Kabale University Interdisciplinary Research Journal (KURJ)

Internal controls, corporate governance and financial performance of MFIs in Uganda

*Abanis Turyahebwa, Byamukama Eliab Mpora and Arthur Sunday

Department of Business Studies, Kabale University, Uganda

*Corresponding Author
aturyahebwa@kab.ac.ug

KURJ
ISSN 2790-1394

pp. 102 -117
Vol 1. Issue 4.
Dec 2022

ABSTRACT

The article reconnoitered the rapport between internal controls, corporate governance and financial performance of MFIs in Uganda a case of Central Uganda. The study adopted a descriptive, cross-sectional and correlational design. The study covered 76 MFIs in Uganda with 332 respondents. The findings argument to a significant positive relationship between internal controls, corporate governance and financial performance of MFIs. Internal Controls and financial performance of MFIs (r = 0.651, P-value = 0.000), corporate governance and financial performance of MFIs (r = 0.562, P-value = 0.000). From the results, we sanction that internal controls, corporate governance, predict over 70.2% of the change in financial performance of Micro Finance Institutions in Uganda. The findings display a good model fit and fig.2 defines the model of internal controls and corporate governance on financial performance of MFIs in Uganda and is comprised of 3 magnitudes of Internal Controls in terms of Control Environment, Control Activities, Risk Assessment as well as corporate governance and their predictive power on financial performance of MFIs in Uganda. Figure 2 and table 1 and 2 clearly indicate that Internal Controls and Corporate Governance are significantly associated with financial performance of MFIs. The study spoke to pragmatic issues that have not been shielded in the literature, more especially in the microfinance industry Uganda. Besides, the study has attempted to negate or confirm whether the theoretical underpinnings are empirically supported in Microfinance Institutions in Uganda. Consequently, the study has underwritten to the lasting internal controls and corporate governance debate in the field of financial industry. The study has further established that internal control and corporate governance magnitudes operate in a synergic way to affect financial performance in Microfinance Institutions in Uganda.

Keywords: *Internal Controls, Corporate governance, Financial Performance, MFIs, Uganda*

Introduction

The general objective of this study was to establish the relationship between internal controls, corporate governance and financial performance of Micro Finance Institutions (MFIs) in Uganda.

Primarily, microfinance was introduced to the globe by Muhammad Yunus in 1976 in Jobra's village in Bangladesh (Khan and Rahaman 2007). It has currently been an effective instrument for poverty reduction in many countries, Uganda being no exception.

Micro Finance Institutions (MFIs) in Uganda and all over the world have been acknowledged as stern institutions to countries' pursuit for elucidations to the poverty eradication issues and development challenge (CGAP, 2002). Most microfinance firms have embraced a more business-oriented outlook and maintained their target groups of economically-active poor, while focusing on achieving operational and financial sustainability (Kalyango, 2004; Baguma, 2008).

Ugandan microfinance institutions have embraced an approach driven by the market together with an enterprise development model after putting aside social-mission-oriented activity that could no longer be undertaken on a commercial basis (Fernando, 2007). As an ingenious form of financial intermediation with the poor community (Otero, 2002), the Microfinance Institution is, in effect, "double tasked" to achieve sustainable performance and lessen poverty among societies (CGAP, 2002; Adongo & Christopher, 2005). However, microfinance institutions' struggles to sustainable performance have taken center stage and turned out to be perpetual phenomena that have threatened the going concern of microfinance industry. The struggles designed to address poor performance trends (marked by deteriorating returns and portfolio quality) in most microfinance institutions (PMT, 2002/07; Microfinance banker, 2007) have failed to address the phenomenon.

Micro Finance Institutions in Uganda charge exorbitant interest rates which range from 36% to 48% per annum (Sunday *et al*, 2018), still with such high interest rates their financial performance are still wanting (Baguma *et al*, 2022). This has lingered a mysterious marvel which has spawned exhilarating argument among researchers and practitioners.

ISA 400 (IAASB, 2019) describes internal control as a process, conceded at numerous organizational levels, intended at providing judicious inevitability concerning the accomplishment of the intents of efficiency and effectiveness of organization activities in relation to risk assessment, control environment and control activities in acquiescence with operating procedures.

Poor financial performance marked by deteriorating returns and portfolio quality has taken a center stage and remained unexplained in microfinance firms (PMT 2006/2009). Though some studies have financial management practices as a predictor of financial performance in different industries, there are still mixed results have not yet resolved (Turyahebwa *et al*, 2013; PekChen, 2005). More so, theories and models covered in previous studies apparently used to explain financial performance in firms have proved to be weak and inadequate in explaining this phenomenon Olaniyan *et al*., (2008). Besides, the possibility of using findings of Maylun *et al*. (1999), Cabrita *et al*. (2005) and PekChen (2005) from financial institutions in developed economies to explain performance trends in developing countries have also been rendered irrelevant by the social cognitive theory (Bandura1986).

The existent literature asserts that the MFI's competitive advantage and performance are largely influenced by its internal controls (Tovstiga *et al*., 2005, Barney, 1991; Prahalad *et al*., 1990). However, there is inadequate empirical research emphasizing the concrete role of corporate in the relationship between internal control and performance. The interceding effect of corporate governance and the magnitude it associates internal control to financial performance of MFIs is consequently imperfect in the literature.

Deficiency of precision on the magnitude to which internal control components impact financial performance of financial institutions (Byamukama *et al*, 2021) will consequently continue to impede conjoint understanding and elucidation which might dissuade performance enhancement in microfinance institutions in Uganda.

