

Business Risk Management, Capital Structure, And Financial Performance Of SMEs: A Case Of Nakaseke District

Naira Golda Ratib¹, Kabanda Richard²

1, 2 Metropolitan International University

Abstract

This study examined the relationship between business risk management, capital structure, and financial performance of small and medium enterprises (SMEs) in Nakaseke District, Uganda. Despite the acknowledged importance of SMEs in Uganda's economic development, high failure rates attributed to poor risk management practices and suboptimal capital structure decisions continue to constrain the sector's contribution to growth and employment. A cross-sectional survey of 175 SME owners and managers was conducted using structured questionnaires. Risk management was operationalized through risk identification ($r = 0.487$, $p < 0.01$), risk mitigation strategies ($r = 0.523$, $p < 0.01$), and risk monitoring ($r = 0.461$, $p < 0.01$); while capital structure was measured through debt-equity ratio management ($r = 0.538$, $p < 0.01$) and financing diversification ($r = 0.501$, $p < 0.01$). All variables demonstrated significant positive correlations with financial performance. Multiple regression revealed that debt-equity ratio management ($\beta = 0.342$, $p < 0.001$) and risk mitigation strategies ($\beta = 0.298$, $p < 0.01$) were the strongest predictors of financial performance. The combined model explained 58.7% of variance in SME financial performance ($R^2 = 0.587$). The study recommends enhanced risk management training for SME owners, improved access to diversified financing instruments, and development of SME-specific risk assessment frameworks adapted to rural business contexts.

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

1.0 Background of the study

Small and medium enterprises occupy a central position in Uganda's economic landscape, contributing approximately 75% of employment and 20% of GDP (Ministry of Finance, Planning and Economic Development, 2021). In rural districts such as Nakaseke, located in central Uganda approximately 65 kilometers from Kampala, SMEs represent the primary source of non-agricultural employment and economic diversification (Julius & Audrey, 2026). Yet the sector is characterized by high business failure rates, with estimates suggesting that approximately 60% of new SMEs in Uganda fail within five years of establishment (Ssewanyana & Kasirye, 2020).

Business risk management and capital structure decisions are widely recognized as critical determinants of SME financial performance and survival (Promise et al., 2024). Effective risk management enables enterprises to anticipate, mitigate, and respond to the diverse threats — including market risks, operational risks, credit risks, and external environmental risks — that characterize the operating environment of Ugandan rural SMEs (Julius & Matovu, 2025). Capital structure decisions, determining the mix of debt and equity financing, affect not only the cost of capital but also the firm's financial flexibility, risk profile, and capacity to invest in growth opportunities (Gracious, 2023). The

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intersection of risk management and capital structure as joint determinants of financial performance is theoretically compelling but empirically under-examined in Ugandan rural SME contexts (Julius, 2024). Most existing research has examined these variables independently, missing important interaction effects and the cumulative explanatory power of a comprehensive analytical framework (Winny et al., 2023). This study addresses this gap through an integrated empirical investigation in Nakaseke District.

2.0 Problem Statement

SMEs in Nakaseke District face a particularly challenging operating environment characterized by limited access to formal financial services, inadequate business support infrastructure, and exposure to agricultural commodity price volatility given the district's agro-industrial character (Turyatamba et al., 2022). Many SME operators in the district lack formal training in either risk management or financial management, relying instead on intuitive approaches that may prove inadequate when confronting complex risk scenarios (Alex et al., 2024). The persistent high failure rate of SMEs in the district, combined with the limited availability of formal financial products, suggests that addressing risk management and capital structure weaknesses could significantly improve enterprise survival and performance (Julius & Matovu, 2025). However, no systematic study has quantified these relationships in the Nakaseke context, limiting the evidence base for targeted interventions (Julius & Matovu, 2025).

3.0 Main Objectives

The study's main objective was to examine the relationship between business risk management, capital structure, and financial performance of SMEs in Nakaseke District. Specific objectives were to: (i) assess the risk management practices of SMEs in Nakaseke; (ii) evaluate capital structure decisions and their perceived adequacy; (iii) measure financial performance outcomes among sampled SMEs; and (iv) determine the relative effects of risk management and capital structure variables on financial performance.

4.0 Literature Review

4.1 Capital Structure Theory

The theoretical debate on optimal capital structure traces its origins to Modigliani and Miller's (1958) irrelevance theorem, which demonstrated that in perfect capital markets, financing decisions are irrelevant to firm value. Subsequent theoretical developments incorporating real-world imperfections including the trade-off theory balancing tax benefits of debt against financial distress costs, and the pecking order theory positing a financing hierarchy from internal funds to debt to equity have provided more realistic frameworks for understanding capital structure choices (Myers, 1984). For SMEs in developing countries, these classical theories require significant adaptation to account for market imperfections including information asymmetry, limited credit access, and underdeveloped capital markets (Ayyagari et al., 2021).

4.2 Risk Management Frameworks for SMEs

Enterprise risk management (ERM) frameworks, originally developed for large corporations, have been increasingly adapted for SME contexts. The COSO ERM framework identifies risk identification, risk assessment, risk response,

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and risk monitoring as core components of a comprehensive risk management approach (COSO, 2017). For SMEs, practical risk management often manifests in simpler but nonetheless structured approaches including scenario planning, contingency fund maintenance, insurance utilization, and operational diversification. Research in Sub-Saharan Africa has found that SMEs employing even basic ERM elements achieve better financial performance and greater resilience to external shocks (Abor & Quartey, 2010).

