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FACTORS CONTRIBUTING TO MANUFACTURING FIRM PROFITABILITY IN TANZANIA

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ABSTRACT

The study assessed factors contributing to manufacturing firm profitability in Iringa Municipality in Tanzania. Specifically, the study determined the contribution of macroeconomic factors, industry specific factors and firm specific factors on firm profitability. The study employed positivism paradigm and quantitative research approach. Explanatory cross-sectional design used to explain the causal effects relationship between variables. Population of the study was 150 employees with managerial positions and the sample size was 109. Data was collected using structured questionnaire and analyzed using descriptive statistics namely frequencies, percentage, mean and inferential statistics Multiple Linear Regression Model. The results show that firm specific factors, macroeconomic factors and industry specific factors have positive significant relationship with firm profitability.

Keywords: *Firm specific factors, Industry specific factors, Macroeconomic factors and Firm profitability*

1.0 Introduction

Profitability is the ratio which measures the performance of the company. The profitability of the manufacturing company shows a company's ability to generate earnings for a certain period at a rate of sales, assets and a certain amount of capital stock. Profitability is a measurement of efficiency and ultimately the success or failure of a company (Bhutta and Hassan, 2013). A business can produce a return on an investment based on its resources in comparison with an alternative investment. Profitability is a commonly used indicator of firm performance. Consequently, it is in the best interest of every organization to maximize its return rate to satisfy shareholders, attract new capital and ensure continued operations (Msami and Wangwe, 2016).

Worldwide, profitability is viewed as one of the elements of performance evaluation, showing the proportion of profit in comparison with asset investment, equity or sales (Avdalovic, 2018). Improving profitability is one of the key tasks for enterprises, especially in the context of manufacturing firms. This is due to the fact that, only a stable economy with high profitability can provide enough financial resources for sustainable development, and attract attention and investment from internal and international investors (Muzahem, 2021). Not only being a reliable basis for evaluating business performance, profitability also is a useful tool for forecasting the performance of businesses in the future. Profitability reflects shareholders' wealth, and accordingly, appeals to investors. This is the reason why identifying different factors contributing to firm profitability (Avdalovic, 2018).

In Tanzania, manufacturing sector is ranked as the third most important to Tanzania's economy after agriculture and tourism. It plays a great role in the national economy by contributing 29% to the country's Gross Domestic Product (GDP), creating employment for skilled and unskilled people, producing goods which are used internally and others are exported (Nyamu, 2016; Bhutta and Hassan, 2013; Mbilinyi, 2018). Investing in manufacturing companies requires heavy finances on a long-term basis to strengthen profit making, however, the sector is still facing a problem of profit-making and most of the companies are operating at a loss and some are able just to cover the operational costs because they do not generate enough profit from their businesses.

Previous scholars on factors contributing to firm profitability have come up with factors like firm specific-factors (firm size, asset growth, asset tangibility, financial leverage, debt equity, age of the firm and number of stocks as pointed out by Dahmash et al 2021; Bhutta and Hassan, 2013; Avdalovic 2018); others have mentioned macroeconomic factors such as inflation, unemployment, GDP, exchange rates and lending rates as revealed by Dew et al 2019; Cheong and Hoang 2021; Nyamu, 2016 and Industry specific factors (growth rates, market share, market concentration and intensity of research and development) were mentioned by Zampara et al., (2017), Kant, 2018, and Raza et al, 2017). Furthermore, previous scholars reported that the high cost of capital and energy, taxation issues and other legal aspects affected firm profitability. The persistent issue of profit generation failure among the majority of manufacturing firms in Tanzania remains inadequately examined by previous scholarly investigations. This has necessitated the need for this study to explore the extent to which these factors contribute to firm profitability. In this regard, the current study intends to investigate factors contributing to firm profitability by focusing on manufacturing firms in Iringa Municipality in Tanzania.

