INTEREST RATES AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS IN UGANDA

A CASE OF STANBIC BANK MASAKA BRANCH

BY:

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Declaration

I **Kasibante Rodgers** declare to the best of my knowledge and capacity that the work presented in this report is original unless otherwise acknowledged. It has never been submitted before to any institution either partially or in total for any academic award or publication or otherwise.

Signature: …………………………………….

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Date…………………………

Approval

This research under the title "Interest Rates and Financial Performance of Commercial Banks in Uganda" A case of Stanbic Bank Masaka City branch is hereby submitted for examination with my approval.

Signature:

Date: 20/09/2021

Name of the supervisor:

Mr. Anthony Agume

Dedication

I dedicate this piece of work to my dear parents Mr. & Mrs. Mukwaya John Baptist. My dearest brother Rev Sem. Morris Kayanja, my lovely Spiritual Mothers Sr. Harriet and Sr. Suzan who are so much concerned about my health during my career pursuit, My Friends who have laid an assistance towards my successful completion of my work. Mr Batiibwe Julius, Kato Tonny, Mrs. Akankwasa Eunice, (RIP) Fr. Mukalazi John Mary and Letitia for the spiritual, financial and moral support given to me that has enriched my work and kept me determined to this time of my life.

May the almighty God bless you!

Acknowledgement

I thank Almighty God for guiding me throughout my life for without Him I would not have come this far.

My special thanks go to my supervisor, Mr. Anthony Agume, for providing unlimited, invaluable and active guidance throughout the study. His immense command and knowledge of the subject matter enabled me to shape this research project to the product that it is now.

I also thank my family for letting me use their valuable time to work on this project. Finally, I owe my gratitude to a number of people who in one way or another contributed towards completion of this project especially my fellow colleagues at work and students.

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Abbreviations

BOU: Bank of Uganda

Abstract

The study was undertaken to examine the effect of interest rates and financial performance of commercial banks in Uganda. It was guided by the following objectives namely; to determine the relationship between the interest rates and performance of commercial banks in Uganda, to assess the interest rates variations on the financial performance of commercial banks in Uganda, to determine how the rise of interest rates affect commercial banks in Uganda. The study was guided by three theories that is Keynes's liquidity preference theory which states that the supply of money is determined by the monetary authority (the central bank) by the tending of commercial banks and by the public preference for holding cash (were, kamau, sichei, kiptu 2013). Micro economic theory which assumes that growing the money supply in excess of real growth causes interest rates to rise. This is also a result from the Harberger, (1963) model, the Schumpeter economic theory which calls those fluctuations/cyclical processes in economic life business cycle. Schumpeter shows the intermediary role of financial sector between those who save and invest through a process referred to as credit creation by bank financing that leads to economic growth and development. The study was guided by stratified random sampling case study research design. The researcher used simple random sampling for the employees of Stanbic Masaka Branch. The researcher selected 44 participants as the sample for the study. The study found but that, there is a positive and moderate linear relationship between financial performance and interest rates charged by commercial bank. The study supports the dynamic and constant update of the credit policy guidelines it also found out that proper management of working capital management components helps in reducing the liquidity risk of the firm and this highly contributes in reducing the liquidity risk of the firm and thus mitigating financial losses that might be attributed to lack of finances to take advantage of profitable investments.

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CHAPTER ONE

INTRODUCTION

1.0 Introduction

The study focuses on the Interest Rates and Financial Performance of Commercial Banks Uganda. This chapter basically focuses on the background of the study, research problem, specific objectives, research questions, the scope of the study, significances of the study and the conceptual framework.

1.1 Background of the Study

Commercial banks play a major role in the economy through their economic role of financial intermediation that performs both a brokerage and a risk transformation function (Hara, 1983). Commercial banks are financial intermediaries that mobilize savings from surplus economic units to deficit economic units. They are also special financial intermediaries that mobilize funds between depositors and borrowers participating in an economy. How well they perform this intermediary function has direct linkage with banks profitability and economic health of a nation. Profitability of banks has relationships with growth and development of an economy (Wainaina, 2013).

The banking industry has been facing numerous lending challenges. The explanation for this from a global context elicits varied reasons. Mulei (2003) points out that, this challenge arises because of paucity of skills required to determine the soundness of security valuation and the validity of legal charges associated with loan collateral while (Berger,1995) alleges that, the evolution of the banking industry has presented both challenges and opportunities for commercial banking institutions. Association of profitable organization is a dream of every individual, enterprise and government.

Determinants of banks profitability in one continent are different from another continent

(Yuqi, 2008)

The performance of commercial banks can be affected by internal and external factors which can be classified into bank specific (internal) and external factors. The internal factors are individual bank characteristics which affect the bank's performance, these factors are basically influenced by the internal decisions of management and board. The external factors are sector wide or country wide factors which are beyond the control of the company and affect the profitability of banks (Ongore, 2013). This study will focus on the effect of interest rates on the profitability of commercial banks in Uganda which are beyond the control of the banks. In order to survive in the long run, it is important for a bank to find out what are the determinants of profitability so that it can take initiatives to increase its profitability by managing the dominant determinants. Bank performance is also vitally important for all stake holders, such as the owners, the investors, the debtors, the creditors, depositors, bank managers, regulators and the government. The performance of banks gives directions to the stake holders in their decision making (Panayiotis, Athanasoglou, Delis and Staikouras, 2006).

1.1.1 Interest Rates Background

Although it is difficult to prove the direction of the relationship between interest rates and profitability, interest rates instability generally has an effect with financial performance of commercial Banks. High interest rates will lead to increased commercial banks interest income but also lead to low demand for the loans and hence crowding out the increased interest income. Without interest rates stability, domestic and foreign investors will stay away and resources will be diverted elsewhere. In fact, econometric evidence of investment behavior indicates that in addition to conventional factors (past growth of economic activity, real interest rates, and private sector credit), private investment is significantly and negatively influenced by uncertainty and

macroeconomic instability (Sayedi, 2013). In addition to low (and sometimes even negative) growth rates, other aspects of macroeconomic instability can place a heavy burden on the commercial banks leading to reduced profitability (Gilchris, 2013).

Chen, Roll and Ross (1986) maintains that these macroeconomic factors are significant in explaining firm performance (profitability) and subsequent returns to investors. Simon (1997) found that exchange rate and current account have direct and positive relationship with inflation and both exchange rate and current account are the key factors that badly affect the small economies. Herrero (2003) points out that deteriorating local economic condition for instance low GDP, inflation, interest and exchange rate cause bank failure.

In conclusion, interest rate volatility is expected to affect financial performance of commercial banks whose role in an economy is the economic resource allocation where they channel funds from depositors to investors. Banks can only perform this vital role, if they generate necessary income to cover their operational cost they incur in the due course. Although it is difficult to prove the direction of the relationship between interest rates and profitability, studies confirm that interest rates instability has generally been associated with poor commercial banks financial performance in elastic loan markets since high interest rates reduces the demand for loans (Gilchris, 2013).

Interest rate is the price a borrower pays for the use of money they borrow from a lender/financial institutions or fee paid on borrowed assets. Interest can be thought of as "rent of money". Interest rates are fundamental to a capitalistic society and are normally expressed as a percentage rate over the period of one year (Sayedi, 2013). Interest rate as a price of money reflects market information regarding expected change in the purchasing power of money or future inflation Interest rates are derived from macroeconomic factors which is the study of the behavior of the

economy as a whole such as total output, income, employment levels and the interrelationship among diverse economic sectors (Karl, Ray, and Shannon, 2009). These macro-economic factors include economic growth captured by gross domestic product (GDP), interest rates, exchange rates and inflation rates. Interest rates are worsened by regulations imposed on banks. The effect of macroeconomic factors in other sectors of the economy will always affect the banking sector and what goes on in the banking sector will affect the other sectors of the economy (Wainaina, 2013).

Inflation and inflationary expectations can press interest rate upward which affects lending terms resulting to reduced credit demand and lending ability of commercial banks (Keynes, 2006). Exchange rates affect interest rates and have an indirect impact on profitability through cost of loan able funds. High exchange rates lead to increased value commercial banks get from selling foreign currency that result to increased profitability. Studies have found positive relationship between exchange rate and bank loan loss. It may reflect how fluctuation and volatile exchange contribute to the debt profile of banks and reduce the profit level of borrowers (Owoeye, and Ogunmakin, 2013; Macharia, 2013). GDP is the measure of economic activity of a country. Increased economic activities increase the demand for loan able funds which in turn drives up the exchange rates. Decline in GDP result to reduced interest rates and fall in profitability of commercial banks and asset prices, leading to non-performing loans, lowers borrower's financial capacity and depresses the value of collaterals as secondary means of servicing debts (Wainaina, 2013).

