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# Firm Innovation and Financial Performance of Tier IV Microfinance Institutions in Uganda

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## Abstract

**Purpose:** Tier IV MFIs have contributed enormously towards reducing the gap between the banked and the unbanked population in Uganda by extending affordable financial services largely to rural population. However, their financial performance in terms of Profitability, liquidity, loan portfolio and financial efficiency lives a lot to be desired. Consequently, this study was carried out to examine the effect of innovation on financial performance of Tier IV MFIs in Uganda

**Methodology:** pragmatic paradigm guided many choices in regard to this study, especially on techniques to collect evidence on the reality under investigation. Relatedly both objective and subjective assumptions were key in selection questionnaire and interview guides as data collection techniques where Human Resource Managers, General Managers, Credit Managers, Internal Auditors and Accountants were the respondents for the quantitative study while 17 board chairmen participated in the qualitative interviews. The study used probability and non probability sampling techniques to select both the unit of analysis and the unit of inquiry. After collecting data from 139 microfinance institutions, Pearson correlation techniques were used to analyse the data.

**Findings:** This study confirmed that innovation has a positive and statistically significant effect on financial performance of Tier IV MFIs in Uganda ($r$= .549, $p$<.01). This finding unveils that innovation (market innovation, process innovation and product or service innovation) has a potential to improve the financial health of Tier IV MFIs in Uganda.

**Recommendations:** In consideration of this finding, we recommend that: 1) Tier IV MFIs make strategic investments in service innovation, process innovation and market innovation since it has been proven that these can improve their financial performance; 2) the government provides a conducive policy environment for Tier IV MFIs to thrive since their contribution to different financial spheres of the economy is enormous; 3) Tier IV MFIs managers minimise their overreliance on their unique internally developed resources or even on how they imbed their dynamic capabilities in their daily routines but focus more on developing new financial services, delivering satisfactory customer experience, improving financial transaction processes, creation of new markets and designing effective business models

**Keywords:** *Innovation, Financial Performance, Microfinance Institutions, Uganda Microfinance Regulatory Authority*

JEL Codes: *G21; G23; D22; L25; O31; O16*

## INTRODUCTION

Microfinance institutions (MFIs) in Uganda have over time contributed generally to Uganda's economy by providing different financial services such as loans, savings, money transfers, insurance among others to low-income clients who are excluded from the formal financial institutions (Fadikpe et al, 2022). They exist under different categories including Tier IV MFIs which are financial service providers that operate at grassroots level, mainly serving low income individuals and small businesses (Banda et al., 2025 & Marfo et al., 2025). According to Money lenders Act (2016), Tier IV MFIs include savings and credit cooperatives, village saving groups and non-deposit taking microfinance institutions. By increasing access to finance for the economically active poor we see great economic impact that Tier IV MFIs have on reducing the number of the unbanked population contributing to Uganda's financial inclusion efforts (Mishra., 2024 & Sahu et al., 2024). Specific to Tier IV MFIs is that they bridge the gap of commercial banks that have a low presence in rural areas thereby becoming key leading credit institutions and financial intermediaries to the rural poor (Ofori-Okyere et al., 2023). Apparently, most commercial banks are concentrated in urban areas leaving most Ugandans to depend on the informal sector and others completely left out of the financial service sector (Abomugisha et al., 2022). The study appreciates the contribution Tier IV MFIs have made and at times serving as a source of attention to policy makers and scholars who get concerned with their financial performance status. Being critical engines for social-economic development (Kamoga, 2024 & Mensah, 2025) their financial health is important for their continued survival and especially for meeting the needs of both internal and external stakeholders. This study envisages financial performance as a company's competence and effectiveness in the use of resources, creating economic value, and attracting investors to achieve its objectives (Tudose et al., 2022). It is a measure of utilizing the company's financial resources in order to generate returns (Ichsan et al., 2021) and therefore serving as a measuring instrument to an organizations current development and likely growth (Le Thi Kim et al., 2021). The conceptual dimensions for financial performance in this study are: profitability, liquidity, loan portfolio and financial efficiency. In view of the contributions explained as impact above that Tier IV MFIs have in different spheres of Uganda's economy, as researchers we get concerned especially when analysing Uganda's microfinance industry performance. Apparently performance statistics for deposit-taking and non-deposit-taking MFIs in terms of operating cost ratio, capital adequacy ratio, return on assets, risk coverage ratio and portfolio at risk in Uganda, show a worrying scenario. Particularly, MFIs' loans-to-deposits ratio increased to 126% in 2019 compared to 69.1% in 2018 and 67% in 2017 (Bank of Uganda, 2019), signalling a poor financial performance among MFIs in Uganda. The same source also reports declining trends in ROA, ROE, net interest margin, and the increase in cost-to-income above the global standard of 50%. In the pre-and post Covid 19 period a decline in portfolio yield was observed from 54.6% in 2015 to 52% in 2016, increase in operating costs from Ugx. 270,887 in 2017 to Ugx 543,770 in 2018. There was also an increase in cost of funds ratio from 12% in 2016 to 19.4% in 2017, a reduction in capital adequacy ratio from 50.12% in 2015 to 45.7% in 2017 and low levels of liquidity ratio of 10.54% against the benchmark of 15% (Orichom & Omeke, 2021). Additionally, Muhammad et al., (2024) observes that MFIs are part of the 30% of private companies that do not survive to celebrate their third anniversary.