2.0 Literature Review

2.1 Theoretical Framework

Signaling theory is the theory developed by Michael Spence (1973) which explains factors that affect the firm profit, both internal and external factors. The internal factors affecting firm profitability are firm and industry specific factor while the external factors are the macroeconomic factors. These factors can directly or indirectly affect the firm profitability. However, this research will group these factors based on three factors namely firm specific factors, macroeconomic factors and industry specific factors. The rationale for this grouping is to enable the researcher to capture all main factors as pointed by previous scholars instead of only studying some. The signaling theory relates to the current study as factors pointed out in this theory was used as the key factors contributing to firm profitability in Iringa Municipality.

In addition, the signaling theory is one of the theories, which have a clarification for the association between profitability and capital structure (Alkhazaleh&Almsafir, 2014). This theory presupposes that a superior capital structure is an optimistic signal to the market worth of the organization (Adeusi, Kolapo& Aluko, 2014). The signaling theory further postulates that majority of the profitable firms signal their competitive power by communicating new and important information to the market. Thus, information is disclosed using specific indicators or ratios which, very often, measure specific conditions on which to enter into or renew the agency contract (Bini, Dainelli& Giunta, 2011). According to the signaling theory, the management of banks signals good future expectations by increasing capital. This indicates that, less debt ratio necessarily means those manufacturing firms perform better than their identical (Alkhazaleh & Almsafir, 2014).

In addition, the theory argues that managers who strongly believe that their firms can outperform other banks in the industry will want to relay such information to various stakeholders to attract additional investments. Thus, the signaling theory affirms that when a firm performance is excellent, directors signal the manufacturing profitability to its stakeholders and market by making various disclosures that poor performing firms cannot make. By enhancing more disclosure most managers will wish to receive high benefits and a good reputation which may increase the value of the firm and profitability (Muzahem, 2021). This study stipulates factors contributing to firm profitability in terms of internal factors and external factors which categorized into firm specific factors, macroeconomic factors and industry specific factors, hence specific objectives of the study were drawn from here.

2.2 Empirical Literature Review

Zampara, Giannopoulos and Koufopoulo (2017) conducted a study titled “Macroeconomic and Industry specific Determinants of Greek Bank Profitability” where they specifically grouped construct based on the growth rates, unemployment rates, banks’ market shares, market total assets and total deposits. Multiple linear regressions were used to analyze data. The study found that unemployment rates had a negative impact on bank profitability; whereas gross domestic product had a positive impact. The industry- related factors such as industry rate of growth deposits, bank deposits and bank assets market share have a positive impact on firm profitability. However, the rate of growth of the industry assets and the bank’s deposit market share harms bank’s profitability. A potential gap in this study could be the absence of other industry- specific factors that could be relevant to the Greek banking industry, and that could be addressed in future research.

Dewi, Intanie, Soei, Catharina, Surjoko and Oriana (2019) conducted a study on the “Impact of Macroeconomic factors on Firm Profitability in Niger”. The purpose of the study was to determine the influence of macroeconomic factors such as inflation rate, unemployment level, Gross domestic product and exchange rates on firm profitability which is reflected by the return on Assets. The study used Return on asset as a dependent variable and the independent variables were macroeconomic factors. A Multiple Linear Regression was used to analyze data and it was found that all independent variables influence Return on Assets (firm profitability). However, a partial t-test showed that only Gross Domestic Product (GDP) level has a significant influence on firm profitability, while the other three macroeconomic factors have no significant influence. A potential gap in this study could be the absence of any consideration for other factors that could influence firm profitability in Niger, and that could be addressed in future research.

Chinaemerem (2019) conducted a study entitled Determinants of industry specific factors affecting banks profitability in Nigeria’s banking industry: Panel Auto- Regressive Distributive Lag (ARDL) approach, profitability indicators such as Return on Asset (ROA), Return on Equity (ROE), and Net Interest Margin (NIM) were used in the study. The Pool Mean Group (PMG) was used to investigate the effects of industry- specific factors such as market concentration based on the result of the Hausmann test. According to the findings, banking sector development has a statistically significant impact on bank profitability. Market concentration, on the other hand, is not a significant driver of bank profitability.