Commercial banks' main role in an economy is the economic resource allocation. They channel funds from depositors to investors continuously. They can only perform this vital role, if they generate necessary income to cover their operational cost they incur in the due course. In other

words, for sustainable intermediation function, banks need to be profitable. Beyond the intermediation function, the financial performance of banks has critical implications for economic growth of countries. Good financial performance rewards the shareholders for their investment. This, in turn, encourages additional investment and brings about economic growth. On the other hand, poor banking performance can lead to banking failure and crisis which have negative repercussions on the economic growth (Panayiotis *et al*., 2006).

Financial performance on the other hand is a measure of the change in financial state of an organization or the financial outcomes that results from management decisions and the execution of those decisions by members of the organization. Its outcomes are not universal in nature but largely depend on the organizational context hence selection of the measures that represent performance of a particular organization is done based upon the circumstances of the organization being rated. Financial performance is commonly measured by ratios such as return on equity, return on assets, return on capital, return on sales and operating margin (Gilchris, 2013).

Financial performance analysis of commercial banks has been of great interest to academic research since the Great Depression of 1940's. In the last two decades studies have shown that commercial banks in Sub-Saharan Africa are more profitable than the rest of the world with an average Return on Assets (ROA) of 2 percent. One of the major reasons behind high return in the region was investment in risky ventures. The other possible reason for the high profitability in commercial banking business in sub-Saharan Africa is the existence of huge gap between the demand for bank service and the supply thereof. That means, in Sub-Sahara Africa the number of banks is few compared to the demand for the services; as a result, there is less competition and banks charge high interest rates. This is especially true in East Africa where the few governments owned banks take the lion's share of the market (Flamini et al., 2009).

The performance of commercial banks can be affected by internal and external factors (Al-Tamimi, v 2010; Aburime, 2005). These factors can be classified into bank specific (internal) and macroeconomic variables. The internal factors are individual bank characteristics which affect the bank's performance. These factors are basically influenced by the internal decisions of management and board. The external factors are sector wide or country wide factors which are beyond the control of the company and affect the profitability of banks. Studies show that performance of firms can also be influenced by ownership identity (Ongore, 2011).

The banking sector is the single sector highly affected by key macroeconomic variables which include interest rates, inflation and Economic growth measured by GDP and therefore, their financial performance will mostly depend on macroeconomic stability.

Macroeconomic stability is the cornerstone of any successful effort to increase private sector development and economic growth. Cross-country regressions using a large sample of countries suggest that growth, investment, and productivity are positively correlated with macroeconomic stability (Easterly, Islam, and Stiglitz, 1999).

1.2 Research Problem

Interest rate volatility has negative impact on the financial performance of commercial banks posing challenge to commercial banks managers in their core function of credit management and profitability (Baum, Mustafa, and Neslihan, 2009). The volatility on interest rates is blamed on poor macroeconomic policies which include excessive government spending, high inflation, and overvalued exchange rates.

Interest rates in Uganda have been fluctuating over the last few years with the effect of fluctuations remaining unknown (Otuori, 2013). The latest interest rates volatility was the motivation behind this study as there was little information about effect of same on commercial banks' financial performance in Uganda. In addition, there is insufficient empirical evidence that commercial banks financial performance is hindered by interest rates volatility and poor macroeconomic variables at large. In addition, commercial banks' profitability for most of the Sub-Sahara African countries has been about 2 percent over the last 10 years which is higher than that of commercial banks in developed countries (Al-Tamimi and Hassan, 2010). A major research question is why commercial banks profitability has remained high irrespective of the unfavorable interest rates environment.

The need for this study is further supported by the fact that most studies conducted in relation to bank performances in Uganda has focused on sector-specific factors that affect the overall banking sector performances or determinant of bank performance with no study focusing on interest rates and commercial banks financial performance. Macharia (2013) studied the effects of global financial crisis on the financial performance of commercial banks offering mortgage finance in Uganda where interest rates and inflation were found to have negative effect on performance while positive effect with exchange rates. Wainaina (2013) studied the effect of macroeconomic factors on commercial banks lending to agricultural sector in Uganda and found

that increase in interest rate affected the amount of credit provided by the commercial banks. Mbok. (2013) studied the effects of macroeconomic variables on non-performing loans of commercial banks in Uganda and found a strong correlation between interest rates and bank profitability.

1.3.0. Objective of the Study

1.3.1. General objective

- To determine the effect of interest rates on financial performance of commercial banks in Uganda.

1.3.2 Specific objectives

- To determine the relationship between the interest rates and financial performance of commercial banks in Uganda
- To assess the interest rate variations on the financial performance of commercial banks in Uganda
- To determine how the raise of interest rates affect commercial Banks in Uganda.

1.4 Research Questions

- What is the effect ofinterest rate variations on the financial performance of commercial banks in Uganda?
- What is the relationship between the Bank interest rates and financial performance of Stanbic Bank in Masaka City?
- How does the raise of interest rates affect commercial Banks in Uganda?

1.6.1 Content scope

The subject of the study was to examine the role of Bank interest rates on financial performance of commercial banks. Although there are various determinants of financial performance like profitability, liquidity and solvency, the study was specifically to concentrate on Return on Assets on Equity, profit margin as the major determinants of the performance because these are popularly used by commercial banks. However, the bank has some other branches in different parts of the Country like in Kampala, Mbarara, Wakiso, Mubende and so many others. Although Stanbic is made up of several departments like the marketing department, Human resource, Loans department, The study was carried out in Accounts Department since it is the one in line with the research which is more concerned with books of accounts, preparation of the financial statements which shows financial position of the Bank branch hence enabling me to attain needed information.

1.6.2 Geographical scope

The study was conducted in Stanbic Bank located in Masaka City - Uganda. And it is 15kms away from Mbarara Highway. The study was confined mainly Stanbic Bank. Since it is one of the major commercial banks in Masaka town,

1.6.3 Time scope

The study covered a period of two years from 2019-2020. This time frame was sufficient to generate adequate analysis on how Bank interest rates have been used in financial performance measurement, and relate with performance of commercial banks in financial institutions.

1.7 Significance of the study

The research will be beneficial to the commercial Bank executives since it can be relied on to determine the weaknesses on bank's performance and how, when to modify in the services, still the information can be relied on in future.

- The study presented the terms of academic contributions and practical use that might be made of the findings to the organization on which the researcher based on and the public at large.
- It is important for investors and potential policy holders to know the financial position of their commercial bank and the factors which could be affecting it. This would enable them to make the right decisions at the right time and cut their losses. It is therefore hoped that this study would shed some light regarding financial decisions.
- On the side of policy holders, the findings of this study are hoped to give them a better understanding why some commercial banks work hard against paying claims. Based on this, they can understand that it is imperative to consider the financial position of a commercial bank before they buy policies, to establish the commercial banks which are viable and the ones which are not.
- On academic perspective the study was added on to the available literature on factors that determine the financial performance of commercial banks and hence might shed some light to any interested research in future.

1.8 Justification of the study

This study gave the rationale of the study where it can be methodological, problem justification. The need for this study was supported by the fact that most studies conducted in relation to commercial banks in Uganda has focused on microeconomic factors that affect the overall commercial bank industry in performance, with no specific studies focusing on commercial

bank's interest rates and commercial bank financial performance (Matovu, 2014). Wamala (2013) studies the effect of macroeconomic factors on commercial bank in Uganda and found that increase in interest rate affected the amount of premium collected by the commercial bank. Mboka (2013) also studied the effects of macroeconomic variables on commercial bank industry in Uganda and found a strong correlation between interest rates and commercial bank profitability.

None of these studies examined the effect of Commercial Banks' interest rates on commercial banks' financial performance yet interest rates on commercial banks' financial performance and hence bridge the knowledge gap that existed in literature. It answers the question, what is the effect of commercial banks' interest rates on financial performance of commercial banks?
In addition to the above, the study was carried out by the researcher as partial fulfillment of the requirement for the award of the Bachelors degree of Business Administration and Management of Uganda Martyrs University.

1.8.1 Operational definitions

Inflation, this is the result of excess aggregate demand over the aggregate supply and the true inflation starts after full employment. (Business topia, January 2018)

Economic productivity, this is the ratio between the output volume and inputs.

Economic growth, this refers to an increase in the amount of goods and services produced per head of the population over a period of time.

Returns on Assets refers to a profitability ratio that provides how much profit a company is able to generate from its assets.

Liquidity, liquidity is described as the degree to which an asset or security can be quickly bought or sold in the market at a price reflecting its intrinsic value, cash is universally considered the most liquidity asset. (James, 1958)

Net profit, this is what is left after all the costs have been made from its sales.

Company policies & regulations, these are procedures that are put in place to protect the rights of worker as well as the business interests of employers.

Monetary policies, these are policies that are adopted by the monetary authority of the country that controls either the interest rate payable on a very short-term borrowing or the money supply, often targeting inflation or the interest rate to ensure price stability and general trust in the currency.