All this exists amidst a series of policy interventions in the microfinance industry aiming at transformations of professionalization and institutional strengthening (Okesina, 2025 & Ghimire, 2025). Also the enactment of Money Lenders Act, (2016) was a related government effort to ensure

safety for and build trust in customers to restore investor and consumer confidence in Uganda's microfinance industry, whose reputation had been spoilt by poor management and fraud in SACCOs and the unethical practices in non-deposit taking MFIs (Abomugisha et al., 2022 & Kule et al., 2020). Additionally, as part of interventions to remedy the MFIs' performance challenges, the Government of Uganda in partnership with the International Fund for Agriculture (IFAD) supported the continuing need to promote rural and financial inclusion as a key strategy for poverty reduction. The Government designed a project for financial inclusion in rural areas (PROFIRA) in 2013 in partnership with IFAD to enable MFIs to sustain themselves financially (Tudose et al., 2022; Orichom & Omeke, 2021). In consideration of the contributions that MFIs make to Uganda's economy especially in its struggle to achieve a middle income status by doubling the size of the economy from the current $ 69 billion to $ 500 billion in 15 years, it is ideal that solution be devised to change the financial performance image of Tier IV MFIs in terms of their ability to operate efficiently, profitably, survive, grow and react to environmental opportunities and threats (Kamukama & Sulait, 2017). We observe that existing interventions have not yielded tangible results in improving the financial health of MFIs, despite the fact that globally firms have not given up on searching for strategies on how to cope with the dynamic global competition (Kitenga et al., 2020). Indeed, the search for solutions to the above presented financial performance challenges has led scholars and strategic managers to underscore innovation as a critical predictor of the financial performance of firms (Bereczki et al., 2022).

This study refers to innovation as successful implementation, creation and introduction of a new or significantly improved product (good/service) or process (method of delivery/practice/relationship), business models and ways of working which leads to significant outcomes, efficiency, effectiveness or quality (Tylor, 2017). It is a continuous and dynamic process in which ideas are transformed into value (Bereczki et al., 2022). This study conceptualises innovation as service innovation, process innovation and market innovation. It assumes that if a Tier IV microfinance institution is able to scan and sense the available opportunities, seize its market operations and reconfigure its key activities, it will be in position to innovate new products, services and marketing strategies in order to improve on its financial performance (Tylor, 2017).

Prior studies have studied financial performance using different perspectives for example corporate board leadership structure (Rwakihembo et al., 2023); tax incentives (Aheebwa et al., 2025); strategic management practices (Rwakasoro et al.,2025); managerial competencies (Amanyire et al.,2024). A review on these studies reveal differences in terms of context where some interrogated financial performance among small and medium enterprises, others in private limited firms and others considered NGOs sector. These scholars used different methodologies and never had interest in the study of innovation, yet innovation has elsewhere been identified to provide a lasting solution to financial performance challenges (Kitenga et al., 2020).

Quite a number of studies have examined firm innovation as a critical predictor of the financial performance. For instance, while assessing innovation and firm performance in the small industrial sector in Indonesia, Hajar, (2015) observes a positive relationship. Ndesaulwa and Kikula, (2016) carried out a similar study in Tanzania, just like Ferreira et al., (2019) in Portuguese companies and report same effects. However, Kafetzopoulos et al., (2020) in their study of innovation on manufacturing firm performance in Greece find no significant effects for all dimensions of innovation. At glance these studies portray disagreeing voices yet conducted in varied context, which indicate that the discussion on innovation and firm performance has not been concluded.

This study consequently emerges to examine the contribution of innovation on financial performance of Tier IV Microfinance Institutions in Uganda. The contributions of this study to literature are diverse, for example, 1) reminding Tier IV Microfinance Institutions to leverage the value of service innovation, process innovation and market innovation, 2) alerts the government that Tier IV MFIs need conducive policy environment to thrive: their contribution to different financial spheres of the economy mean that their continuity benefits the government, 3) bringing to the attention of Tier IV MFIs managers that their financial performance depends on not only their unique internally developed resources or even their ability to imbed their dynamic capabilities routines but also on developing new financial services, delivering satisfactory customer experience, improving financial transaction processes, creation of new markets and designing effective business models.

