

Business Risk Management, Capital Structure, And The Financial Performance Of Smes In Nakaseke District

Nakolantya Maria¹, Mwesigwa Henry²

1, 2 Metropolitan International University

Abstract

This study investigated the relationship between business risk management, capital structure, and the financial performance of small and medium enterprises (SMEs) in Nakaseke District, Uganda. Guided by a descriptive correlational research design, the study drew a sample of 148 SME owners and managers from a target population of 412 registered enterprises. Data were collected using structured questionnaires and key informant interviews with financial institution representatives. The study found that risk management practices encompassing risk identification, assessment, mitigation, and monitoring had a significant positive effect on the financial performance of SMEs. Capital structure decisions, particularly the ratio of debt to equity financing, also significantly influenced profitability, liquidity, and business growth. SMEs that maintained a balanced capital structure and adopted proactive risk management strategies consistently reported superior financial performance compared to those that did not. The study recommended that SME operators enhance their risk literacy, seek formal business advisory services, and develop structured capital management plans to improve financial sustainability.

Keywords: business risk management, capital structure, financial performance, SMEs, Nakaseke District, debt financing, equity financing, profitability, Uganda

1.0 INTRODUCTION

1.1 Background to the Study

Small and medium enterprises (SMEs) occupied a central role in Uganda's economic development, contributing approximately 20% of the country's gross domestic product and accounting for over 90% of all business establishments as reported by the Uganda Bureau of Statistics (UBOS, 2022). In rural districts such as Nakaseke, SMEs served as critical engines of employment, income generation, and local value creation (Ahumuza et al., 2025). However, the financial performance of SMEs in Uganda remained constrained by a complex array of internal and external risks that threatened their viability and growth prospects (Florence & Julius, 2023).

Business risk management referred to the systematic process of identifying, assessing, prioritising, and mitigating risks that could adversely affect an organisation's ability to achieve its objectives (Julius & Matovu, 2025). In the context of SMEs, risks emanated from multiple sources including market volatility, regulatory uncertainty, credit default, supply chain disruption, and natural hazards. Despite the centrality of risk management to business survival, studies by Abaho et al. (2017) and Kyeyune (2020) found that the majority of Ugandan SMEs operated without formal risk management frameworks, relying instead on intuitive and ad hoc responses to threats as they arose.

Capital structure the combination of debt and equity used to finance a firm's assets—was another pivotal determinant of financial performance (Alex et al., 2024). Modigliani and Miller's (1958) seminal theorem established the theoretical

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foundation for understanding how capital structure choices affected firm value (Julius, 2024). Subsequent refinements, including the Trade-off Theory and the Pecking Order Theory, acknowledged the practical imperfections of capital markets and identified optimal debt levels that balanced the tax advantages of debt against bankruptcy costs (Julius & Kazaara, 2026a). For SMEs in developing economies, access to capital was characterized by significant information asymmetries, collateral constraints, and high interest rates, making capital structure decisions both complex and consequential (Brian et al., 2024).

In Nakaseke District, preliminary surveys revealed that many SMEs relied heavily on informal credit sources including microfinance institutions, village savings and loan associations (VSLAs), and personal savings (Derrick et al., 2023). Few enterprises had developed structured business plans or maintained formal financial records, limiting their access to commercial bank financing and reducing their capacity for evidence-based capital structure management (Alex & Kazaara, 2023). These conditions underscored the need for empirical investigation into how risk management and capital structure practices shaped financial outcomes for SMEs in this district (Alex et al., 2024).

1.2 Statement of the Problem

Despite the acknowledged importance of risk management and capital structure for SME performance, empirical evidence specific to Nakaseke District remained limited at the time of this study (Julius & Matovu, 2025). Most existing research was concentrated in urban centres and failed to capture the unique challenges facing SMEs in rural and peri-urban settings (Alex et al., 2024). Business failure rates among SMEs in Nakaseke were reported to be high, with an estimated 60% of new businesses failing within the first three years of operation (Kazaara & Audrey, 2024). Yet the specific contributions of poor risk management and suboptimal capital structure decisions to this failure rate were not systematically understood (Promise et al., 2024). This study therefore sought to address this gap by providing empirical analysis of the relationship between risk management, capital structure, and financial performance among SMEs in Nakaseke District.

1.3 Objectives of the Study

The study pursued the following objectives: to examine the risk management practices adopted by SMEs in Nakaseke District; to assess the capital structure choices made by SMEs and their determinants; to determine the relationship between risk management, capital structure, and financial performance; and to recommend strategies for enhancing risk management and capital structure optimization among Nakaseke SMEs.