Amariati (2013) in her study entitled financial factors that affect the profitability of manufacturing companies listed in the NSE in Kenya. This study was a descriptive research survey and it covered a period of the past 36 months. The finance and procurement staffs of 9 NSE-listed manufacturing firms were the target population. There was no sampling because the population was small and variable. A sample size of 9 respondents was chosen from a population of manufacturing firms. This study made use of both primary and secondary data. According to the study, Kenyan manufacturing firms face a volatile business environment, high product market competition, ineffective government policies, and uncertainty and volatility of key macroeconomic factors, all of which reduce profit margins and make future planning difficult or impossible. The study concludes that financial factors such as exchange rates, tax regime, interest rates and inflation rates have an impact on the profitability of Kenyan manufacturing firms.

Bhutta and Hassan (2020) in the study of the impact of Firm Specific Factors on the Profitability of Firms in food sectors in Pakistan specifically focused on debt- equity, tangibility, growth and size and macroeconomic factors including inflation. The study found significant negative relationships between size and profitability. However, tangibility, growth of the firm and food inflation were found to be insignificantly positively related to profitability. Empirical results provide evidence that the profitability of the food sector is shaped by firm specific factors and not macroeconomic factors. However, the limitation of the study is that it just focused on one macroeconomic factor, inflation.

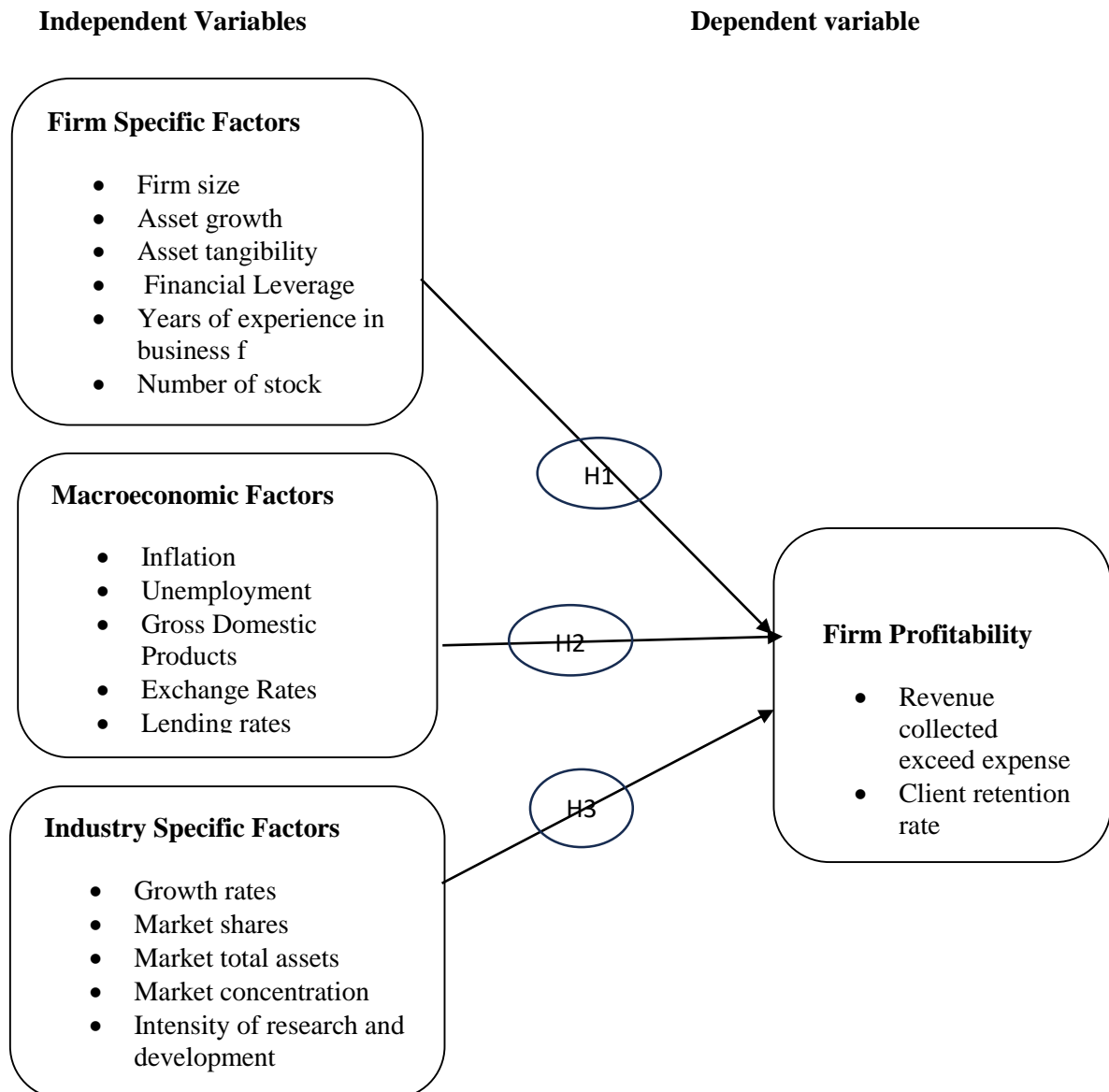
Avdalovic’ (2018) in his study Impact of firm-specific factors on the profitability of industry grinding companies in Belgrade Stock Exchange, a sample of 62 companies was taken from 2008 to 2014. Return on equity considered as a measure of profitability was a dependent variable whereas firm sizes, leverage, years of firm existence, and number of stocks per share were considered as dependent variables. The study found leverage, number of stocks and book per value