1.9 Conceptual Framework

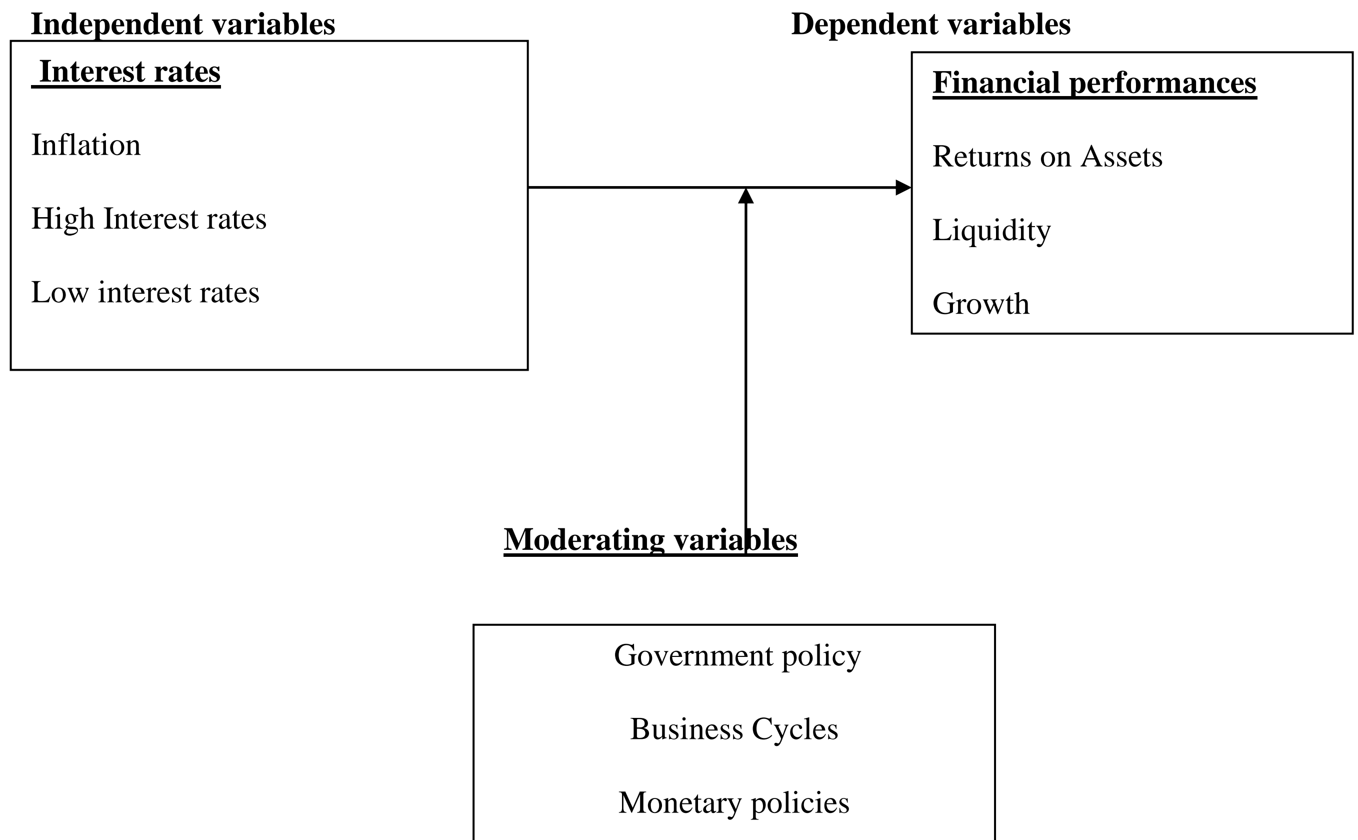
The framework indicated the independent variables, dependent variables and intervening variables.

So, in this case the conceptual framework below demonstrated the relationship between banks 'interest rates and financial performance of commercial banks. It indicated Bank interest rates as an independent Variable and Financial performance as dependent variables. It also demonstrated the moderating factors that may influence the outcome from the relationship between interest rates and financial performance of commercial banks. These are perceived as, Company policies, regulations and Business cycles. (Thordsen S. and Nathan S, 1999).

1.9.1 Conceptual framework

Figure 1: Conceptual framework

The study was conceptualized as follows.



Source: (Guildford, 2002)

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

This chapter focuses on theoretical, empirical literature, review of the local literature and ends by a chapter conclusion.

2.1 Theoretical review.

These theories were included; Schumpeter economic cycle theory, Keynesian liquidity preference theory and macroeconomic theory.

2.1.1 Schumpeter Economic Cycle Theory

The theory was propounded by Schumpeter (1939) who indicated the process of economic change or evolution that consists of two distinct phases, "prosperity" and "recession". One under which the impulse of entrepreneurial activity, draws away from an equilibrium position, and the second of which it draws toward another equilibrium position. Schumpeter calls those fluctuations/cyclical processes in economic life business cycle. Schumpeter shows the intermediary role of financial sector between those who save and invest, through a process referred to as credit creation by bank financing that leads to economic growth and development. The effect of this process leads to profit and loss generation by the lender and the borrower.

Certain macroeconomic variables typically display unique pattern of boom and recession in a business cycle. A crisis is said to occur at the peak of expansion when growth in real GDP and domestic demand decline leading to acceleration in inflation. During periods of economic expansion, firms and their respective sectors profits increases, asset prices rises aggregate sector demand for credit facilities expands leading to growth in bank lending resulting to increased interest income. Banks may underestimate their risk exposures, relaxing credit standards and

reduce provisions for future losses while the economy Indebtedness rises. As the down turn sets in individuals, firms and sector profitability Deteriorate. (Bikker and Hu, 2002).

The theory assumes that recessions and periods of economic growth are efficient response to exogenous changes in the real economic environment and that decline in profitability result in fall of asset prices, non-performing loans, lowers borrowers' financial capacity, and fall in employment levels, and depresses the value of collaterals as secondary means of servicing debts. Banks' risk exposure increases, and consequently raises the need for larger loan provisions and higher levels of capital, exactly when it is more expensive or simply not available. This may lead to banks reacting by reducing the amount of lending, especially if they have low capital buffers above the minimum capital requirement, thus increasing the effects of the economic downturn as well as increasing the lending rates.

Critics of the theory states that it is a common misconception that macroeconomic purely based on shocks to supply, as opposed to shocks on demand, and this leads to the common criticism of Schumpeter economic cycle theory by ignoring the demand side of the economy. However, in real business cycles situation, consumers will change their intertemporal consumption and savings decisions based on the real interest rate available to them, which is a shift in demand.

In relation to the study, the theory views interest rates change as normal economic occurrences which will affect commercial banks performance. It disregards the argument that interest rates are determined by the liquidity in the economy but are determined by the prevailing macroeconomic environment as determined by the business cycles. Hence, according to the theory, interest rates will keep on changing according to the prevailing macro-economic conditions.

2.1.2 Keynes's Liquidity Preference Theory

The theory was advanced by Keynes (2006). According to the liquidity preference theory, the interest rates are determined by the demand for and supply of money balances. The theory

assumes that people's demand for money is not for transactions purpose but as a precaution and for speculative purposes. The transaction demand and precautionary demand for money increase with income, while the speculative demand is inversely related to interest rates because of the forgone interest. The supply of money is determined by the monetary authority (the central bank), by the lending of commercial banks and by the public preference for holding cash (Were, Kamau, Sichei, Kiptui, 2013).

Therefore, interest rates are expected to increase as the maturity profile of securities Increase
This is so because the longer the maturity, the greater is the uncertainty; and therefore, the premium demanded by investors to part with cash increases as the maturity profile increases. The expectation, therefore, is that forward exchange rates should offer a premium over expected future spot exchange rates since those who are risk-averse demand a premium for securities with longer-term maturities. A premium is offered by way of greater forward rates in order to attract investors to longer-term securities.

Consequently, current interest rates reflect expected inflation rates, income (GDP) and expected money supply changes (Were *et al*., 2013).

Critics of this theory argue that the liquidity preference theory of interest suffers from a fallacy of mutual determination. Keynes alleges that the rate of interest is determined by liquidity preference. In practice, however, Keynes treats the rate of interest as determining liquidity preference. The critics state that "The Keynesians therefore treat the rate of interest, not as they believe them do- as determined by liquidity preference- but rather as some sort of mysterious and unexplained force imposing itself on the other elements of the economic system (Were *et al*., 2013).

In relevance to the study, the theory views interest rates as being mainly driven by the liquidity level in the economy. The theory does not recognize the role of macroeconomic policies formulated by the central bank but interest rates are purely driven by the demand of money in the economy. Therefore, interest rates will go up and down according to the level of liquidity in the economy and preference for the liquidity by the users of funds.

2.1.3 Macroeconomic Theory

The theory was proposed by Friedman, (1963). The theory views interest rates as always and everywhere a monetary phenomenon (Friedman, 1963). Further, macroeconomic theory assumes that growing the money supply in excess of real growth causes interest rates to rise. This is also the result from the Harberger, (1963) model, which assumes that prices adjust to excess money supply in the money market. It is on the basis of this assumption that it is possible to invert the real money demand and control interest rates.