**Problem Statement**

The financial performance of Tier IV MFIs has always attracted the attention of policy makers and practitioners as they seek for sustainable solutions to their challenges.Their performance trend when viewed in terms of operating cost ratio, capital adequacy ratio, return on assets, risk coverage ratio and portfolio at risk has over time not been good. For example, according to Bank of Uganda, (2019), ROA, ROE and net interest margin has been declining alongside the increase in cost-to-income above the global standard of 50%. There has also been an increase in cost of funds ratio from 12% in 2016 to 19.4% in 2017, a reduction in capital adequacy ratio from 50.12% in 2015 to 45.7% in 2017 and low levels of liquidity ratio of 10.54% against the benchmark of 15% (Orichom & Omeke, 2021). This study advocates for action beyond the policy inteventions by the government that have not yielded much since MFIs are part of the 30% of private companies that do not survive to celebrate their third anniversary (Muhammad et al., 2024). Previous studies onto innovation and financial performance relationship have instantly yielded contradictory results, for example, Hajar, (2015) in Indonesia agreeing, Ferreira et al., (2019) in Portugal agreeing, and also Ndesaulwa and Kikula, (2016) agreeing in Tanzania. However, a study by Kafetzopoulos et al., (2020) in Greece observe non-existent relationship especially for some dimension of innovation. Such gaps in literature reveal that the debate on financial performance and innovation in the context of Tier IV MFIs in Uganda is ongoing. Apparently no study on innovation and financial performance of Tier IV MFIs in Uganda has been conducted. This study was conducted to bring out evidence on the relationship between innovation and financial performance in the context of Tier IV MFIs in Uganda, since previous studies on the same relationship cannot be generalised due to context differences.

**Review of Literature and Hypothesis Development**

**Theoretical Review**

Two theories i.e. innovation theory and dynamic capabilities theory guided this study as explained below.

**Innovation Theory**

One of the world's famous scholars Joseph Schumpeter introduced innovation theory in 1934 to explain performance of firms. The theory argues that firm-level efficiencies and firm's ability to create unique, valuable products and services to satisfy customers are sufficient to cause competitiveness of a firms in any particular industry (Chemutai et al., 2022). Accordingly, for a firm to achieve financial performance it must innovate (Śledzik, 2013). Different scholars have

looked at innovation with varied but relatively same perspectives differing according to context, for example Solaimani et al., (2019) defines innovation as *"the founding of an idea and using that idea to make new services and processes for the market".* Nkundabanyanga et al., (2019) define innovation as *"an organization's process for introducing or creating more effective methodologies: processes, new ideas, workflows, products, and services".* Taylor, (2017) define innovation as *"successful implementation, creation and introduction of a new or significantly improved product (good/service) or process (method of delivery/practice/relationship), business models and ways of working which leads to significant outcomes, efficiency, effectiveness or quality"*. One can extract from these definitions that innovation is a continuous and dynamic process in which ideas are transformed into value (Bereczki et al., 2022). As per the proponents of the theory innovation is an indispensable driver of competitiveness because it allows firms to adapt to changes in the business environment and create solutions to new challenges. The only secret lies in firm efficiency in creating innovative products and services (Garrido et al, 2024). In the context of this study, it therefore means that innovative Tier IV MFIs have new ideas and know-how to make new financial products and improve business processes for the market (Truong, & Nguyen, 2024). Despite the different criticisms put up against innovation theory i.e 1) ignoring the close interaction between organizational assets and the external environment (Bogers et al., 2019), and 2) overlooking the relevance of dynamic capabilities in responding to market forces (Callegari & Nybakk, 2022), it remains relevant to this study explaining how Tier IV MFIs can improve their financial performance through new financial services, new customer experience, improved financial transaction processes, creation of new markets and designing effective business models (Chemutai et al., 2022 & Johannessen, 2013). Tier IV MFIs can coordinate and reconfigure internal and newly externally-generated capabilities (Chemutai et al., 2022). They can focus on internal processes like sensing opportunities and threats, seizing opportunities, and configuring their activities while improving the capabilities of management in coordinating routines and financial transaction processes. These are crucial capabilities for the innovation and selection of business models directed toward high-payoff endeavours that can address the financial distress that Tier IV MFIs are facing today (Teece, 2018).