The study underwrites to the literature through desertion from conventional procedures of financial performance of Micro Finance Institutions (MFIs), such as return on investment, return on equity and return on assets. Expending factor analysis, the study came up with a three-dimensional financial performance indicator that is grounded on distinct measures of CAMEL variables which stands for Capital Adequacy, Asset Quality, Management Efficiency, Earnings, and Liquidity. The study estimated the bearing of the aforesaid elements on the financial performance of Micro Finance Institutions in Uganda, using Structural Equation Modelling.

Related Literature

Theoretical Review

Stakeholder Theory

Stakeholder theory contends that directors and or, managers ought to make pronouncements so as to take account of the comforts of all stakeholders in an enterprise (Twaha *et al*, 2021). From a stakeholder standpoint, an enterprise should endeavor to meet manifold goalmouths of a varied series of stakeholders somewhat those of shareholders only (Byamukama *et al*, 2021). Freeman (1984) contends that enterprises ought to be more alarmed about the benefits of other stakeholders when taking premeditated decisions.

The stakeholder theory relays to the term "internal control" which ISA 400 defines as all procedures and policies espoused by the managers of an enterprise to succor in attaining the major intents of the organization by guaranteeing that the transactions are conducted in the most proficient way probable and also warranting stern devotion to policies, prevention and detection of fraud, safeguarding of assets among others (Akinyemi, *et al*, 2021). Quality financial information may be delivered to the numerous stakeholders in the context that the enterprise has virtuous corporate governance practices and an excellent board oversight (Sunday *et al*, 2018). Stakeholder theory necessitates directors to avail dependable information to the numerous stakeholders at all times (Peasnell *et al.*, 1998).

Opponents of stakeholder theory have alleged that the needs and interests of the numerous stakeholder clusters modestly cannot be acquiescent equitably. This is because under stakeholder theory, stakeholders signify manifold bulky and sundry groups, and one or more of those groups will inexorably take a back seat at some point in the process (Susan Key, 1999).

Stewardship Theory

According to Davis *et al* (1997) stewardship theory postulate that a steward protects and maximizes shareholder's wealth through firm performance, because by so doing, the stewards utility functions are maximized. A steward compares with the agent in the agency theory, where he is entrusted with the running of the business on behalf of the owner. He prepares the statements to show financial performance and

position. He makes the decisions in managing the business to protect the interest of the owner. The sharp contrast between the two theories is on the perception and attitude towards the job. In agency theory, an agent is solely aimed at financial benefits from the organization whereas in stewardship theory a steward derives motivation from his achievement. Unlike in agency theory where agent is viewed as opportunist, a steward is cognizance of the owners' interest in running of the business (Donaldson and Davis 1991). He aligns himself with the organization (Donaldson and Davis 1991) hence his passion is when the organization achieves the objectives. His goals are similar to that of the principal since his aspirations are big, he is motivated to do the good work and takes good care of the corporate assets (Brennan, 2010; Danaldson&Davis, 1991; Aras& Crowther, 2007)

Stewardship theory proposes establishment of the structures that will empower the steward to work independently. He does not require supervision or close monitoring (Donaldson and Davis 1991). Similarly, the board of directors of MFI underpin stewardship by granting the steward unlimited authority to run the organization. This reduces the costs that organization

Agency theory

The agency theory was proposed by Alchian and Demsetz (2002) and was later advanced by Jensen and Meckling (2006). It was essentially introduced to separate ownership and control of an organization (Bhimani, 2008). In this context the principal denotes the owners of the organization whilst agents are the people whom the owners charge with the responsibility of managing their organization (Clarke 2004). Agents therefore run the business on behalf of the owners (Clarke 2004). They make the decisions aimed at increasing shareholder's wealth.

They prepare statements for the shareholders to see financial performance and position of their organization. For this reason, the theory advocates for congruency between goals of the agents and those of principals (Jensen and Meckling 2006). Conversely this rarely happens as the agents pursue their personal interest (Padilla 2000). They indulge in risky and high returns projects not minding the corporate image as long as they get fixed wage.

In view of agency theory employees are more self-interested, individualistic and are bounded rationality where rewards and punishments seem to take priority (Jensen & Meckling, 2006). This creates conflict of interest between them and principals who are their employers. A good example was revelations by Adam Smith in 18th century which was later explored by Ross (2003). This problem of separation between ownership and control has also been confirmed by Davis, *et al* (1997). The owners through the board of directors need to monitor the activities of the managers by demanding accountability (BBVA Microfinance Foundation, 2011b). Through policy formulation the directors need to develop strong controls and governance mechanisms (Donaldson & Davis 1991; Heenetigala, 2011). Employees are held accountable for their responsibilities and therefore they should be part of good governance structures themselves as opposed to providing the need of shareholders.

The membership of the board of directors varies across the MFI's albeit most of them have non-executive directors and executive director who doubles up as CEO and secretary to the board. Within principal agent setting, CEO's use their own power to make the decision that are less in line with desires of principal (the

shareholders in case of for-profit MFI's and stakeholders in case of not-for-profit MFI's). More powerful CEO's can decide to take severe decisions since they leverage from them or take less severe to reduce the risk of bad performance.