Interest rates volatility in open economies results from different disequilibria in many markets specifically, the domestic money market, external/foreign markets and the labor market. Thus, increase in interest rates emanates from three main sources that include excess money supply, foreign prices and cost push factors (Were et al., 2013). The theory is related to keysian liquidity preference theory but recognizes additional sources of interest rates not only demand for money but also foreign prices and cost push factors.

Critics of this theory base their argument on the grounds that governments would in practice be unlikely to implement theoretically optimal policies. According to them, the implicit assumption underlying the macroeconomic revolution was that economic policy would be made by wise men, acting without regard to political pressures or opportunities, and guided by disinterested economic technocrats. They argued that this was an unrealistic assumption about political, bureaucratic and electoral behavior.

In relevance to the study, macroeconomic theory views growing money supply in excess of real growth as the cause of interest rates to rise. Interest rate volatility is seen by the theory as emanating from three main sources that include excess money supply, foreign prices and cost push factors. Interest rates volatility will also result from different dis18 equilibrium in many markets specifically, the domestic money market, external/foreign markets and the labor market. Hence controlling interest rates volatility will involve dealing with disequilibrium in the markets.

2.1.4 Determinants of Commercial Banks Profitability

Determinants of bank profitability can be internal or external. Internal determinants of banks financial performance normally consist of factors that are within the control of commercial banks. Gilchris S. (2013). they are the factors which affect the revenue and the cost of the banks. Some studies classified them into two categories namely the financial statement variables and non-financial variables. External factors are said to be the factors that are beyond the control of the management of commercial banks. The external determinants of commercial banks profitability are indirect factors, which are uncontrollable. (Asimakopoulos, I.et al, 2009)

2.2 Conceptual review.

2.2.1The concept of the interest rates

According to Michael p. Todaro (1992), interest rates is the amount the borrower must pay to the lender over and above the total borrowed expressed as the percentage of the total amount of the funds borrowed. ACCA (2003), explained the interest rates as a measure of the cost for the borrowing. Bank interest rates are rewards expected by the lenders (bank) for the period the borrower spends using the borrowed funds. It is the time value of money for the funds granted to borrowers in a specific period of time.

2.2.0 Interest rates

Interest rates instability generally has been associated with poor financial performance of commercial Banks. Without interest rates stability, domestic and foreign investors will stay away and resources will be diverted elsewhere. In fact, econometric evidence of investment behavior indicates that in addition to conventional factors (past growth of economic activity, real interest rates, and private sector credit), private investment is significantly and negatively influenced by uncertainty and macroeconomic instability (Sayedi, 2013). Although it is difficult to prove the direction of the relationship between interest rates and profitability, studies confirm that interest rates instability affects commercial banks financial performance with studies giving contradicting findings (Gilchris, 2013).

2.2.1 Types of the interest

David C. (1990) categorizes the interest rate as the bank base rates, personal loan rates, deposit rate, interbank interest rates, house purchase loan rates and the overall level of interest rate**s** while **Wikipedia A**rticles (2007) categorized interest rates as simple interest rates, compound, cumulativeand real interest rates.

According to APPS (1991), interest rates are regarded as purely monetary phenomenon, a payment for the use of money. The possession of the actual money wills our disquietude and the premium which we require to make us part with the money is the measure of the degree of our disquietude. By the way of contract, this theory emphasizes the supply and demand for money, arguing that it is the interaction of variables which determines the interest rates. It stated that the classical theory focuses on what might be termed as the economic variables and argues that the level of real interest rates is determined by the level of savings. And the level of investment in the capital equipment (which provides the demand for the loan able funds). This theory dismisses the

relevance for the money, arguing that its use is to merely determine the absolute price level and does not influence the interest rate.

2.2.2 Factors that determine changes in the general level of interest rates.

When lenders or investors are uncertain about the future interest rates, they may wish to hedge their belts (**Robert L.H**, **1969**). This introduces new dimensions into the interest rates calculations and gives rise to the term structure of the interest rates while **APPS (1991**) noted that the inflationary policies and the related monetary policies would often bring about an increase or the fall in the general level of the interest rates.

2.3 Actual review

Under this study, the researcher looks at objective by objective.

2.3.2 The relationship between bank interest rates and liquidity.

If the difference between the amount of sensitive assets and liabilities in each currency is negative, there was an interest rate risk arising from the risk of liquidity shortage within the interval is positive, then the loss of interest rates results in bank loss.

According to Berrios, (2013) short term interest rate or Money marker interest rates include the Treasury bill rate. As a short-term interest rate increases and since it has less default risk, banks tend to invest more in Treasury bill and other short-term instruments and enhance their liquidity position. Treasury bill is considered as liquid asset according to the NBE. A Treasury Bill (TB) is a short-term money market instrument which is issued by the government. The TB rate is the discount at which the Treasury bill is issued (Michael, 2010). The TB rate is no stated on the bill itself, but like interest rates on bonds, has an inverse relationship to its price. TBs serve as a benchmark indicator of money market conditions and act as a reference rate for the calculation of interest rate on many other money market assets (Clementi, 2011). Treasury bill market is the

only regular primary market where securities are transacted on a fortnightly basis. Therefore, the proxy for short term/money market interest rate in this study will be the weighted average yield on all types of Treasury bill annually (28 days, 91 days and 182 days). The annual rate will be used due to the form of data used in this study (i.e. annual base).

Rajan (2011) says that interest rate is the price that has to be paid by a borrower of money to a lender of money in return for the use of the funds. Short term/money market interest rate is the rate paid on money market instruments. Money market instruments are securities that when issued have a year of less to maturity, which includes Treasury bills, commercial papers, bankers' acceptances, certificates of deposit, repurchase agreements and Eurocurrency deposits (Diamond and Rajan, 2005). Treasury bills are the most important since they provide the basis for all domestic short term interest rates. The money market is important because many of these instruments are held by bans as part of their eligible reserves, that is, they may be used (are eligible) as collateral if bank wishes to raise funds from central bank because they are short maturing and have less default risk. Therefore, the higher short term interest rate induces banks to invest more in the short-term instruments and enhance their liquidity position. According to the Falconer, (2011) investments in the Treasury bill are considered as liquid assets to the banks

2.3.3. Interest rate variations on the financial performance of commercial banks

From the theoretical background given, one point stands out, interest rates. From the first indicator, which is operating income, interest rate is the highest determinant of the operating income of a bank in a given year. A similar trend is also observed when it comes to the operating expenses, where again the expenses of running the bank are majorly determined by the interest rates. Subsequent indicators are all determined by these two indicators; therefore, interest rates generally determined a bank's financial performance.

However, to completely understand how the interest rates affect a bank's financial performance, we need to highlight the two key principles of interest rates that affect a bank. First, all banks make a profit from the difference between the lending rates given to the borrowers and the deposit it rates given to the customer making deposits into the banks. This always results in a lending spread that falls when the yield curve flattens (Genay, 2014). Secondly, higher interest rate decreases the present discounted value of the assets. This is because banks hold onto fixed income assets e.g. loans and bonds. Furthermore, banks face bigger losses when the duration of their assets increases relative to that of the liabilities (King, 2015).

The Empirical relationship between interest rates and financial performance of commercial banks has been confirmed in various studies previously undertaken. Sattare and Khan (2014) in their study concluded that interest rates considerably affect the bank's interest income. They further proved that banks' income is related to interest rates that shows that the financial performance of commercial banks and the interest rates offered to investors cannot be separated.

Another study by Okoye & Onyekachi, (2013) supports the relationship between interest rates and bank financial performance and go further to conclude that the two are intertwined and hence the significant relationship.

2.3.4. How the raise of interest rates affects commercial Banks

One factor that influences the level of interest rates in Uganda is the actions of the Central Bank of Uganda (BoU). In trying to avoid massive swings in the business cycle, the BoU will adjust short-term interest rates. It raises interest rates to slow down an economy that is expanding too rapidly and lowers them when the economy is heading for a recession. Rising and falling interest rates will directly affect consumer and personal financial decisions. Rising interest rates make saving relatively more attractive and borrowing relatively more expensive. Falling interest rates

have the opposite effect. Consequently, the effect of an interest rate rise or fall will depend on whether you are a saver or a borrower. Gilchris S. (2013):

2.3.5 The effect of interest rates on profitability.

When an interest rate rise, profitability on loans also increases, as there is a greater spread between the federal funds rate and the bank charges its customers. It reflects the strong underlying conditions and inflationary pressures that tend to prompt an increase in interest rates.

2.4 Conclusion.

The findings were supported by Wensheng et al, (2003) who concluded that a change in the domestic interest rate along with the US interest rate had little impact on the margin in the period under study. Ashim & Ranjula, (2013) also pointed out that high interest improves profitability, reduce compensation rates and lead to mission drift. The study therefore found out the effect of interest rates on financial performance of commercial bank in Masaka. Therefore, there was a gap in literature regarding the effect of interest rates on commercial bank's financial performance hence the study bridged this gap.

