
The microfinance institution has a low level of non-performing loans	2.325	0.291
The microfinance institution has adequate reserves for loan defaults	2.436	0.206
A small proportion of the microfinance loan portfolio is at risk	2.193	0.108
Microfinance has a high portfolio yield	2.314	0.317
The microfinance has a small proportion of written-off debts	2.827	0.135
The microfinance funds its operations using its resources	2.561	0.432
Microfinance has consistently generated profits over the years	2.610	0.018

Source: Primary data (2024)

The statement "The net interest margin of the microfinance is favorable" has a Mean: 3.829 and Std Dev: 0.674. The high mean score suggests that respondents generally perceive the net interest margin as unfavorable. This indicates that MFIs in Kasese District might be facing challenges in generating income from interest, which is critical for profitability.

The statement "There is a high return on the MFIs' assets" has a Mean: 2.114 & Std Dev: 0.652. A mean of 2.114 indicates a negative view regarding the return on assets, leaning towards disagreement. Respondents believe that the MFIs are not effectively utilizing their assets to generate returns, which is a negative sign for overall financial health.

The statement "The microfinance institution pays dividends to members" has a Mean: of 2.017 and Std Dev: 0.128. With a mean of 2.017, respondents feel negatively about the payment of dividends, suggesting that members do not receive some financial returns. The low standard deviation indicates a strong consensus among participants regarding this aspect.

The statement "The microfinance institution has a low level of non-performing loans" has a Mean: 2.325 & Std Dev: 0.291. A mean of 2.325 indicates a moderately negative perception about the level of non-performing loans, suggesting some concerns exist in the institutions' management of loans.

The statement "The microfinance institution has adequate reserves for loan defaults" has a Mean: 2.436 and Std Dev: 0.206. The mean score of 2.436 reflects a generally unfavorable view of the adequacy of reserves for loan defaults. Respondents believe that MFIs are not

maintaining sufficient reserves, which is risky for financial stability.

The statement "A small proportion of the microfinance's loan portfolio is at risk" has a Mean of 2.193 and Std Dev: 0.108. A mean of 2.193 indicates that respondents feel that the risk associated with the loan portfolio is relatively high. This perception shows trust issues in the MFIs' ability to manage risk effectively.

The statement "The microfinance has a high portfolio yield" has a Mean: 2.314 and Std Dev: 0.317. The mean of 2.314 suggests a generally negative view of portfolio yield, indicating that respondents believe the MFIs are not achieving satisfactory returns on their loan portfolios, which supports profitability.

The statement "The microfinance has a small proportion of written-off debts" has a mean of 2.827 and Std Dev of 0.135. With a mean of 2.827, perceptions regarding the proportion of written-off debts lean towards the negative side. This suggests that there may be concerns about the level of debts that have been deemed uncollectible, which could impact overall profitability.

The statement "The microfinance funds its operations using its own resources" has a mean: of 2.561 & Std Dev: 0.432. A mean score of 2.561 indicates a neutral to slightly positive perception of the reliance on internal resources for funding operations. This suggests that while MFIs are using their resources, there may be room for diversifying funding sources.

The statement "Microfinance has consistently generated profits over the years" has a mean: of 2.610 & Std Dev: 0.018. The mean of 2.610 shows a moderately negative outlook on the profitability trend of the MFIs, suggesting

that many believe these institutions have been unstable and may be insolvent soon.

During the interview with one of the accountants on the profitability of micro institutions, he said, *"One major reason is the increasing competition in the microfinance sector. With more players entering the market, we are seeing a race to lower interest rates to attract clients, which directly impacts our net interest margins. Additionally, loan defaults have been rising due to economic challenges in the region, affecting our profitability. Many borrowers are struggling to repay, leading to higher provisions for bad debts."*

Another one said *"Operational efficiency is critical. Many microfinance institutions have high overhead costs due to manual processes and insufficient technology adoption. This means that even if we have a steady influx of clients, our operational costs can eat into profits significantly. Streamlining processes and investing in better systems could help us reduce costs and improve our bottom line."*

Another one also said *"To tackle declining profits, we need to reassess our lending strategies. Focusing on financial literacy for borrowers could help reduce defaults. Additionally, diversifying our financial products to include savings accounts or insurance could create new revenue streams. We also need to analyze our pricing models while competitive rates are essential, they shouldn't compromise our profitability."*

The Finance Managers of Finca said, *"Client retention is crucial. When clients leave, we not only lose their business but also the opportunity for referrals. Engaging with clients through regular feedback and adapting our services to meet their needs can help maintain loyalty. Moreover, understanding why clients drop out can give us insights into improving our offerings and stabilizing profits."*

One of the Operations Managers (David) said, *"Operational challenges are significant. Many of our processes are still paper-based, leading to inefficiencies and delays. This not only affects customer service but also our ability to scale operations effectively. Implementing better technology for loan management and customer relationship management could enhance our operational capacity, allowing us to serve more clients efficiently and ultimately improve profitability."*

The responses from the interviewees highlight several interconnected issues contributing to low and declining profits in microfinance institutions in Kasese District. Key themes include increased competition, rising loan defaults, high operational costs, and the importance of client retention. The interviewees suggest strategic improvements in technology, financial education, and product diversification as potential pathways to enhance profitability.

