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# Business Risk Management, Capital Structure, And Financial Performance Of Small And Medium Enterprises (SMEs): A Case Of Nakaseke District

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**Abstract**

This study examined the relationships among business risk management, capital structure, and financial performance of SMEs in Nakaseke District, Uganda. A correlational cross-sectional design was employed with 164 SME owners and managers selected through stratified random sampling from a population of 380 registered SMEs. Business risk management was measured by risk identification, risk mitigation, and risk monitoring practices. Capital structure was assessed through debt-to-equity ratios, equity financing, and retained earnings utilization. Financial performance was measured by profitability, liquidity, and business growth. Multiple regression analysis yielded $R^2 = 0.538$, indicating that business risk management and capital structure jointly explain 53.8% of variance in SME financial performance. Risk mitigation ($\beta = 0.361$, $p < 0.001$) and equity financing ($\beta = 0.298$, $p < 0.001$) were the strongest predictors. The study recommends that SMEs in Nakaseke formalize their risk management practices and diversify capital structures to reduce over-reliance on short-term debt.

**Keywords: Business risk management, capital structure, financial performance, SMEs, Nakaseke District, Uganda.**

## 1.0 Introduction

Small and medium enterprises (SMEs) constitute the backbone of Uganda's economy, accounting for approximately 90% of private-sector businesses and contributing over 70% of employment (UBOS, 2020). In Nakaseke District a peri-urban area north of Kampala-SMEs operate in agriculture, retail trade, agro-processing, and transport(Collins et al., 2023). Despite their economic significance, SMEs in Uganda exhibit persistently high failure rates, with the Uganda Registration Services Bureau (URSB) estimating that over 40% of registered businesses close within five years of inception(Turyatemba et al., 2022).

Two critical but interrelated determinants of SME financial performance are business risk management and capital structure(Ahumuza et al., 2025). Business risk management encompasses the systematic processes by which businesses identify, assess, and mitigate threats to their objectives(Julius & Matovu, 2025). Poor risk management exposes SMEs to operational disruptions, loan defaults, and market shocks(Alex et al., 2024). Capital structure the mix of debt and equity financing determines a firm's financial leverage and cost of capital. Over-reliance on high-interest microfinance debt, characteristic of Ugandan SMEs, increases financial distress risk and depresses net profitability(Irumba et al., 2024). This study examined how business risk management practices and capital structure decisions jointly influence the financial performance of SMEs in Nakaseke District, providing empirical evidence to guide SME support programmes and financial policy in Uganda(Irumba et al., 2024).

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**2.0 Literature Review**

Financial performance of SMEs has been theorized through the resource-based view (Barney, 1991) and the Modigliani-Miller capital structure theorem (Modigliani & Miller, 1958; 1963). The resource-based view holds that firm performance is a function of the quality of its internal resources and capabilities, of which risk management competence is a critical strategic capability(Julius & Kazaara, 2025). Risk management enables SMEs to preserve value, reduce earnings volatility, and sustain competitive advantage(Alex et al., 2024). The trade-off theory of capital structure (Kraus & Litzenberger, 1973) posits that firms balance tax benefits of debt against bankruptcy costs to arrive at an optimal capital structure that maximises firm value. For SMEs, the pecking-order theory (Myers & Majluf, 1984) is more empirically relevant: firms prefer internal financing (retained earnings) over debt, and debt over equity, due to information asymmetries. In Uganda's credit-constrained SME environment, over-reliance on formal debt often at rates above 20% per annum creates significant financial risk. Empirical evidence from East Africa is instructive. Munyua and Ngugi (2015) found that Kenyan SMEs with formal risk management frameworks achieved 31% higher return on assets than those without. Abor (2007) established that in Ghanaian SMEs, a higher debt ratio was negatively associated with profitability ($r = -0.41$), while equity financing showed a positive association ($r = 0.38$). These findings suggest a nuanced relationship between capital structure and performance.