According to agency theory, when the chairperson of MFI assumes the role of CEO, that is acting as a decision maker and as supervisor, the function of the board to minimize agency costs could weaken further: ultimately corporate performance goes down (Wu *et al*, 2009). The directors will ensure Microfinance mission is accomplished whether it has financial benefit or not unlike the agents who are profit minded. Agency theorists suggest that broad and diverse board of directors is a better monitor of managers since diversity enhances independence (Kusyk& Lozano, 2007; Chhaochharaia & Grintesin 2007). Despite its contribution to the finance and accounting field the theory is castigated on a number of weaknesses.

This is because there are information asymmetries, transaction costs and fraud which are obstacles to efficient contracting (Brennan, 2010). Similarly, the theory does not ratify management and director's prowess. Brennan (2010) argues that the agency theory may be suitable for monitoring of managers, role of boards, but does not explain the other board chores.

Internal Controls and financial Performance of MFIs

Hayes *et al* (2005) Internal control encompasses five components; control activities, control environment, risk assessment process, the information and communication systems, as well as monitoring of the controls. The supplementary components of the internal control systems will be held steady. Gupta (2001) depiction from Statements of Standard Auditing Practices (SAP 6) describe Internal control as the plan of entity and all the systems and procedures espoused by the management of an entity to succor in achieving management objectives of warranting as far as feasible, the orderly and competent performance of its production, together with compliance with organization policy, the protection of assets, prevention and detection of fraud and mis- statements, the accuracy, incomplete records of accounting as well as the timely preparation of reliable financial information.

Sunday *et al* (2018) appropriately established systems of internal control will ensure; completeness of all transactions commenced by an entity, that the entity's assets are protected from stealing and misuse, that dealings in the books of accounts are detailed at the appropriate amounts, and that all resources or assets in the firm's financial statements actually do exist, that all the assets obtainable in the firm's financial statements are recoverable and that the firm's dealings are obtainable in the suitable manner according to the pertinent reporting framework.

Hitt *et al* (1996) contended that there are two types of major internal controls concomitant with the management of large firms, largely diversified firms, which have a noteworthy consequence on firm improvement, these are; monetary controls and strategic controls. Deliberate controls encompass the use of long-term and purposefully pertinent criteria for the appraisal of business-level managers' actions and performance. Strategic controls accentuate principally particular and sometimes spontaneous criteria for assessment (Gupta, 1987).

The use of deliberate controls requires that managers have a deep indulgency of business-level operations and markets. Such controls also require a rich information exchange between corporate and divisional managers (Hoskisson *et al*, 1994). On the other hand, financial controls necessitate objective criteria such as return on investment (ROI) in the evaluation of business-level managers' performance. They are similar to what Ouchi (1980) and Eisenhardt (1985) mentioned to as outcome controls.

Consequently, directors set up financial targets for each firm and define the business-level managers' performance against those targets. Generally, such a slant may be difficult when the gradation of inter reliance among individual business units is high. Accordingly, prominence on financial controls necessitates each separation's performance to be mainly independent.

Turyahebwa *et al*, (2013) asserts that financial performance is as a result of how owners or managers exploit their available resources efficiently to create earnings. The tenacity of business is principally dependent on its financial performance with which the assortment of its capital subsidize massively to boost the performance.

A comparison between studies done in developed countries like USA and developing countries like Nigeria does not show any significant differences among MFIs. A number of studies have assessed the financial performance of financial institutions using a number of models of which CAMEL has been one of them (Gupta *et al*, 2008).

Numerous Micro Finance Institutions have circumvented audits or the more expensive Camel due to inadequate funds or expertise or because of a yearning to edge outside examination. Stirring the process of courteous financial reporting to a grander level of transparency inexorably will be up to the organizations that supply capital. In other instances, it may be indispensable to subsidize audits (Michael Tucker, 2021).

Utmost studies that explore the financial performance of financial institutions use a one-dimensional ration mainly; return on equity, return on assets as well as net interest margin (Byamukama *et al*, 2021). Zhao *et al* (2009) have revealed that using indexes is better than using raw accounting variables, because the latter ominously reduce the cost of expected misclassification. Aforementioned studies, for example Derviz *et al*. (2008) and Rashid *et al* (2016), either used constructed a financial performance index or a CAMEL index provided by local authorities. According to Khrawish (2011) accounting based performance utilizes indicators such as: return on assets (ROA), Net Income, liquidity, the return on total equity (ROE), Return on Investment (ROI), and Net Interest Margin (NIM). The pointers are widely used in assessing the performance of financial institutions

The dependent variable in the current study is financial performance measured in terms of capital adequacy, asset quality, management capability, earnings strength and liquidity (CAMEL).

Thus;

H1: There is a significant relationship between internal controls and financial performance of MFIs in Uganda.

Corporate governance and Financial performance of MFIs

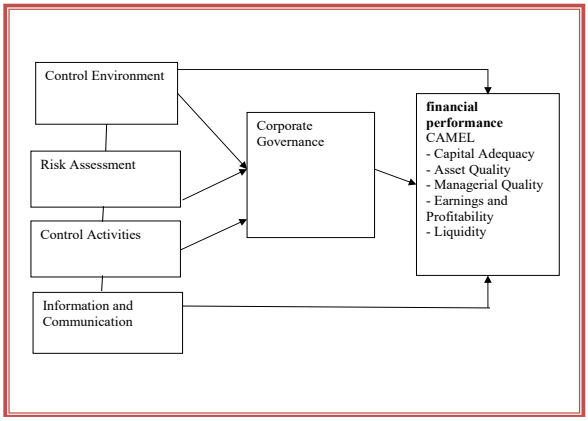
The study by Gompers *et al.* (2014) built a governance index to proxy the balance of power between directors or managers and shareholders by using 24 corporate-governance provisions. The study used the sample data from 1500 large firms during 1990s. The study pragmatically investigated the relationship of the governance index with corporate performance. The study concluded that entities with stronger shareholder rights had better results such as higher sales growth, higher profits and higher firm value. Consequently, those entities made lower capital expenditures and made fewer acquisitions. In a study by Bhagat *et al.* (2008) an endeavor to answer the question of what is the relationship between corporate governance and financial performance by bearing in mind the endogeneity of the interactions among corporate governance, performance and ownership structure. The study concluded that better corporate governance is positively correlated with better synchronous and successive financial performance.