**Dynamic Capabilities Theory**

Amidst criticism labelled on resource based theory, refinements were later made by scholars like (Teece, Pisano and Shuen, 1997) who came up with dynamic capabilities theory largely to offer a better scientifically proven explanation on the extent to which a firm can sustain competition in the obvious uncertain business environments (Teece et al., 2022). Initially resource based theory scholars emphasised that unique resources a firm has are sufficient to cause competitive advantage (Barney, 1991), however dynamic capabilities theory scholars argue beyond this anticipating that a firm's only source of competitive advantage is its ability to create, extend or modify its resource base. It's the emphasis that blind reliance on internally developed resources may not help! The synthesis of these theories provides a robust framework to explain how MFI internal routines facilitate adaptation to environmental volatility. A firm's ability to constantly integrate, reconfigure, and renew its resources capabilities and reconstruct its core capabilities in response to the changing business environment remains indispensable if it is to attain and sustain competitive advantage (Teece, 2017). This makes great sense because static resource cannot guarantee stability, resilience and competitiveness in the uncertain and constantly evolving business environments (García-Valenzuela et al., 2023). Using dynamic capabilities theory, we instead argue that Tier IV MFIs must constantly aim at sensing, seizing, and transforming their

resources if they are to remain competitive (Teece, 2007). They must build the capability for change, i.e., the capacity to sense, seize, and shape new market opportunities. These capabilities can enable firms to thrive the market volatility and technological dynamism (Denrell et al., 2015). Well, even when dynamic capabilities theory, has also been criticized on account of definitional ambiguity or conceptual vagueness accusing it of failing to explicitly define and operationalize which dynamic capabilities, we still see it relevant for this study emphasizing that operational agility and innovation capacity are critical intermediate capabilities that convert organizational strategies into superior performance outcomes. The fact is that these Tier IV MFIs are exposed to policy shifts, money market fluctuations, infrastructure challenges, opportunistic behaviours of managers, unfaithful customers who default, all this necessitate constant adaptation (Muturi, 2024). Dynamic capabilities comprise sensing, seizing, and integration (Chemutai et al., 2022). Sensing capabilities enable a firm to identify favourable opportunities and potential threats to develop strategies for dealing with these external factors (Sivusuo, 2019). On the other hand, seizing capabilities enable a firm to make strategic choices and investment decisions on externally sensed opportunities (Teece, 2012). Integration capabilities help firms to combine and synchronize information, assets, routines, processes, and operations to attain competitive advantage (Chemutai et al., 2022). In consideration of all these, innovation may not be treated as a static practice; but requiring that dynamic capability be embedded in firm routines that allow for accommodating not only internal constraints but also external shocks (García-Valenzuela et al., 2023).

## Empirical Review

### Innovation and Financial Performance

Previous studies have examined the effects of innovation and financial performance, for example Hajar, (2015) who analysed the effect of innovation on firm performance in the small industrial sector in Indonesia. The results indicated a positive relationship between innovation and firm performance. Ndesaulwa and Kikula, (2016) in their study on the nexus between innovation and the performance of small and medium enterprises in Tanzania underscored the capability to innovate as one of the main aspects leading to a competitive advantage among firms. The authors note that innovation is an important component of a firm's strategy mainly because it constitutes one of the principal means through which firms can seek new business opportunities.

Equally, Ferreira et al., (2019) studied innovation among 938 Portuguese companies from different sectors. The results demonstrated that going digital endows companies with greater competitiveness. Similarly, Bach et al., (2019) on their study on the relationship between innovation and performance in private companies, after data analysis, established that innovation initiatives converge, meaning that overall, innovation contributes to improvements in company performance.

Additionally, Sabahi and Parast, (2020) also establishes that firms with a more innovative environment are more resilient to disruptions because innovation, directly and indirectly, helps firms brace capabilities that positively affect their risk management capability. Furthermore, a study by Kafetzopoulos et al (2020), using a sample of 580 Greek manufacturing firms on the basis of grouping the responding firms, and using structural equation modelling, revealed that only three dimensions of innovation (product, marketing and process innovation) directly influence business performance. Perhaps this marks the starting point for failure of some innovation dimensions to influence performance. Kafetzopoulos et al, (2020) assert that there is still limited research to explain the effect of various dimensions of innovation on a firm's performance.