CHAPTER THREE

METHODOLOGY

3.0 Introduction

This chapter describes the methodology that was used in the study, research design, area and population of the study, sample size, sample selection technique, sources of data collection instruments, data quality control, study variables, data analysis and interpretation, measurement of study variables, procedure of the study, data processing, presentation of the research findings and limitation of the study.

3.1 Research Design

According to Kothari (2003), research design refers to the arrangement of conditions for collection and analysis of data in a manner that aims to combine reliance purpose with economy in procedure. The researcher used a cross sectional descriptive study design focusing on the use of quantitative and qualitative techniques, which were chosen as appropriate since it sought to document the relationship between Internal financial control and performance of NGOS. The descriptive design also allowed the in-depth investigation of the study problem and was considered cost effective in terms of cost, time and amount of data collected, according to Marshal and Roman (1990). Qualitative data was generated in the study because mainly qualitative methods were used. However, some quantitative methods were used to help in interpretation and explanation of the collected data.

The research design was used for accurate estimate of relationship between the variables interest rate and financial performance. This also gave an analytical result about the situation on the ground as far as the effect of bank's interest rates on the financial performance of Stanbic bank is concerned. Quantitative methods were also used and involve with the calculation of the

correlation, frequencies and charts while Qualitative methods involved interviews and secondary data. (Mugenda & Mugenda, 1999).

3.2 Study population

The study population was 50 in total and the sample size was 44. The target population for this study was the Branch Managers, General Manager, and Accounts Department staffs of Stanbic Bank because they are involved in implementing and providing accounting information.

3.3 Sampling procedure

The study used stratified random sampling for selecting some customers for response as well as the bank staff in the sampled area. Purposive sampling was also used so as to select respondents in this case targeting Bank officials for and in charge of loan and all bank customers.

3.4 Sampling design

The desired sampling design was stratified random sampling to select respondents from selected departments because there was homogeneity within each department.

3.5 Area of Study

The study was carried out at Stanbic bank in Masaka city which is 16 kmls West of Kampala and 500ms away from Mbarara highway. During the study, the management department participates in the interview of the study.

3.6Sample size

Sample size refers to the subset of a population. The sample size for the study is 44 respondents determined using the Krejcie & Morgan (1970) mathematical table (appendix). Sampling

technique is the process of drawing a sample from a large population about which one would wish to make inferences. Further urged that a well selected sample, refers accurately the characteristics of the population.

3.6.1 Table 1: The sample size

Category	**Population**	**Sample size**	**Sample technique**
General manager's Department	20	19	Purposive
Accounts Department	25	24	Simple random sampling
Branch Manager	05	01	Purposive
Total	**50**	**44**	

Source: primary data

3.7 Data collection and methods and instruments.

The study employed open and closed structured questionnaire, secondary data analysis. It was used because it is simple to administer and less time consuming. Secondary data analysis was based on the financial reports since 2015-2019 and statements were also be used. According to Admin (2005), the triangulation of both data collection methods was helpful in the generalization and neutralizing any inherent bias. Three methods were used; questionnaires, (sekaran, 2003).

3.7.1 Questionnaires

A questionnaire is a predetermined written set of questions used to obtain data from the respondents by having the responses in writing. The researcher used questionnaires in order to gather quantitative data from both categories of respondents. Questionnaires preferred in the study because they are a convenient method since respondents gave their responses independently and secretly.

3.8 Quality Control Methods

Data quality ensured through validity and reliability.

3.8.1 Validity.

Validity refers to the degree to which accurately reflect or assess the specific concepts the researcher is attempting to measure (Fide, 1993). The types of validity include internal validity which clearly indicates the principles of cause and effects in research. External validity which clearly focuses on the effects of research that can be generalized. In this case, the researcher intends to measure the variables which are on interest rates and financial performance.

Therefore, the researcher administered the questionnaires to the randomly selected respondents to test the validity and accuracy of the instruments. The validity of the questionnaire was determined by ensuring that questions or items in it conform to the study's conceptual framework (figure)

3.8.2Reliability

According to Amin (2005) Reliability is the description of precision, constituency, repeatability and dependability with which the instrument generates the required data for the study. An instrument or method is reliable if it produces the same results whenever it is repeatedly used to measure concept or trait for the same respondents even by the other researchers. Reliability was ensured through informing the respondents the essence of the research that it is purely for academic purposes

3.9 Data Management and Processing

3.9.1 Data Analysis

Data from the field was carefully classified, edited, basing on clarity, completeness, accuracy and consistence to ensure reliability. Data analysis will base on the objectives of the study and done by use of Statistical Package for Social Sciences on collected data to draw meaningful interpretation and conclusion to give findings and suggestions.

3.10. Ethical Considerations

Through the introduction letter from the Faculty of Business Administration and Management, the researcher got an approved consent from the respondents and explained to them that the main purpose of the research was purely for academic before engaging them in the interview.

3.11. Limitations of the study

The following were highlighted as the limitations to this study; High costs to cover all the research requirements.

- Limited time in which the research was to be completed.
- Inconsistencies in information given by different respondents.
- Difficulty in data sourcing; the researcher may find difficulty in getting the right information from the selected population.

3.12 Conclusion

The above methodology used was developed from the ideas of the researcher and the ideas of different scholars. This was so because the researcher made an addition contribution to the problem that has been in existence for many years.

CHAPTER FOUR

DATA PRESENTATION, INTERPRETATION AND ANALYSIS

4.1. Introduction

This chapter presents the data gathered from the field and covers the background information of the respondents and the responses on the questions that were presented to them. The beginning part of the chapter covered the demographic details which included; the gender distribution, age distribution, level of education, time spent in the organization, work experience, job designation and size of work force in the organization. This chapter also covered the research objectives in relation to the topic of study.

4.2. Response Rate

The researcher distributed a total of 44 questionnaires. The researcher identified the respondents in good time and informed them on the intention to carry out the study. Close communication with the respondents ensured that all the questionnaires that were handed out were duly filled to the best ability of the respondents and consequently availed to the researcher to move ahead and carry out the analysis. All the questionnaires that were handed out were successfully returned. Thus, a response rate of 100 percent was achieved, and as Mugenda (2003) put it, a response rate of above 50 percent was fit to carry out statistical reporting.

4.3. Background Data

Background data includes all the demographic details that were captured for the respondents of the study. They include; gender, age, education level job designation and work experience.

4.4.1. Gender Distribution

Table 4.1 Gender distribution

Gender	Frequency	Percentage (%)
Male	24	54
Female	20	46
Total	**44**	**100**%

Source: Primary data, 2021

The study involved 44 participants and as table 4.1 shows; Male representation was about 54 % while the female participation was about 46%. These findings show that the gender representation in the microfinance institution is fairly balanced with a slight favor in the men representation. For a value of 46% against 54% is a significant achievement, especially for the fact that the microfinance institution is a vital part of the country economy.

4.4.2. Age of the respondents

Table 4.2 Age of the respondents

Age	Frequency	Percentage (%)
18-30 years	22	50
31 -40 years	20	45
41 years and above	02	5
Total	**44**	**100**%

Source: Primary data, 2021

Findings indicate that 22 (50%) were 18- 30 years, 20 (45%) were 31-40 years, 02 (5%) were above 41 years and lastly 02 (8%) were below 20 years. This indicates that respondents were mature enough to answer questions. It also shows that most of the employees employed by the bank are still energetic.

4.4.3. Highest level of education attained

Table 4.3 Level of education

Level of education	**Frequency**	**Percentage (%)**
Bachelor	21	47.0
Diploma	20	45.0
A-level	01	03.0
O-level	02	05.0
Others	00	00.0
Total	**44**	**100**%

Source: Primary data, 2021

Majority of the respondents indicated that they had attained a university degree in education, about 47%. Furthermore about, 45% of the respondents indicated that they had attained a Diploma in their education level. About 3% percent indicated that they had attained advanced level certificate. Finally, about 5% of the respondents, they indicated that they had attained an education to the ordinary level. The study makes findings that, majority of the people working in the commercial Bank are well educated with many having attained a university degree.

This is also a positive outcome as education enables people to acquire the necessarily technical skills that are needed in ensuring effectiveness in service delivery for a particular organization.

4.4.4. Marital status of the respondents

Table 4.4 Marital status

Marital status	Frequency	Percentage (%)
Single	24	55.0
Divorced	00	00
Married	20	45.0
Total	**44**	**100**%

Source: Primary data, 2021

Research findings indicate that majority 24 (55%) of respondents were single and 20 (45%) of the respondents were married and none was divorced. All the respondents irrespective of their marital status participated in the study.