Abounding studies are available in the literature on the nature of corporate governance and financial performance of entities. A number of studies undertake corporate governance to be an exogenous variable that upsets firm performance while different view submits that corporate governance itself is affected by prior entity performance henceforth suggesting its endogenous nature. These studies include those done by; Chen *et al.* (2007); Oxelheim *et al.* (2003); Fernandez *et al* (2002) and Jensen and Meckling (1976) among others.

Nevertheless, countless studies in literature deliver justification for the two-way or reverse-causality in corporate governance and financial performance relationship by reviewing different corporate governance variables endogenously; Wintoki *et al.* (2009); Adams *et al.* (2009); Bohren *et al.*, (2001) among others emphasized the prominence of studying the direction of causality in corporate governance and financial performance relationship. Manderlier *et al.* (2009) suggested that auxiliary research should be done on the reverse causality in corporate governance and financial performance relationship in microfinance sector of South Asia. The literature concludes that corporate governance and financial performance could be jointly determined by each other, hence suggesting the presence of reverse or two-way causality in their relationship. Thus the following hypotheses:

H2: Corporate governance is significant and positively related financial performance of MFIs in Uganda.

Fig.1: Conceptual framework of the study variables.



Source: Reviewed literature

Explanation of the model

The model in Figure 1 makes an assertion that where internal controls and corporate governance are appropriate, this will improve financial performance of Micro Finance Institutions (MFIs). The internal controls are conceptualized to mean control environment, risk assessment, control activities and information and communication are in place. The operationalization of financial performance of MFIs takes the form of CAMEL which stands for Capital adequacy, Asset quality, Managerial quality, Earnings and profitability and Liquidity. The model predicts, and consistent with the Stakeholders theory, Stewardship theory (Grant, 1996) and Agency theory (Teece *et al*. 1997); that owner managers must possess the skills, knowledge and agility necessary to augment the internal controls if good financial performance of a microfinance is to ensue. The model shows that a multiplicative effect of a number of internal controls may improve the multiplicative effect of financial performance dimensions than individually. Moreover, internal controls will have a positive effect on the global financial performance of MFIs in Uganda.

Materials and Methods

Research Design, Population and Sample

The study betrothed a descriptive design. The study employed a descriptive design in order to define the profile of the respondents (Turyahebwa etal, 2013). The study also espoused cross sectional research design as the study envisioned to attain a random sample as well as comprehend a cross section of interest at a precise time. Cross-sectional studies are convenient for engendering and expounding hypothesis and they help setting the ground work for pronouncements about future follow up studies (Kraemer, 1994). The study also adopted a correlational design in order to establish the relationship between internal controls, corporate governance and financial performance of MFIs.

A total sample of 92 Micro Finance Institutions which are licensed by Uganda Micro Finance Regulatory Authority (UMRA). These included 5 Micro Deposit taking Institutions and 87 Non-Deposit taking Institutions. The non-deposit taking MFIs were also included in the study because they are currently licensed and they are required to have a system in place and keep records (Byamukama *et al*, 2021). The unit of analysis was Micro Finance Institutions (MFIs) and the unit of inquiry was directors, board members, senior members of staff and as well as customers.

A sample size of 76 firms was targeted and arrived at by adopting Yamane (1973) sample size determination guidelines. According to Yamane, sample size is given by n = N/1+N (e) 2, where: n- is a sample size, N- is total population; and e- is tolerable error. On the basis of Yamane's approach with total population (N) 92 and tolerable error (e) 0.5%, the sample size (n) was 76 firms. Yamane's sample determination guideline was preferred because it yields a fairly representative sample. Besides, the 76 sample size generated using this approach impartially reflects the results one would have got using a table of random samples by Krejcie and Morgan (1970). Further, the determined sample size is consistent with the sample size guidelines of Field (2006) and Ntoumanis (2001).

As stated earlier the unit of analysis was Microfinance Institutions (MFIs) and the unit of inquiry was directors, members of the board, and senior members of staff within the units of inquiry. Though a maximum of 7 senior managers per micro finance institution were targeted, actual number of respondents from the

MFIs ranged between 3 and 5 senior managers. To address variations in MFIs responses, a minimum of 5 senior managers were considered for analysis. The decision to accept a minimum of five senior staff per firm is based on the guidelines Ntoumanis (2001) and Field (2006) on sample selection. Other intellectuals, like Ngoma (2009), Baer and Frese (2003) adopted and used a minimum of 3 respondents per firm. Thus, a minimum of 5 senior managers per Micro finance Institution was sufficient for the study. Nevertheless, out of 76 firms, 61 responded, hence giving a response rate of 80.3%. A total of 332 respondents were covered.

Measurement of Variables

The independent variables of this study are internal controls (Control Environment, Control Activities, Risk Assessment and Information and Communication) and corporate governance, while the dependent variable is financial performance (CAMEL) measured as below.