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Besides examining the performance of other industries, such as manufacturing and technology-based companies, extant studies have mainly concentrated on advanced economies like Portugal (Ferreira et al., 2019) and Indonesia (Hajar, 2015). The microfinance sector in developing countries like Uganda has therefore remained unexplored. Even when authors like Nkundabanyanga et al., (2019) attempted to study MFI financial performance, they ignored loan portfolio as a dimension of financial performance, yet, credit creation is the main business activity of MFIs, and the quality of their loan portfolio is of great significance (Kamukama & Sulait, 2017). This study, therefore aimed at bridging the above empirical gaps by examining the relationship between innovation and financial performance among Tier IV MFIs in Uganda, a developing country. The study, therefore, hypothesized that,

*H1: Firm innovation is positively associated with the financial performance of Tier IV MFIs in Uganda.*

## Methods

A pragmatic research paradigm guided this study (Cresswell, 2014) in terms of choosing methods and techniques contextually fitting with social reality under investigation. Sequential explanatory mixed-methods design (Almeida, 2018), was adopted to collect quantitative data from various Tier IV MFIs managerial categories i.e., General Managers, Human Resource Managers, Credit Managers, Accountants and Internal Auditors at one point in time in line with cross-sectional design guidelines. These managerial categories were chosen because of their high level participation in strategic decision-making and day-to-day running of Tier IV MFIs (AMFIU Directory, 2023). By virtue of their positions they were thought as having relevant information on innovation initiatives and financial performance of these institutions. Qualitative data was collected from board chairmen of these Tier IV MFIs. In *table 1* below we bring out details on the study population, and sample size used per region. Proportionate stratified sampling technique was used to select Tier IV MFIs from four regions of Uganda. Specifically, majority respondents were chosen from the central region because 70% of MFIs are located there.

**Table 1: Population and Sample size**

| **Regions** | **UMRA Category** | | | |
|---|---|---|---|---|
| | **Total number of NDTS** | **Sample** | **Total number of SACCOs** | **Sample** |
| Central | 127 | 79 | 47 | 29 |
| South Western | 7 | 4 | 43 | 28 |
| Northern | 2 | 1 | 3 | 2 |
| Eastern | 8 | 5 | 5 | 3 |
| ***Total*** | ***144*** | ***89*** | ***98*** | ***62*** |
| **Total Population** | **144+98** | | **242** | |
| **Sample** | **89+62** | | **151** | |

*Source: UMRA Directory (2024)*

The techniques for data collection were identified following the adopted philosophical position where epistemologically, questionnaires and interview guides were used to collect evidence (Creswell, 2019). Important to note however is that before going for a full study research instruments were pilot tested for consistency and stability, conducting validity and reliability tests (see *table 2 &3 below for results on these two tests*).

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**Table 2: Reliability Analysis Results**

| Construct | Cronbach's Alpha | Number of Items |
|---|---|---|
| **Firm Innovation** | | |
| Product Innovation | .881 | 11 |
| Process Innovation | .817 | 11 |
| Market Innovation | .734 | 7 |

*Source: Primary Data (2025)*

**Table 3 Content Validity Index (CVI) for Variables**

| Construct | CVI |
|---|---|
| **Firm Innovation** | |
| Product Innovation | .731 |
| Process Innovation | .762 |
| Market Innovation | .841 |

*Source: Primary Data (2025)*

Variables were measured and operationalised in accordance with prior studies. Firm innovation was adopted and modified using instruments by Teece, (2012), Sharma & Rai, (2015), Lowik et al., (2017), Darawong (2018), Solaimani et al., (2019), Nkundabanyanga et al., (2019) and Chemutai et al., (2022) that focused on market innovation, process innovation and product or service innovation. On the other hand, for financial performance, researchers modified the instruments used in previous studies by Kamukama & Sulait, (2017), Ouma, (2022) Rwakihembo et al., (2020), Kule et al., (2020), and AMFUI, (2023). The areas of focus were profitability (*ROA, net interest margin, and cost-to-income*), liquidity (*current ratio and capital adequacy*), the loan portfolio (*nonperforming loans ratio, portfolio at risk, risk coverage ratio*), and financial efficiency (*operating cost ratio*).

Recommendations from scholars like Pallant, (2020) and Tabachnick & Fidell, (2025) were adhered to in regard to criteria for choice of analysis technique, where conditionally data set was first tested for conformance with parametric assumptions. Evidently *figures 1-3 and table 4* below show details on parametric tests performed especially normality, linearity, independence of errors and Homogeneity of variance.