4.4.5. How long have you been an employee of this organization

Table 4.5 Time spent in the organization

Time spent in the Organization	Frequency	Percentage (%)
0-5 years	20	45.0
6-10 years	15	34.0
11-15 years	5	11.0
Over 15 years	4	10.0
Total	**44**	**100**%

Source: Primary data, 2021

Majority of the respondents, about 45% of the respondents had a working experience of about 0-5years. next was about, 34% among the respondents who indicated that they had a working

experience of about 6-10 years. Further, about 11% of the respondents indicated that they had working experience of about 11-15 years. Finally, 10% of the participants indicated that they had a working experience of over 15 years. The study makes a finding that majority of the respondents indicated to have an experience enough to have exposed them to the intricacies of lending operations. Therefore, their opinions will reflect on the realities on ground from the firsthand experience.

4.4.6. Work designation of the respondents

Table 4.6 Work designation of the respondents

Work designation of Respondents	**Frequency**	**Percentage (%)**
Credit officer	25	57.0
Bank manager	01	02.0
Departmental manager	15	34.0
Other	03	07.0
Total	**44**	**100**%

Source: Primary data, 2021

The study makes a finding that an overwhelming majority of the respondents were designated asthe credit officer's staff with a participation of about 57%. Departmental managers at banks were also well represented, and were about 34% of the respondents. Further, 2% of the participants indicated that they were bank mangers. Finally, a marginal 7% of the participants indicated that they worked in different sections other than the ones pre-identified. The study was centralized on the issues of lending affairs of the commercial Bank, which is greatly dominated by credit officials. Therefore, the diversity of the participant's occupation was valuable in identifying existing relationships between lending division and other banking

departments.

4.5. The effect of interest rate on financial performance of commercial Bank

One of the study objectives sought of indicating the effect of interest rate on financial performance of commercial Bank. To this objective, data was collected and according to the study findings, the following information was reported by the respondents of STANBIC BANK.

Table 4.7 The effect of interest rate on financial performance Of Commercial Banks.

Response	Category	Frequency	Percentage (%)
Most customers are sensitive to loan interest rates	Strongly agree	20	45.0
	Agree	10	23.0
	Disagree	12	27.0
	Strongly disagree	02	05.0
	Total	**44**	**100**%
Interest rates volatility affects the profitability of our bank	Strongly agree	22	50
	Agree	12	27
	Disagree	10	23
	Strongly disagree	00	00
	Total	**44**	**100**%
Our customers are strictly based in our interest rates	Strongly agree	20	45
	Agree	12	27
	Disagree	10	23
	Strongly disagree	02	05
	Total	**44**	**100**%
Interest rates for different loan facilities affects	Strongly agree	23	52
	Agree	12	27

competitive advantage	Disagree	05	12
	Strongly disagree	04	09
	Total	**44**	**100**%
Capping interest rates has a direct impact on bank earnings	Strongly agree	24	55
	Agree	16	36
	Disagree	04	09
	Strongly disagree	00	00
	Total	**44**	**100**%
Interest rates influence the repayment rate amongst borrowers	Strongly agree	25	57
	Agree	15	33
	Disagree	02	05
	Strongly disagree	02	05
	Total	**44**	**100**%
The interest rates drive the borrowing volumes among different financial institutions.	Strongly agree	20	45
	Agree	18	41
	Disagree	04	09
	Strongly disagree	02	05
	Total	**44**	**100**%
Interest rates are continuously Reviewed in line withprevailing economic conditions.	Strongly agree	24	55
	Agree	20	45
	Disagree	00	00
	Strongly disagree	00	00
	Total	**44**	**100**%

Source: Field Data, July, 2021

According to research findings 20 (45%) of the respondents strongly agreed that many customers are sensitive to loan interest rates, 10 (23%) agreed, 05 (20%) were not sure and 02 (8%) disagreed.

Also, research findings indicate that 22 (50%) of the respondents strongly agreed that interest rate volatility affects the profitability of our bank, 12 (27%) agreed, 10(23%) disagreed with the statement.

Also, research findings indicate that 20 (45%) of the respondents strongly agreed that our customers are strictly based in our interest rates, 12 (27%) agreed, 10 (23%) disagreed, 02 (05%) strongly disagreed.

From the table above, 23 (52%) of the respondents strongly agreed that interest rates for different loan facilities affects competitive advantage, 12 (27%) agreed, and 05(12%) disagreed while04 (9%) strongly disagreed.

Research findings also indicate that 24 (55%) of the respondents strongly agreed capping interest rates has a direct impact on bank earnings, 16 (36%) agreed, 04 (9%) disagreed with the statement.

Furthermore, 25 (57%) of the respondents strongly agreed that interest rates influence the repayment rate amongst borrowers, 15 (33%) agreed, 02 (5%) disagreed and strongly disagreed respectively.

Also, research findings indicate that 20 (45%) of the respondents strongly agreed that the interest rates drive the borrowing volumes among different financial institutions and 18 (41%) agreed to the statement followed by 04(9%) who disagreed and 02(5%) who strongly disagreed to the statement.

Furthermore, 20 (45%) of the respondents strongly agreed interest rates are continuously reviewed in line with prevailing economic conditions, 20 (45%) agreed to the statement.

4.6. The factors that influence financial performance of a commercial Bank

The second objective of the study was to assess the factors that influence financial performance of commercial Banks. Table 4.8 presents the results of 5-point like scale level of satisfaction for different factors of interest rates. Each of the 44 respondents contributed their opinions on the influence of interest rates on the financial performance of commercial Banks.

4.7 The factors that influence financial performance of commercial Banks.

Response	**Response Category**	**Frequency**	**Percentage %**
Commercial Banks base profitability on the performance of lending portfolio	Strongly agree	25	57
	Agree	15	34
	Disagree	04	09
	Strongly disagree	00	00
	Total	**44**	**100**%
Growth of loan book indicate positive growth in	Strongly agree	22	50
	Agree	20	45

profitability	Disagree	02	05
	Strongly disagree	00	00
	Total	**44**	**100**%
Effectiveness of lending policies translates to increased regular turnover	Strongly agree	23	52
	Agree	12	27
	Disagree	08	18
	Strongly disagree	01	02
	Total	**44**	**100**%
Creativity in lending products impacts on the performance of the lending portfolio	Strongly agree	32	73%
	Agree	10	23%
	Disagree	02	04%
	Strongly disagree	00	00%
	Total	**44**	**100**%
Performance of lending portfolio is the main influencing factor for expansion programs	Strongly agree	30	68%
	Agree	14	32%
	Disagree	00	00%
	Strongly disagree	00	00%
	Total	**44**	**100**%
Flexibility of the lending procedures influence the growth rate of the commercial Banks	Strongly agree	32	73%
	Agree	10	23%
	Disagree	02	04%
	Strongly disagree	00	00%
	Total	**44**	**100**%
	Strongly agree	20	45%

Statement	Response	Frequency	Percentage
Cost reduction has a direct proportional effect on profitability of commercial Bank institutions.	Agree	10	23%
	Disagree	03	06%
	Strongly disagree	01	02%
	Total	**44**	**100**%
Investors in banking sector base investment decision on the performance of the lending portfolio	Strongly agree	22	50%
	Agree	18	41%
	Disagree	04	09%
	Strongly disagree	00	00%
	Total	**44**	**100**%
Lending portfolio growth rate is an influencing factor of return on investment for the banking sector	Strongly agree	24	55%
	Agree	20	45%
	Disagree	00	00%
	Strongly disagree	00	00%
	Total	**44**	**100**%
Commercial Banks stock value is influenced by veracity of the lending portfolio	Strongly agree	20	45%
	Agree	18	41%
	Disagree	04	09%
	Strongly disagree	02	05%
	Total	**44**	**100**%

Source: Field Data, July, 2021

According to research findings, 25 (57%) of the respondents strongly agreed that commercial Bank base profitability on the performance of lending portfolio, 15 (34%) of the respondents agreed, 04(9%) disagreed. This has made access to loan services more immediate.

Also, research findings indicate that 22 (50%) of the respondents strongly agreed that, growth of loan book indicate positive growth in profitability, 20 (45%) agreed and 2 (5%) disagreed. This implies that bank customers access their banks for loans from Commercial Banks.

Also, research findings indicate that 23 (52%) of the respondents strongly agreed that effectiveness of lending policies translates to increased regular turnover and 12 (27%) agreed to the statement, followed by 08(18%) who disagreed and lastly 1(2%) who strongly disagreed to the statement.

From the table above, 32 (73%) of the respondents strongly agreed that creativity in lending products impacts on the performance of the lending portfolio, 10 (23%) agreed while 02 (4%) disagreed to the statement.

Furthermore, 30 (68%) of the respondents strongly agreed that performance of lending portfolio is the main influencing factors for expansion programs, 14 (32%) agreed to the statement.

Also, 32 (73%) of the respondents strongly agreed that flexibility of the lending procedures influence the growth rate of the commercial Banks, 10 (23%) agreed, 2 (4%) disagreed with the statement. This helps customers to get the loan services in the commercial Banks.

From the table above, 20 (45%) of the respondents strongly agreed that cost reduction has a direct proportional effect on profitability of commercial Banks, 10 (23%) agreed, 03 (6%) disagreed while 1 (2%) strongly disagreed.