Capital Adequacy: for purposes of this study, capital adequacy was measured by Total Equity/Total Assets together with the computation of Total Capital ratio.

Asset Quality: Asset quality was measured in terms of Loan loss provision/Total loans; Impaired loans/Total loans as well as Impaired loans/Total equity.

Managerial Quality: In this study managerial quality was measured by Overheads/Total assets and Cost-income ratio.

Earnings and Profitability: Earnings and profitability was measured by; Return on equity and Return on assets.

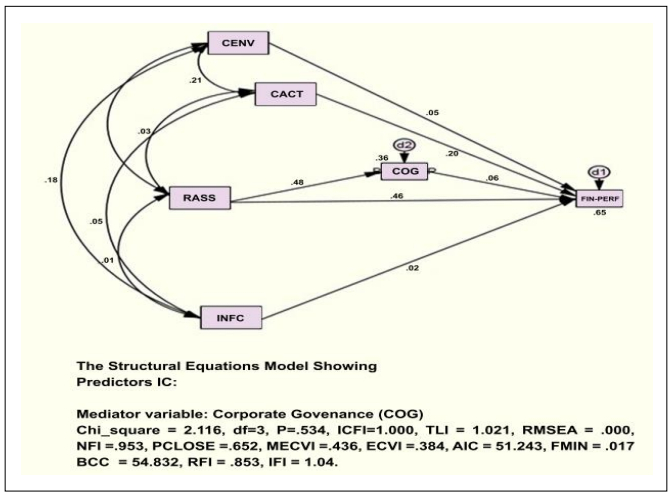
Liquidity: for purposes of this study, liquidity was measured in terms of Fixed assets/total assets, Liquid assets/Deposits and short-term funding, Liquid assets/Total assets, Gross loans/Total deposits.

Structural Equation Modelling

The study employed Structural Equation Modelling (SEM) to estimate the model. This model denotes a set of equations with associated assumptions of the analyzed system, in which the parameters are determined on the basis of statistical observation (Jöreskog and Sörbom 1993). Structural Equation Modelling helps in appreciating the patterns of covariance amid a set of variables and it explicates as much variance as possible with the model stated (Kline, 2011). Consequently, in order to justify the disparity and covariation of internal controls and corporate governance on financial performance of MFIs, the contemporaneous study uses Structural Equation Modelling. The Chi-square test normally considered as an outright test of model fit necessitates that the model is rejected if the p-value is <0.05; Root Mean Square Error of Approximation (RMSEA) ought to be < 0.06 and Tucker-Lewis Index (TLI) values greater than 0.95 (Huand Bentler, 1999). Others like Kim (2007) and Yang (2006) recommend, Goodness of Fit (GFI) > 0.90, Adjusted Goodness of Fit Index (AGFI) > 0.85, TLI > 0.95, CFI > 0.90 and RMSEA < 0.08 as acceptable goodness-of-fit index. The study followed the guidelines mentioned above in fitting the stated model.

Results and Discussion

Fig 2: Model for the Internal Control, Corporate Governance and financial performance of MFIs.



From the above figure, it is visibly showed that there is a significant relationship between internal control, corporate governance and financial performance factor structure of observed variables and their indispensable latent variables in the Micro Finance Institutions in Uganda. The model for internal control, corporate governance and financial performance suggested that there is an NFI of 0.956, which indicates strong convergent validity (Baalaputhiran *et al.*, 2013). Correspondingly, Figure 2 indicates the model estimated and 3 degrees of freedom (df=3). The findings indicate that the chi-square value of 2.116 is non-significant at the 0.05 level: its p-value is 0.534 signifying that the model fits the data suitably in the population under study.

The findings in fig. 2 above also indicate that RMSEA = 0.000 which is reinforced by the result of TLI of 1.021. Furthermore, GFI = 0.853 and AGFI = 0.953 which is way greater than 0.9 which specifies a good fit. Subsequently, the model of internal control, corporate governance and financial performance of MFIs in Uganda is established.

Table 1: Path coefficients for the interaction effects model.

			Unstandardized coeff.	S.E.	C.R.	P	Standardize coeff.
COG	<---	IC	.516	.073	5.713	***	.452
FIN-PERF	<---	IC	.690	.088	4.449	***	.398
FIN-PERF	<---	COG	.284	.095	.883	.017	.078
FIN-PERF	<---	CENV	.145	.037	1.207	.007	.097
FIN-PERF	<---	CACT	.512	.007	1.011	.312	.082
FIN-PERF	<---	RASS	.021	.056	.367	.714	.029

Table 2: Results of the structural equation showing partially and mediated models.

	Fully mediated model	Partially mediated model	*CR*	S.E.
CENV <---CAMEL	.672***		7.301	.121
CAMEL <---CACT	.512***	.432***	4.640	.127
DST <---CAMEL	.624***	624***	6.221	.126
INVD <---CAMEL	.433**	.343**	2.252	.110
FIN-PERF <---COG	.656**		2.325	.116
FP <---CENV	.652**		5.011	.126
FP <---RASS	.432**	.160	2.112	.124
FP <---INFC	.646***	.013	4.115	.116
CACT <---CAMEL	.011	.055	1.024	
X2	20.421	5.214		
df	6	4		
p	.000	.590		
CFI	.999	.875		
NFI	.972	.819		
RMSEA	.001	.124		

The results discovered that internal controls among Micro Finance Institutions is delineated in terms of majorly four observed variables; Control Environment (CENV), Control Activities (CACT), Risk Assessment (RASS) and Information and Communication (INFC). Corporate Governance remained as a single observed variable. The observed factor loadings equated with their standard errors uncovered evidence of an association between internal control, corporate governance and financial performance of MFIs in Uganda.