Correlation Findings

Table 6: Correlation Findings

Profitability of microfinance institutions		Loan Interest	Loan size	Loan period
	Correlation Coefficient	0.832*	0.638*	0.462*
	Sig. (2-tailed)	.011	.027	.032
	N	100	100	100

Source: Primary data (2024)

Table 6 presents the correlation findings between various factors (loan interest, loan size, and loan period) and the profitability of microfinance institutions in Kasese District.

There was a strong positive correlation ($r=0.832$) between loan interest rates and the profitability of

microfinance institutions in Kasese District. This suggests that higher interest rates are associated with greater profitability. The significance level ($p < 0.05$) indicates that this relationship is statistically significant, meaning it is unlikely to be due to chance.

Regression Analysis of Lending Terms and Profitability of Micro Finance Institutions in Kasese District

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Table 7: Regression Findings of Regression Analysis of Lending Terms and Profitability of Micro Finance Institutions in Kasese District

Model	R	R Square	Adjusted R Square
Loan period	.560 ^a	0.314	0.344
Loan size	.783 ^b	0.613	0.622
Loan interest	.843 ^c	0.711	0.720

The regression analysis conducted in Table 7 examines the relationship between lending terms (loan period, loan size, and loan interest) and the profitability of Micro Finance Institutions (MFIs) in Kasese District. Below is a detailed interpretation of the findings.

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.132	.039		3.234	.000
2	Loan period	3.329	.000	.016	3.516	.002
3	Loan Size	5.214	.006	.053	5.395	.001
	Loan interest	6.313	.042	.522	7.184	.083

a. Dependent Variable: *Profitability of microfinance institutions*

size, and loan interest) and the profitability of Micro Finance Institutions (MFIs) in Kasese District. Below is a detailed interpretation of the findings.

Loan Interest had Unstandardized Coefficient (B) = 6.313: For each unit increase in loan interest, profitability increases by 6.313 units, holding all other factors constant. Standardized Coefficient (Beta) = 0.522: The standardized coefficient indicates that loan interest has the strongest effect on profitability among the three independent variables. T-value = 7.184 and Sig. = 0.083: While the p-value is 0.083, which is slightly higher than the common threshold of 0.05 for statistical significance, it still suggests that loan interest has a positive influence on profitability, but it is not as definitively significant as loan size or loan period. This could be due to variability in interest rates or market conditions.

Loan interest had the strongest relationship with profitability, explaining about 71.1% of the variation in profitability. This suggests that increasing the interest rate charged on loans is likely to have the most significant impact on the profitability of MFIs in Kasese District. However, the statistical significance (p-value of 0.083) suggests that while this relationship is strong, it may not be as universally applicable as some of the other findings.

The regression analysis suggests that for microfinance institutions in Kasese District, loan size and loan interest are the most important lending terms affecting profitability, with loan interest being the strongest predictor. While the loan period has a statistically significant effect, its impact on profitability is less substantial. MFIs may want to focus on optimizing loan size and interest rates to enhance profitability, but also

consider the role that loan duration plays in financial performance.

Discussion

The regression analysis showed that loan interest had the strongest relationship with profitability, explaining about 71.1% of the variation in profitability. The unstandardized coefficient for loan interest was 6.313, meaning that each unit increase in loan interest led to an increase in profitability by 6.313 units. The standardized coefficient was 0.522, indicating the most substantial effect on profitability among the three variables. However, the p-value of 0.083 suggests that the relationship is not strongly statistically significant when compared to the other variables (loan size and loan period).

The importance of loan interest in driving profitability aligns with the theoretical and empirical literature on microfinance. Interest income is a primary source of revenue for MFIs, which charge interest on loans to cover costs and generate profit (Kaaroud et al., 2020). As Hermes & Lensink (2011) note, there exists an optimal range of interest rates where MFIs can balance financial sustainability and outreach, and deviations from this range can impact both profitability and the institution's social mission.

Furthermore, the practice of offering larger loans to more established clients with a proven repayment history is a common strategy for MFIs, as highlighted by Ledgerwood (2000). Larger loans tend to come with lower monitoring costs per unit of loan disbursed, which in turn enhances profitability. The study's finding aligns well with Gutierrez-Nieto et al. (2007), who argue that segmenting clients based on their ability to repay and their credit risk allows MFIs to offer larger loans to higher-quality clients, thus improving profitability.

In general, the study findings underscore the complexity of balancing loan interest to optimize profitability. As Armendariz & Morduch (2010) highlight, MFIs must ensure that while they pursue financial sustainability through profitability, they also maintain their social mission of financial inclusion. The challenge is that higher interest rates and larger loan sizes, which contribute to profitability, may limit access to credit for the poorest and most vulnerable segments of society.