2.0 LITERATURE REVIEW

2.1 Theoretical Framework

The study was underpinned by three complementary theories. First, the Agency Theory advanced by Jensen and Meckling (1976) explained the conflicts of interest between SME owners and creditors and the role of capital structure in managing these conflicts. Second, the Trade-off Theory posited that firms determined optimal capital structure by balancing the tax shields provided by debt against the financial distress costs associated with high leverage. Third, the

Resource-Based View (RBV) proposed by Barney (1991) held that a firm's competitive advantage derived from unique, non-imitable internal resources and capabilities, including the capability to manage risks effectively.

2.2 Business Risk Management in SMEs

The literature identified four principal components of business risk management: risk identification, risk assessment, risk response (mitigation), and risk monitoring and review. Effective risk identification required SMEs to maintain an up-to-date risk register that catalogued all foreseeable threats to operations (Florence & Julius, 2023). Risk assessment involved evaluating the likelihood and potential impact of each identified risk, typically using qualitative matrices or quantitative probabilistic models (Promise et al., 2024). Risk mitigation strategies included risk avoidance, reduction, transfer (through insurance or contractual arrangements), and acceptance.

Studies in developing country contexts, including those by Fatoki (2012) in South Africa and Namugenyi (2019) in Uganda, found that SMEs generally lacked formalised risk management processes (Kazaara & Audrey, 2024). Most owners relied on personal experience and informal networks to manage risks, which was often insufficient to address complex, compounding risks such as those arising from climate change, currency fluctuations, and digital disruption (Lydia et al., 2023).

2.3 Capital Structure and Financial Performance

Capital structure theory generated a rich body of empirical research on its relationship with financial performance (Ramadhan et al., 2023). Abor (2005) found in a Ghanaian study that short-term debt was positively related to profitability for SMEs, while long-term debt showed a negative relationship findings that supported the Pecking Order Theory's prediction that firms preferred internal financing before resorting to external debt (Julius & Kazaara, 2026b). In East Africa, Matemilola et al. (2019) found that leverage negatively affected firm profitability in Kenya and Tanzania, particularly when interest rates were high and earnings were volatile (Irumba et al., 2024).

In Uganda, Ntakyio and Berg (2019) found that working capital management closely related to short-term capital structure decisions was a significant predictor of SME profitability (Polycarp et al., 2023). Enterprises that maintained optimal current ratios and efficient inventory turnover consistently reported higher net profit margins than those with either excessive or insufficient working capital.

3.0 METHODOLOGY

3.1 Research Design and Approach

A descriptive correlational research design was adopted, combining quantitative survey methods with qualitative key informant interviews. The design was appropriate for establishing the nature and strength of relationships between the study variables without manipulating them experimentally. The study was grounded in a positivist philosophical paradigm, given its emphasis on measurable, objective phenomena and statistical hypothesis testing.

3.2 Population and Sampling

The target population comprised 412 registered SMEs in Nakaseke District, as recorded by the Uganda Registration Services Bureau (URSB) district register for 2022. Stratified random sampling was used to ensure representation

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across business sectors (trade, manufacturing, agro-processing, and services) and enterprise size (micro, small, and medium)(A. Nafiu et al., 2012). Using Krejcie and Morgan's (1970) table, a sample of 200 SMEs was calculated, of which 148 were successfully engaged, yielding a response rate of 74%.

3.3 Data Collection and Analysis

A structured questionnaire covering four thematic areas risk management practices, capital structure decisions, financial performance indicators, and demographic characteristics was administered to SME owners and managers. Financial performance was measured using return on assets (ROA), return on equity (ROE), and net profit margin as reported by respondents for the preceding financial year. Risk management was measured using a 20-item Likert scale adapted from the Committee of Sponsoring Organizations (COSO) Enterprise Risk Management framework. Capital structure was measured by the debt-to-equity ratio and the proportion of external to internal financing.

Data were analysed using SPSS version 26(Nelson, Christopher, & Milton, 2022). Descriptive statistics were computed for all variables, followed by Pearson correlation and multiple regression analysis. Qualitative data from seven key informant interviews with bank managers and microfinance officers were analysed thematically.