The unstandardized loadings as indicated in Table 1 appear along with a critical ratio, and p-values. In order to ascertain statistical significance, the critical ratio and p-values were used. A critical ratio greater than 1.96 or a p-value smaller than 0.05 indicates significance. Three asterisks (***) indicate that the p-value is smaller than 0.001. From the table1, all of the unconstrained estimates are significant. All the other indicators have strong standardized loadings. The R2 statistics shows a range from astute to strong regressions.

The convergent validity can be measured by scrutinizing factor loadings. The observed factor loadings matched with their standard errors reveal confirmation of an association between internal controls, corporate governance and CAMEL components which represents observed variable of financial performance of MFIs.

The findings portrayed in fig.2 and table 1, showed a significant positive relationship between internal controls and financial performance of MFIs, p (two-tailed) < .01. Correspondingly, findings indicated a significant positive relationship between corporate governance and financial performance, p (two-tailed) < .01. These results offer auxiliary confirmation in support of the hypotheses as stated in the literature section.

Table 3: Direct and indirect effects of Internal Controls on financial performance Standardized Total Effects (Group number 1 - Default model).

	CENV	CACT	RASS	INFC	CAMEL
IC	.000	.000	.000	.000	.646
CAMEL	.522	.656	.654	.423	.000
FIN-PERF	.632	.631	.645	.476	.002

From the results in Table 1 and Table 2, in scrutinizing the fully mediated and partially mediated models on these five criteria, results indicated that the fully mediated model was better depiction of the data. The results indicate that of the 8 out the 9 (about 89%) of the fully mediated model's paths are supported at the $p< 0.01$ level or better. In contrast three of 9 (33 percent) of the partially mediated model's paths are supported at the $p < 0.01$ level. Further, the ability of the models to explain the variance in the outcome, as measured by Squared Multiple Correlation (SMC), supports the fully mediated model.

The higher NFI and CFI recommend that the fully mediated model provides a better fit of the data. Based on these conditions, it was affirmed that the fully mediated model was more precise and expedient delineation of the relationships among the constructs of internal controls, corporate governance and financial performance of MFIs in Uganda.

The results in table 1, clearly reflect the change in the predicted value of financial performance for a unit increase in the predictor variables. Consequently, the β coefficient of 1.0 would indicate that for every unit increase in the predictor, the predicted value of the dependent ariable also increases by one unit (Norusis, 1990). Similarly, table 1 results reveals that there is a significant regression between internal controls and financial performance of MFIs in Uganda. This implies that one-unit increase in equity leads to 0.642 significant positive change in financial performance. In the same regard, there is a significant regression between corporate governance and financial performance. The findings indicate that, one unit increase in corporate governance leads to 0.656 significant positive changes in financial performance of MFIs in Uganda. The positive relationship between risk assessment and financial performance indicates that managing risks appropriately has been effectually used as way to allay managerial cash flow waste and reduce the deceitful tendencies of managers of MFIs through timely handling of situations. These findings are in agreement with Chu *et al.*, (2006) and Sunday *et al* (2018) in their study internal control system and financial performance of MFIs in Uganda. Similarly, the results indicate that there is significant regression between Control Activities and financial performance of MFIs. The results point to the fact that one-unit increase in Control Activities leads to 0.512 significant positive change in financial performance of MFIs. These findings support our hypothesis which states that there is a significant relationship between internal controls and financial performance of MFIs in Uganda. These findings are contrasted by Andrieş *et al*, (2014) who studied the Convergence of bank efficiency in emerging markets. It is important to note that the above study was not done on MFIs and were done on large commercial banks.

Aboagye, *et al*. (2010) explored Are Ghanaian MFIs' performance associated with corporate governance? The study revealed that strong corporate governance practices positively affect performance of MFIs. In same regard, Daher *et al* (2013) established that risk assessment and financial performance of MFIs are positively related. These findings are in support of our tested hypothesis which affirms there is a significant relationship between internal controls and financial performance of MFIs in Uganda.

The results in table 1 also divulge that there is a significant regression between corporate governance and financial performance of MFIs. This signifies that a unit increase in corporate government leads to 0.562 significant positive changes in financial performance of MFIs in Uganda. These results support our hypothesis which states there is a significant relationship between corporate governance and financial performance of MFIs in Uganda. These findings are in agreement with a number of scholars; Sunday *et al*. (2018) and Ngari (2017).

The pragmatic results show indisputably that the financial performance of MFIs is dependent upon a number of factors as being portrayed by CAMEL variables. The results suggest that MFIs benefit from strong internal controls coupled with effective corporate governance. This result is in line with the findings of Woolcock, (1999). Deposits, as measured by the ratio of deposits to total assets, seem to have no significant effect on asset quality and earnings of Micro Finance Institutions. This result is inveterate for all the stipulations used. According to the results, asset quality and earnings are positively and significantly affected by the diversification of banks. This result is in line with the findings of Petria *et al*. (2015).

Conclusion

The findings show good fitting models in respect of internal control and corporate governance on financial performance of micro finance institutions in Uganda. Particularly, internal control is a composite construct comprising of control environment, control activities and risk assessment. Whereas there was a direct relationship between internal control and financial performance, the results of the study also showed that this relationship can in addition be mediated by corporate governance. Besides, the relationship between corporate governance and financial performance was also mediated by internal control.