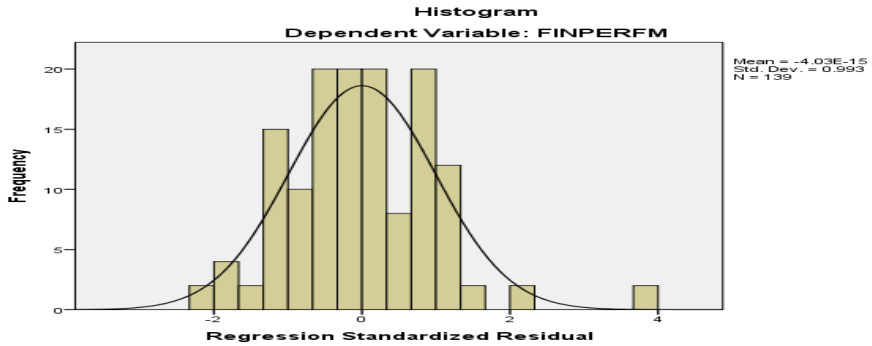


*Figure 1: Test for Normality and Linearity*

*Source: Primary data*

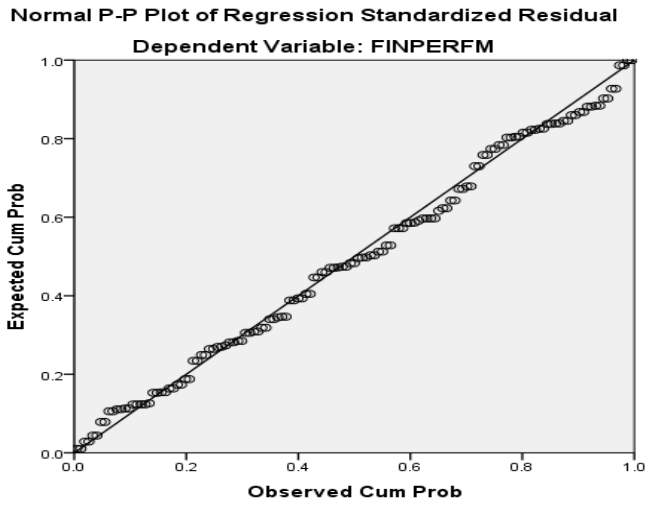


*Figure 2: Test for Linearity*

*Source: Primary data (2025)*

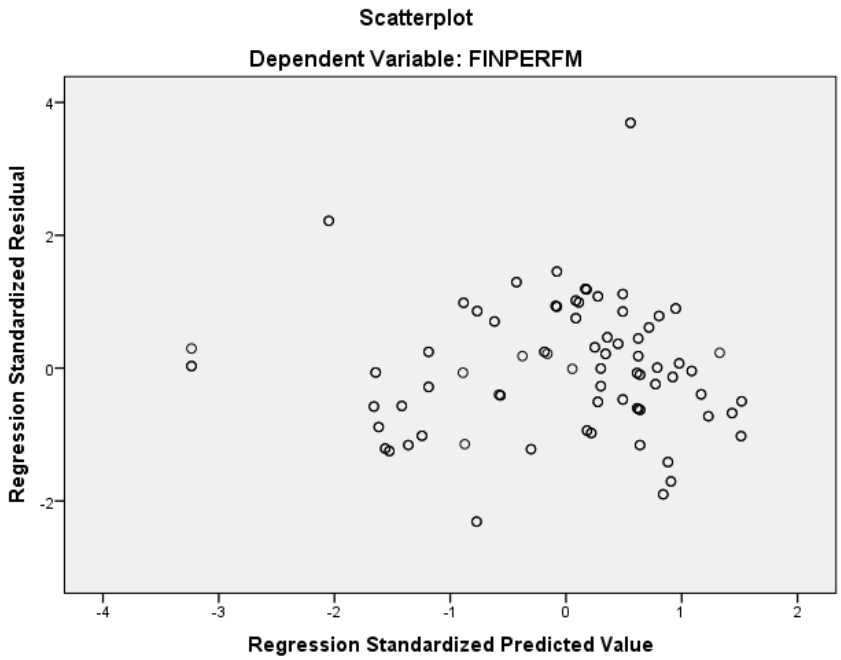


*Figure 3: Test for Independence of Error (Autocorrelation)*

*Source: Primary data (2025)*

**Table 4: Test for Homogeneity of Variance**

| | Levene Statistic | df1 | df2 | Sig. |
|---|---|---|---|---|
| Financial Performance | 0.000 | 1 | 106 | .993 |
| Firm Innovation | 0.560 | 1 | 106 | .456 |

**Source:** Primary Data (2025)

## Findings

### Response Rate

The study targeted a sample of 151Tier IV UMRA Licensed MFIs but only 139 participated with no errors signifying a 92.05% response rate. 17 respondents were interviewed for the qualitative study.

### Respondent Characteristics

Respondent characteristics were investigated in terms of level of education, age, position held in the organization and job tenure as indicated in *tables 5-8* below.