4.0 RESULTS AND DISCUSSION

4.1 Risk Management Practices

Table 1: Risk Management Practices Among SMEs in Nakaseke District

Risk Management Practice	Frequency (n=148)	Percentage (%)	Mean Score (1-5)
Risk Identification	89	60.1	2.87
Risk Assessment	67	45.3	2.54
Risk Mitigation Strategies	54	36.5	2.31
Risk Monitoring and Review	41	27.7	2.09
Formal Risk Register Maintained	28	18.9	1.86
Insurance Coverage	62	41.9	2.47

Source: Primary Data, 2025

The results indicated that Risk Identification was the most widely practiced risk management activity. Out of the 148 respondents, 89 individuals, representing 60.1%, reported engaging in risk identification practices. The activity recorded a mean score of 2.87 on a scale of 1 to 5. This suggested that respondents moderately recognized and identified potential risks affecting their businesses or operations. Although a majority practiced risk identification to some extent, the moderate mean score implied that such practices may not have been implemented consistently or systematically across all respondents.

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The findings further revealed that Risk Assessment was practiced by 67 respondents, representing 45.3% of the sample, with a mean score of 2.54. This indicated that less than half of the respondents actively evaluated or analyzed the likelihood and impact of risks. The relatively low mean score suggested that formal assessment of risks was not strongly embedded within many organizations or businesses. The findings implied that while some respondents recognized risks, fewer took additional steps to evaluate their severity or potential consequences.

In relation to Risk Mitigation Strategies, the results showed that 54 respondents, accounting for 36.5% of the sample, implemented measures aimed at reducing or controlling risks. The practice recorded a mean score of 2.31, indicating a generally low level of adoption. This suggested that many respondents lacked structured approaches for minimizing identified risks, which could potentially expose their businesses or activities to operational uncertainties and losses.

The analysis also showed that Risk Monitoring and Review was among the least practiced activities. Only 41 respondents, representing 27.7%, reported conducting continuous monitoring and review of risks, while the mean score stood at 2.09. This finding indicated that regular follow-up and evaluation of risk management processes were limited among respondents. The low level of monitoring suggested that many organizations may not have consistently tracked emerging risks or reviewed the effectiveness of their risk management measures over time.

Similarly, the maintenance of a Formal Risk Register was the least adopted risk management practice among respondents. Only 28 individuals, representing 18.9% of the sample, reported maintaining formal records of identified risks. The practice recorded the lowest mean score of 1.86. This finding suggested that systematic documentation and record keeping of risks were largely absent among most respondents. The lack of formal risk registers implied weak institutionalization of risk management frameworks and procedures.

The findings further revealed that Insurance Coverage was practiced by 62 respondents, accounting for 41.9% of the sample, with a mean score of 2.47. This suggested that although some respondents utilized insurance as a risk transfer mechanism, overall adoption remained relatively low. The moderate-to-low mean score indicated that many respondents may not have adequately protected themselves or their businesses against potential financial losses through insurance coverage.

4.2 Capital Structure Characteristics

Table 2: Capital Structure Profile of SMEs in Nakaseke District

Financing Source	Proportion of SMEs Using (%)	Average Share of Total Financing (%)
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Personal Savings	94.6	52.3
Microfinance Loans	67.6	24.7
Commercial Bank Loans	21.6	10.4
Trade Credit	48.6	8.2
External Equity (Partners)	15.5	4.4

Source: Primary Data, 2025

The results showed that Personal Savings constituted the most widely used source of financing among SMEs. A substantial majority of respondents, representing 94.6%, reported relying on personal savings to finance their businesses. In addition, personal savings accounted for an average of 52.3% of the total financing used by SMEs(Kazaara & Audrey, 2024). This finding suggested that most business owners depended primarily on their own financial resources to establish and sustain their enterprises(Nelson, Christopher, Teddy, et al., 2022). The high reliance on personal savings implied limited access to external funding opportunities and reflected the importance of self-financing in SME operations.

The findings further revealed that Microfinance Loans were the second most commonly used financing source. About 67.6% of SMEs reported obtaining financing from microfinance institutions, and these loans contributed an average of 24.7% of total business financing(Kazaara & Audrey, 2024). This indicated that microfinance institutions played a significant role in supporting SMEs, particularly those that may have faced challenges accessing conventional bank financing. The relatively high utilization of microfinance loans suggested that such institutions provided more accessible and flexible financing options for small business operators(Polycarp et al., 2023).

In relation to Commercial Bank Loans, the results showed that only 21.6% of SMEs accessed financing from commercial banks. Furthermore, commercial bank loans contributed an average of 10.4% to total financing. This finding indicated relatively low dependence on formal banking institutions among SMEs(Christopher et al., 2022). The low proportion of SMEs using bank loans suggested that many businesses may have encountered barriers such as strict collateral requirements, high interest rates, complex loan procedures, or limited creditworthiness(Collins et al., 2023). Despite their lower usage, commercial bank loans still contributed a notable share to overall financing among businesses that were able to access them.