Thus, a conclusion is arrived at that in absence of corporate governance, internal control influences financial performance of MFIs in Uganda. Thus, the financial performance of the MFIs may significantly be improved by means of effective internal controls through corporate governance.

The results demonstrate good model fits and fig.2 defines the model of internal control and corporate governance on financial performance of MFIs in Uganda and is made up of 4 magnitudes of internal control in terms of Control Environment, Control Activities, Risk Assessment and Information and Communication as well as Corporate Governance and their extrapolative power on financial performance of MFIs in Uganda. Figure 2 and table 1 and 2 evidently designate that internal control and corporate governance are significantly associated with capital adequacy, asset quality, management, earning quality and liquidity which in tandem leads to improved financial performance of MFIs.

The prominence of interaction effects of internal control and corporate governance to financial performance of MFIs have been emphasized in the current study. Precisely, posting a positive and significant relationship between the variables under study, leads to an inference that an assortment of internal control and corporate governance leads to enhanced financial performance of MFIs.

In providing the trajectory for improving financial performance of MFIs, this study has provided support for a multi-theoretic approach in the explanation of financial performance. The present study which applied the theories of stake holders, stewardship and agency theories has shown that utilisation of a multi-theoretic approach offers an alternative route to financial performance of MFIs by integrating internal control to uncover the relevant factors for effective corporate governance, in order to steer financial performance of MFIs in Uganda.

Implication

The directors of microfinance institutions need to appreciate that the augmentation of the need for strong internal controls in the financial industry is unescapable, given the competitive and technological forces that are across-the-board in the 21st Century.

In order to boost the wealth of Microfinance Institutions in Uganda, managers of MFIs should ensure that all forms of internal controls are in place in order to sustain and increase firm value. The fact that all collaborating terms involving internal control have been found to be significant, emphasis however, should be put on risk assessment and control activities, since they make viable blends that can promote the wealth of Microfinance Institutions in Uganda.

The findings also hold far-reaching inferences for accountants and auditors. Given the prominence of internal controls and corporate governance to financial performance, current internal control models that emphasise more of control environment with minimal attention to risk assessment and corporate governance need to be reviewed. Thus, new performance measures and valuation methods based on CAMEL should be emphasized by financial analysts so as to determine the true value of financial institutions rather than basing on returns based on book values and profitability.

References

Aboagye, Q. A., & Otieku, J. (2010) Are Ghanaian MFIs' performance associated with corporate governance? *Corporate Governance: The international journal of business in society*, 10 (3): 307-320. DOI: 10.1108/14720701011051938.

Adams, R. B., & Ferreira, D. (2009) Women in the board room and their impact on governance and performance. *Journal of Financial Economics*: 291–309. DOI: 10.1016/j.jfineco.2008.10.007.

Abanis, T., Arthur, S., & Derick, S. (2013). Financial management practices and business performance of small and medium enterprises in western Uganda. *African journal of business management*, 7(38), 3875-3885.

Andrieş, A. M., & Căpraru, B. (2014). Convergence of bank efficiency in emerging markets: The experience of Central and Eastern European countries. *Emerging Markets Finance and Trade,* 50(s4), 9-30. https://doi.org/10.2753/REE1540-496X5004S401.

Baguma, D.T (2008). *Uganda Microfinance Industry Assessment: Association of Microfinance Institutions of Uganda*. https://openlibrary.org/books/OL23633233M/Uganda_microfinance_industry_assessment.

Barney, J. B. (1991). Firm resources and sustained competitive advantage. *Journal of Management*, 17(1), 99 -120.

Bhagat, S., & Bolton, B. (2008). Corporate governance and firm performance. *Journal of Corporate Finance*, 14(3), 257–273. https://doi.org/10.1016/j.jcorpfin.2008.03.006.

Bohren, O. and Odegaard, B. A. (2001) C*orporate governance and economic performance in Norwegian listed firms, Research report 11*, Norwegian School of Management.

Chen, Y., Lin, B., Lu, L., & Zhou, G. (2020). Can internal audit functions improve firm operational efficiency? Evidence from China. *Managerial Auditing Journal,* 35(8), 1167–1188. https://doi.org/10.1108/MAJ–01–2019–2136.

Daher, L., & Sout, L. E. (2013) Microfinance and Financial Performance. *Strat. Change* 22: 31–45. DOI: 10.1002/jsc.1920.

Derviz, A., & Podpiera, J. (2008). Predicting bank CAMELS and S&P Ratings: The case of the Czech Republic. *Emerging Markets Finance and Trade*, 44(1), 117-130. https://doi.org/10.2753.

Eton, M., Mwosi, F., Okello-Obura, C., Turyehebwa, A., & Uwonda, G. (2021). Financial inclusion and the growth of small medium enterprises in Uganda: empirical evidence from selected districts in Lango sub-region. *Journal of Innovation and Entrepreneurship*, 10(1), 1-23.

Fernandez, C. and Gomez, S. (2002) *Does ownership structure affect firm performance? Evidence from a continental-type governance system*. working paper.

Field, A. (2006). *Discovering Statistics using SPSS* (2nd Ed.). Sage, London.

Gompers, A. P., Ishii, L. J., & Metrick, A. (2003) Corporate Governance and Equity Prices. *Quarterly Journal of Economics* 118 (1): 107-155.