Research findings also indicate that 22 (50%) of the respondents strongly agreed that investors in banking sector base investment decision on the performance of the lending portfolio, 18 (41%) agreed, and 4 (9%) disagreed.

Furthermore, 24 (55%) of the respondents strongly agreed that lending portfolio growth rate is and influencing factors of return on investment for the banking sector, 20 (45%) agreed to the statement.

4.9. The relationship between lending interest rate and financial performance of commercial Banks

The respondents were required to rate the relationship between lending interest rate and the performance of commercial Banks as shown in the table 4.9below;

4.9.1. The type of relationship exists between interest rate and commercial Bank performance

The study conducted inferential analysis using Pearson correlation coefficient, and regression analysis. Correlation coefficient was used to test linear dependence (association) between financial performance and the individual independent variable which is the lending interest rate.

Regression analysis was used to measure the relationship between independent variables (lending

interest rate) and the dependent variable (financial performance) when they act together.

		Interest rate	Financial performance
Interest Rate	Pearson Correlation	1.000	-.702**
	Sig. (2 Tailed)		000
	N	44	
Financial performance	Pearson correlation	-.702**	1.000
	Sig. (2 Tailed)	000	
	N	44	

** Correlation is significant at the 0.05 level (2-tailed).

Using the rating level of;

0 to -+0.3= Weak Relationship

-+0.4 to -+0.6= Moderate/ Average Relationship

-1-0.7 to -+0.9= Very Strong Relationship

The table indicates that there is a very strong negative relationship between interest rates and financial performance of commercial Bank at r= -0.702 and at level of significance 0.05, this implies that the higher the rate of interest, the lower the profits being registered hence deteriorating profits of the commercial Bank.

Correlation Results

The study sought to establish the association between individual independent variables (interest

rate charged and financial performance of the commercial Bank institutions within the four-year period (2010 - 2014). Pearson correlation coefficients were used to test the hypotheses:

Hol: Financial Performance of microfinance institutions is not linearly associated with the amount of loan disbursed.

H02: Financial Performance of commercial Bank is not linearly associated with the interest rate charged.

Variables	**Interest rate**	**Financial performance**
Interest rate	1.000	
Financial performance	-0.379	1.000
	0.468	0.751

The results show that there is a positive but moderate linear relationship between financial performance and interest rate charged by commercial Bank (0.468). The study, thus, cannot reject the second (**H02**) as high interest rate increases the profit margin of microfinance institutions which a resultant decrease in loan demand owing to increased cost of borrowing. That is, it increases performance though not in perpetuity.

The study found a positive and good linear relationship between financial performance and amount of loan (0.751). Therefore, the study rejects the first null hypothesis (**Hol).** This finding follows that higher amount of loan disbursed is directly proportional to the economies of scale experienced thus higher revenue from the consequent interest charged by the microfinance institutions. This results in higher profit (financial performance) of the commercial Banks.

Analysis and interpretations of coefficient of determination

Coefficient of determination explains the extent to which changes in the dependent variable can beexplainedbythechangeintheindependentvariablesorthepercentageofvariationinthedependent

variable (financial performance) that is explained by the independent variables (interest rate).

Model	R	R Square	Adjusted R Square	Std. Error of Estimate
	.0924	.854	.516	.419

Coefficient of determination explains the extent to which changes in the dependent variable can be explained by the change in the independent variable or the percentage of variation in the dependent variable (financial performance) that is explained by the independent variables (interest rate).

The independent variable that was studied, explain only 85.4% of the customer satisfaction as represented by the **R2.** This therefore means that other factors not studied in this research contribute 14.6% of the financial performance of commercial Banks.

Therefore, further research should be conducted to investigate the other factors (14.6%) that affect financial performance of commercial Banks.

4.6.3 The significance of correlation between the interest rate and financial performance

The study was also set to determine the significance of correlation between the lending interest rate and financial performance and the study respondents when asked if there is the significance of correlation between the two variables, all cited that there is significance are elicitable

Table 4.10 The significance of correlation between the lending interest rate and financial performance

Response	**Frequency**	**Percentage %**
Positive significance	22	50.0
Negative Significance	12	27.0

Zero Significance	10	23.0
Total	**44**	**100**%

Source: Field Data, July, 2021

Figure 2.7: Showing the significance of correlation between the lending interest rate and financial performance

As shown in table 8, majority of the respondents reported positive significance as was revealed by 22(50%), followed by negative significance as cited by 12(27%) and this was then followed by 10(23%) of the respondents who indicated zero significance.

CHAPTER FIVE

SUMMARY OF FINDINGS, RECOMMENDATIONS AND CONCLUSIONS

5.1. Introduction

This chapter presents discussions of the key findings presented in chapter four, conclusions drawn based on such findings and recommendations. This chapter is, thus, structured into discussions, conclusions, recommendations and areas for further research.

5.2. Summary

The general objective of the study was to assess the effects of lending interest rate on the financial performance of commercial Bank. The study was guided by the following specific objectives; to find out the effect of interest rate on financial performance of commercial Bank institutions, to examine the factors that influence financial performance of commercial Banks and to establish the relationship between interest rate and financial performance of commercial Banks.

A sample size of 44 respondents participated in the study which represented about 10% (percent) of the target population and the diversity of participants was representative of the whole target population. The research relied on random sampling technique to select the participants of the study.

- The first objective in this study was to determine the relationship between the interest rates and financial performance of commercial banks in Uganda
- The study established that commercial Banks that charge lower interest rates have a bigger consumer base compared to those that charge high interest rates.

- The second objective in this study was to assess the interest rate variations on the financial performance of commercial banks in Uganda
- The study established that a higher percentage of revenues generated by commercial Banks come from interest income on lending meaning that institutions with quality loan portfolios tend to have a positive growth. Excessive high interest rates strongly discourage long-term investment and constrain ability to grow. Interest rates chargeable on mortgages influence the mortgage quality in that the higher the interest the more expensive the mortgage product becomes, and the more susceptible to defaults due to high repayment costs. Low interest rates on the other hand encourage compliance and prompt repayment thus guaranteeing quality products.
- The third objective of this study was to establish the relationship between interest rate and financial performance of commercial institutions. This means that investment can transform swiftly in reaction to changes in interest rates and gross output. This interest rate could be a Factor of the administrative expenses, loan losses, cost of funds, profitability of the loan portfolio and other activities and not just the nominal interest rate.

5.3. Discussion

The following are the discussions in relation to the research objectives;

5.3.1. The effect of interest rate on financial performance of commercial Banks

The study findings revealed that interest rates influence the overall economic activity including the flow of goods, services and financial assets within the economy and as well as the whole world. He points out that interest rates relate to the present value to the future value of money. A high interest rate leads to a high discount rate thus the present value of money. On the other

hand, a low interest rate leads to a future cash flow at a lower discount rate. It is noted that interest rates including those for the deposit taking microfinance institution are determined by three main factors: inflation, level of government borrowing and risk involved. He further found out that inflation sets the floor for the interest rate.

No institution can lend at a rat lower than the expected inflation rate over the similar period. The second determinants are the level of Government borrowing from the public, this rate forms the basis for the microfinance institutions and microfinance institutions while fixing their interest rates. The risk involved on the money borrowed referred to a risk premium which is the implicitly included in the interest rate parity. This means that when the country's currency depreciates, the interest rate must be higher than the rate which the shilling depreciates.

The study findings showed that the adherence to know your customer procedures is vital in ensuring that lending operations are above board. The findings supported the fact that microfinance institutions procedure enhance due diligence in lending operations. Commercial Bank conformity in banking institutions creates auditable evidence of due diligence activities. Furthermore, the study suggested that in addition to need of customer identification indicated that microfinance institutions conformity was important in ensuring that banking institutions are not defrauded and other financial crimes such as money laundering or organized crime do not take place. The findings support the need for micro finance institutions to implement stringent measures in analyzing customer profiles.

5.3.2. The factors that influence financial performance of commercial Banks

The study also revealed that the size is a determinant of financial performance of the firm. Large firms are more likely to manage their working capitals more efficiently than small firms. Most

large firms enjoy economies of scale and thus are able to minimize their costs and improve on their financial performance. The size of the company can have a positive effect on financial performance because larger firms can use this advantage to get some financial benefits in business relations. Large companies have easier access to the most important factors of production, including human resources. Also, large organizations are able to get cheaper source of funds to enable them to be competitive. Such funds however, come with conditions which can be easily met by large organizations.

It was also noted that proper management of working capital management components helps in reducing the costs of the firm this highly contributes in reducing the liquidity risk of the firm and thus mitigating any financial losses that might be attributed to lack of finances to take advantage of profitable investments Since market value is conditioned by the company's results, the level of risk exposure can cause changes in its market value. Since market value is conditioned by the company's results, the level of risk exposure can cause changes in its market value and thereby how it is perceived in the market.