share were statistically significant with profitability for selected grinding companies in Serbia. Size and age were indicating an insignificant relationship with profitability.

In summary, the preceding studies primarily focused on exploring the factors that influence profitability. While these factors are recognized, their specific contribution to profitability, particularly within the context of manufacturing firms, remains unknown. Hence, the present study is warranted to address this knowledge gap.

2.4 Conceptual Frame work

This conceptual framework shows the relationship between the independent variables and dependent variables (Saunders *et al.*, 2006). In this study, the independent variables are firm specific factors, macroeconomic factors and industry specific factors and the dependent variable Firm's Profitability.



Source: Researcher's Conceptualization, (2023)

Figure 1: Conceptual Framework

3.0 Methods

This study was guided by the positivism paradigm owing to the adoption of cross-sectional survey to explain the causal effect relationship between macroeconomic factors, firm specific factors and industry specific factors on firm profitability. The study adopted quantitative research approach with explanatory cross-sectional design. This study is explanatory because it explains the causal effects relationship between macroeconomic, industry and firm specific factors and firm profitability. Also, the study is cross-sectional research design since data collection, analysis, and interpretation were conducted at a single point in time, thus, the cross-sectional survey was obtained and processed in a single phase. Population of the study was 150 employees with managerial positions and the sample size was 109. Data was collected using structured questionnaire and analysed using descriptive statistics namely frequencies, percentage, mean and inferential statistics Multiple Linear Regression Model.

4.0 Findings

4.1 Macroeconomic Factors and Firm Profitability

Results in Table 1 show that, 87(80.0 %) respondents believed that inflation had an impact on business profitability. This means that inflation can help businesses raise their profit margins by granting them pricing power. If profit margins are increasing, it suggests that the prices that manufacturers charge for their products are rising faster than production expenses.