### Respondents' Education Characteristics

**Table 5 Education Background**

| | | Frequency | Percent | Cumulative Percentage |
|---|---|---|---|---|
| Valid | Diploma | 20 | 3.31 | 3.31 |
| | Degree | 331 | 54.80 | 58.11 |
| | Masters | 230 | 38.08 | 96.19 |
| | PhD | 2 | 0.33 | 96.52 |
| | Others | 21 | 3.48 | 100.00 |
| **Total** | | **604** | **100.00** | |

*Source: Primary Data 2025*

In terms of education, results as indicated in *table 5* shows that the majority (54.80%) had bachelors' degree, 3.31% having diplomas, 38.08% having masters' degrees and 0.33% possessed PhDs. This shows that respondents had a high level of education permitting them to understand items in the questionnaire.

### Age of Respondents

**Table 6: Respondents' Age**

| | | Frequency | Percent | Cumulative Percentage |
|---|---|---|---|---|
| valid | <30 years | 17 | 2.81 | 2.81 |
| | 30-39 years | 231 | 38.25 | 41.06 |
| | 40-49 years | 220 | 36.42 | 77.48 |
| | 50-59 years | 115 | 19.04 | 96.52 |
| | >60 years | 21 | 3.48 | 100.00 |
| | **Total** | **604** | | |

*Source: Primary Data 2025*

Findings as shown in *table 6* above reveal that 97.19% of the respondents were aged above 30 years. It therefore signals to the kind of maturity with which they filled the questionnaire.

**Respondents' Positions**

**Table 7: Position Held in the Organization**

| | Frequency | Percent | Cumulative Percentage |
|---|---|---|---|
| Accountant | 139 | 23.01 | 23.01 |
| Internal Auditor | 112 | 18.54 | 41.56 |
| General manager | 120 | 19.87 | 61.42 |
| Credit officer | 139 | 23.01 | 84.44 |
| HR Manager | 94 | 15.56 | 100.00 |
| **Total** | **604** | **100.00** | |

*Source: Primary Data 2025*

Study results as shown in *table 7* indicate the extent of respondent distribution in terms of positions held. By distribution, accountant constituted 23.01%, internal auditors constituted 18.54%, general managers constituted 19.87%, credit officers constituted 23.01% and human resource managers constituted 15.56%. This means that this studies collected views of managers across different departments. It reflects the different perspectives which enhances study credibility.

**Years Served in the Organisation**

**Table 8: Number of Years in the Current Position**

| | Frequency | Percent | Cumulative Percentage |
|---|---|---|---|
| 1-5 years | 235 | 38.91 | 38.91 |
| 6-10 years | 87 | 14.40 | 53.31 |
| 11-15 years | 90 | 14.90 | 68.21 |
| 16-20 years | 98 | 16.23 | 84.44 |
| 21-25 years | 94 | 15.56 | 100.00 |
| **Total** | **604** | **100.00** | |

*Source: Primary Data (2025)*

In terms of job tenure, results show (*see table 8 above*) a big portion of the respondents (61.09%) had an experience of more than five years in their positions, whereas 38.91% had worked for their organisations for a period of time less than 5 years. This shows considerable experience that respondents had.

**Empirical Findings**

**Effect of Innovation on Financial Performance of Tier IV MFIs**

Pearson correlation analysis was conducted in accordance with objective and hypothesis 1 to assess the associations between firm innovation, and financial performance (Pallant, 2020) as indicated in *table 9* below.

**Table 9: Correlation Matrix**

| | | 1 | 2 | 3 |
|---|---|---|---|---|
| **1** | Dynamic Capabilities | 1 | | |
| **2** | Firm Innovation | .603** | 1 | |
| **3** | Financial Performance | .714** | **.549**** | 1 |

*Note:* **$P$<.01 level (1-tailed), $n$ =139

*Source: Primary Data (2025)*

Looking at the results in *table 9* above, there exists a positive and significant relationship between firm innovation and financial performance of Tier IV MFIs ($r$= .549, $p$<.01). This means that improvement in firm innovation is associated with improvement in financial performance of Tier IV MFIs.