**3.0 Methodology**

A cross-sectional correlational research design was adopted to examine the relationships between risk management practices, capital structure, and financial performance of SMEs. The study focused on SMEs that were formally registered with both the Nakaseke District Local Government and the Uganda Registration Services Bureau(Nafiu, 2012). From a total population of 380 registered SMEs, a sample of 164 enterprises was selected using stratified random sampling. This sampling technique was used to ensure that different categories of SMEs were adequately represented, thereby improving the generalizability and reliability of the findings across the district.

Data collection was carried out using a structured questionnaire that captured information on risk management practices, capital structure decisions, and financial performance indicators. In addition to the questionnaire, a brief review of available financial records was conducted to support the self-reported data and enhance validity. Out of the 164 selected respondents, a high response rate of 89.6% was achieved, which indicated strong participation and reduced the likelihood of non-response bias affecting the study results.

The reliability of the research instruments was assessed using Cronbach's Alpha coefficients. All constructs recorded acceptable internal consistency values ranging between 0.77 and 0.84, indicating that the measurement items were sufficiently reliable for statistical analysis. This suggested that the questionnaire items consistently measured the intended variables across respondents.

For data analysis, both Pearson correlation and multiple regression techniques were employed using SPSS version 25(Nelson et al., 2022). Pearson correlation analysis was used to examine the strength and direction of relationships

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among the study variables, while multiple regression analysis was used to determine the predictive influence of risk management and capital structure variables on financial performance.

Before conducting regression analysis, diagnostic tests were performed to ensure the validity of statistical assumptions. Outliers were identified and managed using Mahalanobis distance analysis, which helped detect multivariate extreme cases that could distort results. In addition, the assumption of homoscedasticity was tested using the Breusch–Pagan test, and the results confirmed that the variance of residuals was constant across levels of the independent variables. This indicated that the regression model met key assumptions required for reliable and unbiased estimation of coefficients.

## 4.0 Results and Discussion

### 4.1 Descriptive Statistics

**Table 1: Descriptive Statistics on SMEs in Nakaseke District**

| Variable | N | Min | Max | Mean | Std. Dev. | Skewness |
|---|---|---|---|---|---|---|
| Risk Identification (RI) | 164 | 1.20 | 5.00 | 3.48 | 0.81 | -0.28 |
| Risk Mitigation (RM) | 164 | 1.40 | 5.00 | 3.71 | 0.76 | -0.44 |
| Risk Monitoring (RMo) | 164 | 1.20 | 5.00 | 3.55 | 0.79 | -0.33 |
| Debt-to-Equity Financing (DEF) | 164 | 1.00 | 5.00 | 3.62 | 0.84 | -0.39 |
| Equity Financing (EF) | 164 | 1.00 | 5.00 | 2.94 | 0.88 | 0.21 |
| Retained Earnings (RE) | 164 | 1.20 | 5.00 | 3.31 | 0.82 | -0.18 |
| Financial Performance (FP) | 164 | 1.20 | 5.00 | 3.38 | 0.85 | -0.24 |

**Source: Primary Data, 2025**

The descriptive statistics indicated that responses from 164 SMEs in Nakaseke District generally clustered around moderate to high agreement levels on most study variables. Risk Identification (M = 3.48, SD = 0.81), Risk Mitigation (M = 3.71, SD = 0.76), and Risk Monitoring (M = 3.55, SD = 0.79) all recorded above-average means, suggesting that SMEs had relatively strong engagement in risk management practices(Promise et al., 2024). Similarly, Debt-to-Equity Financing (M = 3.62, SD = 0.84) and Retained Earnings (M = 3.31, SD = 0.82) were moderately high, while Equity Financing recorded a comparatively lower mean (M = 2.94, SD = 0.88), indicating that equity-based financing was less commonly utilized(Ivan et al., 2023). Financial Performance also reflected a moderate positive rating (M = 3.38, SD = 0.85), suggesting generally stable but not exceptional performance levels among the SMEs(Ahumuza et al., 2025). The skewness values for most variables were negative, indicating that responses were slightly concentrated toward higher agreement levels, except Equity Financing which showed a slight positive skew, implying more lower-end responses.