Table 1: Macroeconomic Factors

| Macroeconomic Factors | Agree | Neutral | Disagree |
|------------------------|-----------|-----------|-----------|
| Inflation | 87(80.0%) | 17(15.5%) | 5(4.5%) |
| Unemployment | 58(53.2%) | 28(25.7%) | 23(21.1%) |
| Gross Domestic Product | 59(54.1%) | 48(44.0%) | 2(1.8%) |
| Exchange rates | 82(75.2%) | 25(22.9%) | 2(1.8%) |
| Lending rates | 64(58.7%) | 36(33.0%) | 9(8.3%) |

Source: Field data (2023)

Furthermore, 58(53.2%) respondents declared that unemployment is linked to a company's profitability because high unemployment benefits put upward pressure on wages, reducing the profitability of hiring labor and worsening unemployment. In addition, increasing unemployment

will result in lower income for the majority. For many manufacturing companies, this will mean decreased sales as individuals will spend less, resulting in lower profit margins. However, in other cases, when unemployment is high, demand for certain items and services will rise. Further, 59(54.1%) respondents stated that profitability had an impact on macroeconomic performance as well as on the Gross Domestic Product. This implies that as the economy grows, more jobs will be created, and workers are more likely to benefit from compensation increments. When GDP depreciates, however, the economy shrinks, which is devastating for both individuals and businesses. Nyamu (2016) discovered a non-significant positive association between unemployment and financial performance in terms of exchange rates, money supply, and lending rates in Kenya, which contradicts current study findings.

The findings are consistent with those of Cheong and Hoang (2021) in Hong Kong, who discovered that previous profitability, business size, inflation, and leveraging all had strong associations with profitability. Similar results were also obtained by Zampara, Giannopoulos and Koufopoulo (2017) inflation can provide businesses with pricing power and increase their profit margins. If profit margins are rising, it means the prices that companies charge for their products are increasing at a faster rate than increases in production costs.

Macroeconomic factors such as exchange rates affected the profitability of manufacturing enterprises in 82 (75.2 %) cases. This could be explained by the fact that an increase in the variance of the permanent (transitory) component of the exchange rate process leads to greater (or lesser) variability in the firm's profit growth rate, demonstrating that the source of exchange rate volatility matters when analyzing its effects. Christian et al. (2018) identified a positive significant association between exchange rate and profitability in Nigeria.

Furthermore, 64 (58.7%) respondents agree that loan rates have an impact on firm profitability. This is because manufacturing firms are more inclined to borrow because debt repayment is easier. When interest rates are high, however, manufacturing firms will be hesitant to borrow since loan repayment costs more and, if not cautiously managed, can eat into profits. These findings are consistent with those of Dewi et al. (2019), in an Indonesian study that revealed that the level of GDP, lending rates, and credit procedures have all had a substantial impact on company profitability.

4.2 Industry Specific Factors and their influence on Firm Profitability

Results in Table 2 show that, 107(98.6%) of manufacturing organizations stated that their growth rate had an impact on their profitability, because growth for a manufacturing firm is essentially an expansion, making the company bigger, expanding its market, and eventually making it more profitable. These findings are consistent with those of Yoo and Kim (2015), who discovered that companies invest based on current financial performance rather than the present value of predicted future earnings over an infinite time since they cannot reliably predict expected future profit. From a resource-based perspective, however, company growth does not improve future profitability, but rather the economic growth inherent in the manufacturing firm's features. Although economic development provides organizations with temporary incentives to expand, companies that have grown quickly face higher operating costs than those lagging in growth

Table 2: Industry Specific Factors

| Industry Factors | Disagree | Neutral | Agree |
|-------------------------|-----------------|----------------|--------------|
| Growth rates | 107(98.6%) | 0(0.0%) | 2(1.4%) |
| Market share | 64(58.7%) | 9(8.3%) | 36(33.0%) |
| Market total assets | 81(74.3%) | 23(21.4%) | 5(4.3%) |
| Market Concentration | 97(89.0%) | 5(4.6%) | 7(6.4%) |
| Intensity of research | 99(90.8%) | 5(4.3%) | 5(4.3%) |
| Company Reputation | 96(88.1%) | 8(7.3%) | 5(4.6%) |

Source: Field data (2023)