Govindarajan, V. & Gupta A. (1985). Linking Control Systems to Business Unit Strategy: Impact on Performance. *Accounting, Organization and Society*, 51- 66.

Grant, R.,M. (1996). Toward a knowledge-based theory of the firm, *Strategic Management Journal,* 17(6), 109-22.

Gruszczynski, M. (2006) Corporate Governance and Financial Performance of Companies in Poland. *International Advances in Economic Research,* 12: 251–259. DOI: 10.1007/s11294-

Hayes, R., Dassen, R., Schilder, A. & Wallage, P. (2005). *Principles of Auditing. An Introduction to International Standards of Auditing*. Pearson Education Publisher.

Haynes. P. (2000). Human resources, service quality and performance, A case study. *International Journal of contemporary Hospitality management*, 12(4240- 148.

Jensen, M. C., & Meckling, W. H. (2019). Theory of the firm: Managerial behavior, agency costs and ownership structure. In *Corporate Governance* (pp. 77-132). Gower.

Kalyango,D.L.(2005). *Uganda's Experience with Tiered Banking Regulation*. Bank of Uganda, Seminar Paper.

Kamukama, N., Ahiauzu, A., and Ntayi, J. (2010) Intellectual capital and performance: testing interactioneffects, *Journal of Intellectual Capital*, Vol.11 No. 4, pp.554-574.

Kaawaase, T. K., Nairuba, C., Akankunda, B., & Bananuka, J. (2021). Corporate governance, internal audit quality and financial reporting quality of financial institutions. *Asian Journal of Accounting Research*, 6(3), 348-366.

Key, S. (1999). Toward a new theory of the firm: a critique of stakeholder "theory". *Management decision*.

Khan, M. A., & Rahaman, M. A. (2007). *Impact of microfinance on living standards, empowerment and poverty alleviation of poor people: a case study on microfinance in the Chittagong District of Bangladesh*. https://www.diva-portal.org/smash/record.jsf?pid=diva2:141240

Khrawish, H.A. (2011). Determinants of Commercial Banks Performance: Evidence from Jordan. *International Research Journal of Finance and Economics*, 5(5), 19-45.

Kraemer, H. C. (1994). Special methodological problems of childhood developmental follow up studies: Focus on planning. In S. L. Friedman & H. C. Haywood (eds.), *Developmental follow-up: Concepts, domains, and methods* (p. 259–76). San Diego, CA: Academic Press.

Krejcie, P., Morgan, D.W. (1970), "Determining sample size for research activities", *Educational and Psychological Measurement*, Vol. 30 No.3, pp.607-10.

Kule, J. B. M., Kamukama, N., & Kijjambu, F. N. (2022). The Mediating Role of Financial Accountability in the Relationship between Internal Control Environment and Financial Performance of Savings and Credit Cooperatives in Mid-Western Uganda. *American Journal of Accounting*, 4(1), 39-49.

Manderlier, A., Bacq, S., Giacomin, O., & Janssen, F. (2009) *The impact of South Asian Microfinance institutions corporate governance mechanisms on their social and financial performance: an exploratory study*. CRECIS Center for Research in Entrepreneurial Change & Innovative Strategies.

Michael A. Hitt, Robert E. Hoskisson, Richard A. Johnson, Douglas D. Moesel. (1996). *Market for Corporate Control and Firm Innovation*. The Market for Corporate Control and Firm Innovation.

Ngoma, M. (2009). *Internationalization of services in less developed countries*. Unpublished Doctoral Thesis, Makerere University Kampala, Uganda.

Ntoumanis, N. (2001). A self-determination approach to the understanding of motivation in physical education, *British Journal of Educational Psychology*, 4 (2), 234 -245.

Oxelheim, L., & Randoy, T. (2003) The impact of foreign board membership on firm value. J*ournal of Banking and Finance* 27: 2369-2392.

PekChen. G (2005). Intellectual Capital Performance of Commercial Banks in Malaysia, *Journal of Intellectual capital*, 6(3), 385-396.

Pitt,L., Cruana, A., and Berthon, P.R.(1996). Market orientation and Business performance: some European evidence, *International marketing Review,* 13(1), 5 – 18.

Sunday Arthur, Abanis Turyahebwa, Derrick Ssekajugo, Mabonga Eric (2018). Internal Control System and Financial Performance of Microfinance Institutions in Central Region-Uganda. *International Journal of Research*. https://

journals.pen2print.org/index.php/ijr/article/view/14144

Teece,D.J., Pison, G. & Shuen, A. (1997). Dynamic Capability and Strategic management. *Strategic Journal*, 18(7), 509 – 533.

Tovstiga, G. Tulugurova, E. (2009). Intellectual capital practices: a four- region comparative study, *Journal of Intellectual Capital*, 10(1), 70-80.

Wintoki, B. M., Linck, J. S., & Netter, J. M. (2009) *Endogeneity and the Dynamics of Corporate Governance*. European Summer Symposium in Financial Markets, Study Center Gerzensee.

Woolcock, M. J. V. (1999). Learning from failures in microfinance: What unsuccessful cases tell us how group based programs work. *American Journal of Economics and Sociology*, 58(1), 17–42.

Yamane, T. (1973), *Statistics: An Introductory Analysis*, 3rd ed., Harper and Row, New York, NY.

Zhao, H., Sinha, A. P., & Ge, W. (2009). Effects of feature construction on classification performance: An empirical study in bank failure prediction. *Expert Systems with Applications*, 36(2 PART 2), 2633-2644. https://doi.org/10.1016/j.eswa.2008.01.053