The findings support the context that interest rate determinants form individual entities which directly influence on the performance of the lending portfolio in microfinance institutions. Keynes indicates that the rate of interest represents the cost of borrowing capital for a given period. Given that borrowing is a significant source of finance for the firms, interest rates are of great importance to them since it greatly affects their income and by extension their operations.

The study found that interest rates impact on the volumes of borrowing and consequently impact on the volumes of trade. Therefore interest rates influence the overall economic activity including the flow of goods, services and financial assets within the economy and as well as the

whole world. He points out that interest rates relate the present value to the future value of money. A high interest rate leads to a high discount rate thus the present value of money. On the other hand, a low interest rate leads to a future cash flow at a lower discount rate. Inflation sets the floor for interest rates. Institutions lend at a higher rate than the expected inflation rate over a similar period.

5.3.3. The relationship between interest rate and financial performance of commercial Banks

The study findings support the theory that proper credit policy guidelines contribute to positivity on the performance of the commercial Banks. The findings support for professional
Approach in formulating credit policy guidelines as they impact on the financial performance of many players in the sector. The findings are in agreement on the need for industry regulation on the element of formulation of credit policies.

The study findings showed that there is a positive but moderate linear relationship between financial performance and interest rate charged by commercial Bank. (0.468). The study, thus, cannot reject the second ($H0_2$) as high interest rate increases the profit margin of micro finance institutions which a resultant decrease in loan demand owing to increased cost of borrowing. That is, it increases performance though not in perpetuity.

The study also found a positive and good linear relationship between financial performance and amount of loan (0.751). Therefore, the study rejects the first null hypothesis (**Ho_1**). This finding follows that higher amount of loan disbursed is directly proportional to the economies of scale experienced thus higher revenue from the consequent interest charged by the commercial Banks. This results in higher profit (financial performance) of the commercial Banks.

The study also supports for dynamic and constant update of the credit policy guidelines. These efforts should ensure that at any particular time the policies being implemented are those which enhance the efficiency of the lending operations. There are various policies that an organization should put in place to ensure that credit management is done effectively; one of these policies is a collection policy which is needed because all customers do not pay the firms bills in time. Some customers are slow payers while some are non-payers. The collection effort should, therefore aim at accelerating collections from slow payers and reducing bad debt losses.

5.0 Conclusions

The study makes a conclusion that knows your customer procedures wield significant influence on the financial performance of commercial Banks. The study concludes that, the commercial Bank procedures play a crucial in banking operations by shielding the lending operations against negative practices like fraud. Industry cooperation ensures that for instance, customer details in previous transactions can be relied on for making possible determination of the credit worthiness of a customer.

The study makes a conclusion that ensuring stringent implementation of the commercial Bank procedures, has a direct impact on the banking operation of the commercial Bank. The study concludes that, the commercial Bank procedures demonstrate the level through which commercial Banks are serious with due diligence. The study concludes that, the banking staff more especially those who are attached to the credit division should be well versed on the intricacies of the commercial Bank procedures. This will guide them well when making transactions related to lending operations.

The study makes a conclusion that interest rates influence the financial performance of

commercial Banks to a great extent. The study concludes that customers ought to be the biggest consideration when setting the level of interest rates. The study a conclusion that the market volatility wields heavy influence on the shifts in interest rates and directly impacts on the net turnover of commercial Banks. When there is market is volatile there will be more need for borrowing and consequently will mean that the financial institutions are posed to realize positive increase in financial performance from the returns on the credit income.

The study makes a conclusion that, a situation of weak credit policy execution in an isolated case has the potential of hurting the whole industry thus the base minimum standards on the quality of credit policies should be industry anchored. The study makes a conclusion that the implementation of credit policy guidelines is consistent across board amongst all customers as this is vital in ensuring effectiveness and competitiveness of the lending operations.

5.2 Recommendations

Recommendations for improvement;

Since cost of loans does influence financial performance, the study recommends that commercial Banks should assess their clients and charge interest rates on the loans disbursed accordingly, as ineffective interest rate policy can increase the level of interest rates and consequently cost of Loans borrowing thus negates financial performance. Given that the type of interest rates charged on loans (fixed and floating) dictates on the ability and flexibility of borrowers to repay loans, the study recommends that commercial Banks should have a mixed interest rate policy as each type has its advantage and disadvantage. The Central Bank should apply stringent regulations on interest rates charged by commercial Banks so as to regulate their interest rate spread.

The researcher recommends for consistent implementation on the commercial Banks procedures to ensure uniformity in the lending operations. This should ensure that all the credit staff that is attached to the lending operations in the financial institution is well trained in the intricacies of Bank procedures. Furthermore the study recommends for more concerted efforts in sharing of customer information with all industry players as this will limit any chances of customers defrauding commercial Banks. Sharing of information will also contribute to faster detection of fraudsters and detaining them. This can happen in case, a previous fraudster whom couldn't be traced and pops up suddenly from the cold. If his information was shared across all banks, he should be placed on a watch list with a notification system so as soon as they show up in a financial institution, the authorities can be alerted to apprehend the crook.

The study recommends for Commercial Bank to adopt abrasive approach in formulating internal credit lending operations. This should be considerate of the standards and quality that are consistent with the global best practices. The study recommends for the involvement of regulators, consultants and researchers in the field of credit policies for financial operations in formulation of industry base standards on credit policy. Having a strong practice in adhering to industry should be made a mandatory requirement for all the stakeholders.

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QUESTIONNAIRE

Dear respondent,

I **Kasibante Rodgers** a student of Uganda Martyrs University carrying out research on ***"the effect of interest rates on financial performance of commercial Banks"*** and you have been selected as the targeted population. Therefore, I kindly request you to spare some few minutes of your valuable time to fill in the answers in this questionnaire. Information given in this questionnaire will be kept confidential.

Section A: BIO-DATA (Please tick in the appropriate box)

2 Gender

Male ☐ Female ☐

3 Age

18-30 years ☐ 31-40 years ☐ 41 years and above ☐

4 Highest level of education attained

Bachelor ☐ Diploma ☐ A-level ☐

O-level ☐ Others ☐

5 Marital status

Single ☐ Divorced ☐

6 **How long have you worked in your organization**

0-5 years ☐

11-15years ☐

Married

7 **Please indicate your designation**

6-10 years

Credit officer

Departmental manager at the bank

Over 15 years

Bank Manager

Other (Please Specify)

SECTION B: THE EFFECT OF INTEREST RATES ON THE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS

NO	**The effect of interest rate on the financial performance** the table below is intended to find out the different products and services offered by banks through electronic banking. **SA** means Strongly agree, **A** represents Agree, **SD** means Strongly disagree, and **D** represents Disagree. You are supposed to tick the best alternative basing on your choice of understanding. (**Tick in the boxes according to the answer of your choice**) of commercial Banks.	**SA**	**A**	**SD**	**D**
1	Most customers are sensitive to loan interest rates				
2	Interest rates volatility affects the profitability of our bank				
3	Our customers are strictly based in our interest rates				
4	Interest rates for different loan facilities affects competitive advantage				
5	Capping interest rates has a direct impact on bank earnings				
6	Interest rates influence the Repaymen rate amongst borrower t s				
7	The interest rates drive the borrowing volumes among different commercial Banks.				
8	Interest rates are continuously reviewed in line with prevailing economic conditions.				

SECTION C: THE FACTORS THAT INFLUENCE FINANCIAL PERFORMANCE OF COMMERCIAL BANKS

The table below is intended to find out the factors that influence financial performance of commercial Banks. SA means strongly agree, a represents Agree, SD means strongly.

Disagree, and D represents Disagree. You are supposed to tick the best alternative basing on your choice of understanding. (Tick in the boxes according to the answer of your choice)

NO.	The following are the factors that influence financial performance of commercial Bank.	SA	A	SD	D
1	Commercial Bank base profitability on the performance of lending portfolio				
2	Growth of loan book indicate positive growth in profitability				
3	Effectiveness of lending policies translates to increased regular turnover				
4	Creativity in lending products impacts on the performance of the lending portfolio				
5	Performance of lending portfolio is the main influencing factor for expansion programs				
6	Flexibility of the lending procedures influences the growth rate of the commercial Bank.				
7	Cost reduction has a direct proportional effect on profitability of commercial banks.				

8	Investors in banking sector base investment decision on the performance of the lending portfolio				
9	Lending portfolio growth rate is an influencing factor of return on investment for the banking sector				
10	Commercial Bank stock value is influenced by veracity of the lending portfolio				

SECTION D: THE RELATIONSHIP BETWEEN INTEREST RATE AND FINANCIAL PERFORMANCE OF COMMERCIAL BANKS

1) Is there a relationship between interest rate and financial institutions?

2 Yes ☐

3 No ☐

2) What type of relationship exists between interest rate and financial performance?"

Positive relationship ☐

Negative relationship ☐

3) What is the significance of correlation between the two above variables?

(i) Positive significance ☐

(ii) Negative Significance ☐

(iii) Zero Significance ☐

4) In your opinion, briefly point out the existing relationship between interest rate and financial performance.