According to the study's findings, 64 (58.7%) of the respondents stated that market share influences profitability because a business with a higher profit margin has a declining purchase-to-sales ratio. A decline in marketing costs as a percentage of sales, higher quality, and higher-priced products is more likely to have a higher profit margin. Furthermore, a declining purchase-to-sales ratio, a decline in marketing costs as a percentage of sales, and higher quality and higher-priced products have a higher profit margin. Market share is imperative because it causes network effects, which push competition out of the market and open the door to monopolistic rents. Profit is the sole fuel that can stimulate innovation; hence profit share is prime. These findings are consistent with a study conducted in Alabama, USA, by Bhattacharya, et al. (2021), who discovered that many businesses use market share to set marketing goals and track success and that marketing share is the result of a company's attempts to compete in a production market.

The finding of the study further revealed that, 97 (89.0%) respondents believed market total concentration has an impact on manufacturing business profitability. The sum of the market share percentages owned by the biggest defined number of enterprises in an industry is known as market total concentration. Furthermore, 99(90.8%) respondents revealed that overall expenditure on research and development had an impact on profitability. In the high-tech industry, research and development investments boost performance in the same period and continue to influence it for several periods afterward, suggesting the presence of positive and lagged benefits of Research and innovation. Finally, on firm reputation, 96 (88.1%) respondents believed that it has an impact on profitability. Reputation may make it easier to attract and retain top talent, resulting in increased profitability. as similarly discovered by Maniatis (2016) in Netherlands. Market concentration is important because it demonstrates the market structure and its ability to operate under free competition. Market concentration can be measured using a variety of indices such as percentages of sales, earnings, asset volume, or fixed capital.

4.3 Firm Specific Factors

In reference to firm-specific characteristics, Results in Table 3 show that, 100(91.4%) respondents agreed that larger firms are more profitable. This could be explained by the fact that the size of a company can signal that it is growing and expanding, causing the market to react favourably. This means that the size or scale of a manufacturing firm is proportional to its total assets and sales.

Table 3 Firm Specific Factors

| Firm-Specific factors | Disagree | Neutral | Agree |
|------------------------------|-----------------|----------------|--------------|
| Firm Size | 100(91.4%) | 9(8.6%) | 0(0.0%) |
| Asset Growth | 107(98.6%) | 0(0.0%) | 2(1.4%) |

| | | | |
|-----------------------------|------------|-----------|-----------|
| Asset tangibility | 97(88.9%) | 8(7.3%) | 4(3.7%) |
| Financial leverage | 83(75.7%) | 20(18.6%) | 6(5.7%) |
| Firm experience | 81(74.3%) | 23(21.4%) | 5(4.3%) |
| Number of stocks | 87(80.0%) | 8(7.1%) | 14(12.8%) |
| Employee productivity level | 100(91.4%) | 4(4.3%) | 5(4.3%) |

Source: Field data (2023)

This finding was supported by Dogan (2013) in Turkey, who discovered a favourable relationship between business size indices and profitability. Large manufacturing enterprises, on the other hand, have better access to funding and internal resources, allowing them to boost profit margins in comparison to their smaller counterparts.

Asset growth determines the firm's profitability, according to 107 (98.6%) respondents. This is because an asset is a resource with the economic worth that a person or company possesses or controls with the prospect of receiving a benefit in the future. An asset growth combines all three types of financing. The book of equity of a company grows as a result of both equity issuance and growth in retained earnings. These findings contradict those of a Jordanian study by Dahmash et al. (2021), who found no significant association between asset expansion and profitability, but a significant impact on business size and profit-making.

Regarding asset tangibility, 97 (88.6%) respondents believe it has an impact on a manufacturing firm's profitability. An asset with tangibility has a finite monetary value and, in most cases, a physical form. Liquidity varies across markets, but tangible assets can typically transact for some monetary value. These findings are consistent with those of a study conducted in Kenya by Irungu et al. (2018), and Matimbwa and Ochumbo (2018) whose discovered a positive significant association between asset tangibility and financial performance of listed companies on the Nairobi Securities Exchange.