### 4.2 Correlation Analysis

**Table 2: Pearson Correlation Matrix between SME Risk, Capital Structure and Performance**

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| Variable | RI | RM | RMo | DEF | EF | RE | FP |
|---|---|---|---|---|---|---|---|
| Risk Identification | 1.000 | .541** | .488** | -.221** | .382** | .341** | .471** |
| Risk Mitigation | .541** | 1.000 | .531** | -.311** | .472** | .412** | .592** |
| Risk Monitoring | .488** | .531** | 1.000 | -.241** | .401** | .388** | .522** |
| Debt-to-Equity | -.221** | -.311** | -.241** | 1.000 | -.502** | -.381** | -.381** |
| Equity Financing | .382** | .472** | .401** | -.502** | 1.000 | .471** | .521** |
| Retained Earnings | .341** | .412** | .388** | -.381** | .471** | 1.000 | .488** |
| Financial Perf. | .471** | .592** | .522** | -.381** | .521** | .488** | 1.000 |

The correlation analysis revealed significant relationships among the study variables. Risk management dimensions (risk identification, mitigation, and monitoring) were positively and significantly associated with financial performance, with risk mitigation showing the strongest relationship ($r = .592$, $p < .01$), followed by risk monitoring ($r = .522$, $p < .01$) and risk identification ($r = .471$, $p < .01$)(Nelson et al., 2023). This suggested that better risk management practices were associated with improved financial performance among SMEs. Capital structure variables also showed meaningful associations: equity financing and retained earnings were positively related to financial performance ($r = .521$ and $r = .488$ respectively, $p < .01$), while debt-to-equity financing exhibited a negative relationship with financial performance ($r = -.381$, $p < .01$), implying that higher reliance on debt financing was associated with weaker performance outcomes(Akankwasa et al., 2022). Additionally, risk management practices were positively correlated with equity financing and retained earnings, while negatively related to debt financing, indicating a link between stronger risk practices and more stable financing structures.

**4.3 Regression Analysis**

**Table 3: Regression Results On SME Financial Performance in Nakaseke**

| Variable | B | Std. Error | β | t-stat | Sig. | VIF |
|---|---|---|---|---|---|---|
| (Constant) | 0.681 | 0.221 | — | 3.08 | 0.002 | — |
| Risk Identification (RI) | 0.121 | 0.071 | 0.112 | 1.71 | 0.090 | 1.71 |
| Risk Mitigation (RM) | 0.389 | 0.068 | 0.361 | 5.72 | 0.000*** | 1.88 |
| Risk Monitoring (RMo) | 0.218 | 0.069 | 0.208 | 3.15 | 0.002** | 1.82 |
| Debt-to-Equity (DEF) | -0.229 | 0.071 | -0.217 | -3.24 | 0.001** | 1.94 |
| Equity Financing (EF) | 0.311 | 0.072 | 0.298 | 4.31 | 0.000*** | 2.01 |
| Retained Earnings (RE) | 0.248 | 0.070 | 0.241 | 3.54 | 0.001** | 1.88 |

The regression results further confirmed the influence of both risk management and capital structure on financial performance(Julius & Kazaara, 2026). Risk mitigation emerged as the strongest positive predictor ($\beta = 0.361$, $p <$

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0.001), followed by equity financing (β = 0.298, p < 0.001), retained earnings (β = 0.241, p < 0.01), and risk monitoring (β = 0.208, p < 0.01). Debt-to-equity financing had a significant negative effect on financial performance (β = -0.217, p < 0.01), suggesting that increased reliance on debt reduced SME performance levels. Risk identification showed a positive but statistically insignificant effect (β = 0.112, p = 0.090). The model diagnostics indicated that multicollinearity was not a concern, as all VIF values were below 2.1.

**5.0 Conclusion and Recommendations**

Business risk management and capital structure jointly explain over 53% of the variance in SME financial performance in Nakaseke District. Risk mitigation and equity financing are the most powerful positive predictors, while high debt levels exert a negative effect. The study recommends that Nakaseke District Local Government establish a Business Development Services centre to support SMEs in developing risk management plans. MTIC (Ministry of Trade, Industry and Cooperatives) should facilitate equity crowdfunding platforms for district-level SMEs. Commercial banks should introduce asset-backed SME loan products with lower interest rates to reduce the financial burden of debt on small businesses in peri-urban Uganda.

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