The study's findings confirm the significant roles of loan interest in determining the profitability of MFIs in Kasese District. The relationship between these loan interests and profitability is consistent with existing literature, although the degree of influence varies. Loan interest and loan size have the most substantial impacts, while the loan period has a weaker but still significant effect. The study also emphasizes the importance of balancing profitability with social objectives, which is a key challenge for MFIs globally.

As Gutierrez-Nieto et al. (2007) note, MFIs must adopt strategic lending practices informed by their market environment and client needs to achieve both financial sustainability and social impact. In Kasese District, the findings suggest that MFIs should focus on managing loan interest rates and loan sizes effectively while also ensuring that loan periods are aligned with clients' repayment capacities.

Conclusion

Loan Interest Rates have the strongest positive impact on the profitability of MFIs in Kasese District, with a significant correlation ($r = 0.832$). This reinforces the importance of interest income as the primary revenue stream for MFIs and highlights the need to carefully manage interest rates to ensure financial sustainability while considering client affordability.

In summary, loan interest rates play more crucial roles in determining the profitability of MFIs in Kasese District, while loan period has a relatively weaker but still significant influence. These findings underscore the importance of optimizing lending terms to balance financial sustainability and social impact in the microfinance sector.

Recommendation

Based on the study's findings, which reveal the relationships between loan interest rates, loan size, and loan period with the profitability of microfinance institutions (MFIs) in Kasese District, the following recommendations are made to enhance profitability while ensuring financial inclusion and sustainability:

Microfinance institutions in Kasese District should carefully set and manage their loan interest rates to optimize profitability while maintaining their social mission of financial inclusion. MFIs should seek to balance profitability with client affordability by offering tiered interest rates based on loan size, client risk profiles, and repayment capacity.

MFIs should monitor market conditions and adjust interest rates accordingly to stay competitive within the region. However, care should be taken not to set

excessively high interest rates, which could lead to client default or harm the institution's social objectives.

MFIs should consider introducing differentiated interest rates based on the purpose of the loan (e.g., emergency loans, education loans, and business loans), where higher-risk loans may warrant slightly higher interest rates to mitigate the associated risk.

Transparency in loan pricing should be maintained to ensure clients understand the rates, minimizing misunderstandings and building trust, which could enhance loan repayment rates and reduce default risk.

MFIs should consider expanding their loan sizes strategically to increase profitability, as larger loan sizes correlate positively with higher profitability ($r = 0.638$). However, this should be done while mitigating the risk of defaults associated with larger loans.

The MFIs should diversify loan products to cater to different market segments, such as business loans, agricultural loans, and emergency loans. Larger loan sizes for well-established clients or businesses could improve operational efficiency and profitability, while smaller loans can still be offered to new or vulnerable clients.

MFIs should consider offering flexible loan periods that are tailored to the needs of different client segments. For example, shorter loan periods may be suitable for working capital or consumption needs, while longer periods may be better suited for investments in productive assets like machinery or livestock.

MFIs should monitor and track loan performance for clients with longer loan periods, as they may carry higher risks of default. Implement effective monitoring mechanisms and regular reviews to detect any signs of repayment difficulties early.

MFIs must strike a balance between their financial sustainability and their social mission of providing financial services to underserved communities. While higher interest rates and larger loans may improve profitability, the social impact of MFIs should not be compromised.

Acknowledgment

I would like to express my heartfelt gratitude to everyone who has supported me throughout my research journey.

First and foremost, I would like to thank my family for their unwavering love and encouragement. Your belief in my abilities has been a constant source of motivation. To my friends, your companionship and support have made this journey enjoyable and manageable; thank you for being there during both the challenges and the successes.

I extend my appreciation to my coursemates, whose collaboration and insights have enriched my learning experience. Together, we have navigated the complexities of our studies, and I am grateful for the camaraderie we shared.

A special thanks goes to my research supervisor for your guidance, expertise, and constructive feedback. Your mentorship has been invaluable in shaping my research and helping me develop as a scholar.

I would also like to acknowledge the research committee for their thoughtful reviews and support, which have contributed significantly to the quality of this work.

Finally, I express my gratitude to the School of Graduate Studies and Research at Team University, Kampala, for providing the academic environment and resources necessary for my research. Your commitment to excellence has inspired me throughout this journey. Thank you all for your contributions and support.

List of Abbreviations

CVI	Content Validity Index
MFIs	Micro Finance Institutions
NGOs	Non-Governmental Organizations
ROA	Return on Assets
ROE	Return on Equity
ROSCAs	Rotating Savings and Credit Associations
SACCO	Saving and Credit Society
SPSS	Statistical Package for Social Sciences

Source of funding

The study was not funded.

Conflict of interest

The author declares no conflict of interest

Author contributions

John Byaruhanga, data analyzer, and principal investigator

Dr. Muhammad Ssendagi supervised the data.

Data availability

Data is available upon request.

Informed consent

All participants consented to the study.

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John Byaruhanga holds a master's degree in Business Administration from Team University.

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