Financial leverage has an impact on business profitability, according to 83 (75.7 percent) respondents. This is because companies use debt to buy additional assets, which increases equity. Excessive financial leverage, on the other hand, raises the risk of failure. Similarly, 81(74.3 %) and 87(80.0 %) respondents stated that business experience and the number of stocks increase the firm's profitability. Firm experience boosts profitability because it allows companies to understand how to effectively address competition's unique challenges. Furthermore, stock numbers reflect a variety of potential gains and losses for a business, beginning with direct revenue from inventory sales. Overbuying and carrying excess inventory, on the other hand, can result in overstocked inventory approaching the end of its product life cycle, causing companies to incur losses.

Employees' productivity levels were evaluated to determine whether they have an impact on manufacturing profitability, with 100 (91.4%) respondents agreeing that they did. This could be explained by the fact that highly productive employees either do more work in less time or take fewer hours to complete tasks. This aids in the reduction of operating costs. As a result, fewer workers are needed to generate the same amount of output, thus increasing profitability.

The model summary table 5 shows the strength of the relationship between the model and firm profitability. R, the multiple correlation coefficients is the linear correlation between the observed

and model predicted values of the dependent variable (firm profitability). The Regression (R) square of 84.5% indicates that there is a good model fit since the R square is greater than 50%. This implies that the specified model places firm profitability at 84.5%.

Table 5: Model Summary

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|-------|-------------------|----------|-------------------|----------------------------|
| 1 | .919 ^a | .845 | .840 | .51676 |

a. Predictors: (Constant), FSF, MACF, ISF

Furthermore, the use of p value in the ANOVA output determined whether the differences between some of the means are statistically significant. P value has been used to measure the significance of observational data, after identification of an apparent relationship between two variables. Table 6 shows that p value of 0.000 which indicates that there is significant influence of Firm specific factors, Industry Specific Factors and Macroeconomic factors on Firm Profitability.

Table 6: ANOVAa

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|-------|------------|----------------|-----|-------------|---------|-------------------|
| 1 | Regression | 152.511 | 3 | 50.837 | 190.373 | .000 ^b |
| | Residual | 28.039 | 105 | .267 | | |
| | Total | 180.550 | 108 | | | |

a. Dependent Variable: PROF

b. Predictors: (Constant), FSF, MACF, ISF

The regression analysis output confirmed that there is a significant positive relationship between firm-specific factors (FSF) and Firm Profitability (PROF) as the p-value is 0.02, which is less than 0.05. Saunder *et al.*, (2014) suggest that the p-value should be equal to or less than 0.05 to be significant. Furthermore, the regression analysis output confirmed that there is a significant positive relationship between Macroeconomic factors (MACF) and the Profitability of the firm, as the p-value is 0.036, which is less than 0.05. Moreover, the regression analysis output confirmed that there is a significant positive relationship between industry-specific factors (ISF) and Firm Profitability (PROF) as the p-value is 0.02, which is less than 0.05. Findings evidence that all factors affect firm profitability.

Table 7:Coefficients^a

| Model | | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|-------|------------|-----------------------------|------------|---------------------------|--------|------|
| | | B | Std. Error | Beta | | |
| 1 | (Constant) | .098 | .243 | | .404 | .687 |
| | MACF | .371 | .044 | .790 | 8.412 | .036 |
| | ISF | .829 | .078 | 1.208 | 10.664 | .021 |
| | FSF | .181 | .041 | .403 | 4.455 | .020 |

a. Dependent Variable: PROF

5.0 Conclusion and Recommendation

The study concludes that there is a significant positive relationship between firm-specific factors, industry specific factors and macroeconomic factors as their p values were below 0.05. The study recommends that manufacturing firms in Iringa Municipality to increase market share, total assets, conduct intensive research and maintain good reputation. The study also recommend government to inflations, unemployment and control banks when it comes to lending rates because all of this affect firm profitability.

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