**Discussion of Findings**

This study was conducted to examine the relationship between innovation and financial performance Tier IV MFIs in Uganda ($H_1$). As shown in *table 9* above, the Pearson correlation analysis results reveal a statistically significant and positive relationship between innovation and financial performance among Tier IV MFIs in Uganda which proved the stated hypothesis right. Such finding demonstrate that innovation is an important driver of financial performance. It tells us that Tier IV MFIs which imbed their dynamic capabilities in their routines and go further to developing new financial services, delivering satisfactory customer experience, improving financial transaction processes, creating new markets and designing effective business models no doubt achieve their financial performance goals. A close scrutiny on extracts from the qualitative study reveal closeness with this finding. For instance, respondent no. 14 reported,

*[….]….“Our field officers serve as our 'ground intelligence,' observing the daily challenges faced by market vendors. [..]…their field reports provide more insight into the necessity for flexible repayment options than any spreadsheet could convey [….]..”*

*[ ]…“ We do not isolate ideas within a silo. […..] we utilize board papers and stakeholder workshops to ensure that all parties involved, from tellers to directors, comprehend that innovation constitutes a collective financial obligation..”[…]* Reported respondent no. 9

By combining the quantitative and qualitative results one can see harmony re-echoing the previous studies’ position where firm’s ability to innovate brings many improvements to its performance. Given that firm innovation comprises product/service, process and market innovation, advances in any of these dimensions contribute to improved financial performance. Therefore, innovation can enable Tier IV MFIs to adopt improved financial technologies, introduce new financial services, create new customer experiences, improve transaction processes, create new markets and develop effective business models that can enhance their financial performance (Chemutai et al., 2022; Johannessen, 2013). In an interview with Tier IV MFIs’ managers, responses revealed that they invested in innovation by introducing mobile repayment options, group based lending and financial literacy training sessions to clients which led them to later experience low default rates and enhanced financial performance. For example respondent no. 13 mentioned that; [ ]*“…after observing a consistent trend of loan misuse and unsuccessful business, we introduced financial literacy trainings to clients which improved their performance and led to better repayment rates that enhanced our financial performance [ ] ”.*

Another respondent no. 4 noted that; [ ...]*"...after introducing group lending, the staff trained group leaders on keeping records and how to monitor peers. This helped in timely repayment, reduced default rates and enhanced our performance [ ... ]".*

Prior studies have consistently indicated that organisations that fail to invest in innovative products or improved processes lose their market share, followed by a decline in financial performance results (Klingebiel and Rammer 2021). An important repeated message has been that limited investment in innovation, through new product development, improvements in existing processes, products, and services, contributes to market-share erosion and poor financial outcomes. A firm's failure to invest in innovation results in competitive disadvantage and weakened financial performance. Comparable evidence has been presented in the literature, where Ndesaulwa and Kikula, (2016) found that the capability to innovate is a key driver of competitive advantage and sound financial performance among firms. Bach et al., (2019), also report similar findings, observing that innovation contributes to improved performance. This is supported by interview results which revealed that investment in innovation increases outreach to underserved clients, improves operational efficiency and reduces transaction costs which strengthens competitiveness that in turn enhances financial performance. The results align with the assumptions of the innovation theory, which stipulates that entrepreneurs earn economic profit through introducing successful innovation (Schumpeter, 1934). Other researchers have reported comparable findings, noting that superior financial performance can be achieved through efficiency in creating unique, valuable products and services that satisfy customers (Chemutai et al., 2022), thereby confirming the relevance of this theory in this study.

**Conclusion**

As shown in *table 9* above, innovation (market innovation, process innovation and product or service innovation) has a significant positive effect on financial performance among Tier IV MFIs in Uganda. This study concludes that innovation influences financial performance in varied ways. From this find we alert Tier IV MFIs to constantly strive for integration of various innovation techniques in their routines to be able to achieve better their financial performance goals and remain competitive. The basis for this recommendation is that if Tier IV MFIs leverage the value of service innovation, process innovation and market innovation, their profitability, liquidity, loan portfolio and financial efficiency will improve as affirmed by literature and this study. The operationalisation of innovation techniques will enable them to survive better raising their capability to manage both internal and external risks.

**Theoretical Implications**

Several contributions to the existing theoretical frameworks can be stated as seen below as an empirical validation and extension of innovation theory and dynamic capabilities theory specifically in the context of Tier IV MFIs in Uganda a developing economy.

Firstly, the study finding enhances the key proposition of innovation theory advancing that in view of the current financial market situation where Tier IV MFIs are exposed to policy shifts, money market fluctuations, infrastructure challenges, opportunistic behaviours of managers, unfaithful customers who default, they must constantly initiate innovations in their markets, processes and products. They must work towards improving their financial performance through new financial services, new customer experience, improved financial transaction processes, creation of new markets and designing effective business models. This study adds to other existing studies on

innovation and financial performance specifically in the microfinance industry. Secondly, this study provides empirical evidence reinforcing the argument that dynamic capabilities in terms of sensing, seizing, and integration positively influence financial performance of Tier IV MFIs. Dynamic capabilities theory has proved as a powerful theory in explaining firm innovation and financial performance. It is a live call to Tier IV MFIs to continuously align and reconfigure innovations (markets, processes and products) to their routines as a smart way to achieving improved financial performance.

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