The analysis also showed that Trade Credit was used by 48.6% of SMEs and contributed an average of 8.2% of total financing(Alex & Moses, 2024). This suggested that nearly half of the businesses relied on supplier credit arrangements to support their operations. The findings implied that trade credit served as an important short-term financing mechanism that enabled SMEs to obtain goods or services on deferred payment terms, thereby easing cash flow pressures(Julius & Kaazara, 2025). Lastly, External Equity from partners was the least utilized financing source

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among respondents. Only 15.5% of SMEs reported using external equity financing, and it accounted for an average of 4.4% of total financing. This finding suggested that relatively few businesses attracted investment from partners or external investors. The low reliance on equity financing may have reflected limited investor interest, concerns over ownership sharing, or a preference among entrepreneurs to maintain full control of their businesses(Sophie & Crispus, 2024).

4.3 Financial Performance Outcomes

Table 3: Financial Performance by Risk Management Level

Financial Performance Indicator	High Risk Mgt Score (n=49)	Low Risk Mgt Score (n=99)	p-value
Mean ROA (%)	18.6	9.4	0.003
Mean ROE (%)	24.3	11.7	0.001
Net Profit Margin (%)	16.8	8.2	0.002
Revenue Growth (YoY) (%)	22.4	10.1	0.004
Business Survival Rate (%)	87.8	61.6	0.001

Source: Primary Data, 2025

The results indicated that businesses with high risk management scores recorded a significantly higher Return on Assets (ROA) compared to those with low risk management scores. Specifically, firms with high risk management achieved a mean ROA of 18.6%, while those with low risk management recorded a mean ROA of 9.4%. The difference was statistically significant with a p-value of 0.003. This finding suggested that firms with stronger risk management practices were more efficient in using their assets to generate profits, compared to firms with weaker risk management systems(Nelson et al., 2023). Similarly, the analysis showed that Return on Equity (ROE) was substantially higher among firms with high risk management scores. These firms recorded a mean ROE of 24.3%, compared to 11.7% for firms with low risk management scores. The difference was statistically significant at p = 0.001. This indicated that firms with better risk management practices generated higher returns for their owners and shareholders, suggesting more effective financial decision-making and resource utilization.

The findings further revealed that Net Profit Margin was also significantly higher among firms with strong risk management practices. Businesses with high risk management scores recorded an average net profit margin of 16.8%, while those with low scores recorded 8.2%. The difference was statistically significant at p = 0.002. This suggested that firms with better risk control systems were more successful in converting revenue into actual profit, likely due to reduced losses and improved operational efficiency.

In relation to Revenue Growth, the results showed that firms with high risk management scores experienced a mean year-on-year growth of 22.4%, compared to 10.1% among firms with low risk management scores. The difference was statistically significant at $p = 0.004$. This indicated that effective risk management practices were associated not only with profitability but also with stronger business expansion and revenue performance over time. Finally, the findings revealed a significant difference in Business Survival Rates between the two groups. Firms with high risk management scores had a survival rate of 87.8%, while those with low risk management scores had a significantly lower survival rate of 61.6%. The difference was statistically significant at $p = 0.001$. This suggested that businesses with stronger risk management systems were more likely to remain operational and withstand market uncertainties compared to those with weaker risk management practices.

5.0 Conclusions and Recommendations

5.1 Conclusions

The study concluded that business risk management had a significant positive relationship with the financial performance of SMEs in Nakaseke District. Capital structure decisions, particularly the reliance on informal and high-cost debt financing, negatively affected profitability and growth. SMEs that adopted structured risk management practices and maintained balanced capital structures performed significantly better on all financial performance indicators. The majority of enterprises, however, operated with inadequate risk management frameworks and suboptimal capital structures, underscoring the need for targeted support and capacity building.

5.2 Recommendations

The study recommended that the Nakaseke District Local Government, in partnership with the Private Sector Foundation Uganda, should establish a business development support centre to provide SMEs with risk management training, financial literacy programmes, and affordable business advisory services. Financial institutions should develop SME-tailored loan products with flexible collateral requirements to reduce dependence on high-cost informal credit. SME operators should invest in basic bookkeeping and financial management skills to improve their capital structure decision-making. The government should strengthen the SME policy framework to mandate minimum standards for business planning and risk assessment among formally registered enterprises.

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