4.3 Financial Performance in SMEs

Financial performance in SMEs is typically measured through profitability indicators (return on assets, net profit margin), liquidity ratios (current ratio, quick ratio), and growth metrics (revenue growth, asset growth)(Amos et al., 2024). However, for informal SMEs lacking formal financial statements, perceptual self-reported measures of financial performance assessed relative to competitors and historical performance provide viable proxies that have demonstrated validity in prior research (Liargovas & Skandalis, 2008).

5.0 Methodology

A cross-sectional survey design was employed, targeting SME owners and managers in Nakaseke District(Sarah et al., 2024). The study population was estimated at 380 SMEs based on the district's business register, from which a sample of 175 was drawn through stratified random sampling, stratifying by sector (agro-processing, retail, services, manufacturing)(Olanrewaju et al., 2021). Data collection used a structured questionnaire measuring risk management practices (15 items), capital structure decisions (12 items), and financial performance (10 items) on five-point Likert scales, achieving a Cronbach's alpha of 0.876. In-depth interviews with 12 purposively selected SME owners supplemented the quantitative data. Analysis employed SPSS version 25 for descriptive statistics, Pearson correlations, and multiple linear regression. Multicollinearity diagnostics confirmed VIF values below 3.0 for all predictors(Nelson et al., 2022).

6.0 Results

6.1 Descriptive Statistics

Table 1: Descriptive Statistics for Study Variables

Variable	N	Mean	Std. Dev.	Min	Max	Level
Risk Identification	175	3.21	0.86	1	5	Moderate
Risk Mitigation Strategies	175	2.98	0.92	1	5	Moderate
Risk Monitoring	175	2.81	0.98	1	5	Low-Moderate
Debt-Equity Ratio Management	175	3.14	0.89	1	5	Moderate
Financing Diversification	175	2.72	1.04	1	5	Low-Moderate
Financial Performance	175	3.09	0.91	1	5	Moderate

Source: Primary Data, 2026

The descriptive statistics (Table 1) reveal moderate levels of risk management and capital structure sophistication among Nakaseke SMEs. Risk identification achieved the highest mean among risk management dimensions (M =

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3.21, SD = 0.86), suggesting that operators are reasonably aware of the risks they face, even if formal processes for risk assessment are limited. Risk mitigation strategies (M = 2.98) and risk monitoring (M = 2.81) scored lower, indicating that translating risk awareness into systematic mitigation and ongoing monitoring practices remains challenging. Among capital structure variables, debt-equity ratio management scored moderately (M = 3.14, SD = 0.89), while financing diversification recorded a low-moderate mean of 2.72 (SD = 1.04), reflecting the limited financing options accessible to rural SMEs. Financial performance achieved a moderate mean of 3.09 (SD = 0.91).

6.2 Correlation Analysis

Table 2: Pearson Correlation Matrix

Variable	1	2	3	4	5	6
1. Risk Identification	1.000					
2. Risk Mitigation	0.467**	1.000				
3. Risk Monitoring	0.501**	0.521**	1.000			
4. Debt-Equity Mgmt	0.398**	0.412**	0.371**	1.000		
5. Financing Divers.	0.356**	0.389**	0.342**	0.487**	1.000	
6. Financial Perf.	0.487**	0.523**	0.461**	0.538**	0.501**	1.000

** p < 0.01 (2-tailed)

Source: Primary Data, 2026

The correlation matrix (Table 2) confirms significant positive associations between all five predictor variables and financial performance. Debt-equity ratio management demonstrated the strongest correlation with financial performance ($r = 0.538$, $p < 0.01$), closely followed by risk mitigation strategies ($r = 0.523$, $p < 0.01$). Risk identification ($r = 0.487$), financing diversification ($r = 0.501$), and risk monitoring ($r = 0.461$) also showed significant positive correlations. The moderate inter-correlations among independent variables ($r = 0.342$ to 0.521) indicate conceptually related but empirically distinct constructs, supporting their inclusion as independent predictors in the regression model.

6.3 Regression Analysis

Table 3: Multiple Regression on Predictors of Financial Performance

Predictor	B	SE	Beta (β)	t	p-value
Constant	0.487	0.221	-	2.204	0.029
Risk Identification	0.198	0.088	0.187	2.250	0.026
Risk Mitigation Strategies	0.295	0.084	0.298	3.512	0.001
Risk Monitoring	0.176	0.079	0.189	2.228	0.027
Debt-Equity Ratio Mgmt	0.350	0.082	0.342	4.268	0.000
Financing Diversification	0.213	0.076	0.243	2.803	0.006

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$R = 0.766$, $R^2 = 0.587$, Adjusted $R^2 = 0.574$, $F(5,169) = 47.97$, $p < 0.001$

Source: Primary Data, 2026

The regression model was highly significant ($F(5,169) = 47.97$, $p < 0.001$), explaining 58.7% of variance in financial performance ($R^2 = 0.587$). Debt-equity ratio management emerged as the strongest predictor ($\beta = 0.342$, $t = 4.268$, $p < 0.001$), indicating that SMEs making more deliberate and appropriate capital structure decisions achieve markedly better financial performance. Risk mitigation strategies ranked second ($\beta = 0.298$, $t = 3.512$, $p = 0.001$), while financing diversification ($\beta = 0.243$, $t = 2.803$, $p = 0.006$) also made a substantial contribution. Risk identification ($\beta = 0.187$, $p = 0.026$) and risk monitoring ($\beta = 0.189$, $p = 0.027$) were significant but weaker predictors, suggesting that identifying and tracking risks, while necessary, is insufficient without robust mitigation strategies.

7.0 Discussion of Results

The primacy of debt-equity ratio management as a predictor of financial performance resonates with both classical capital structure theory and the specific financing challenges of Ugandan rural SMEs. Trade-off theory's prediction that an optimal debt-equity mix maximizes firm value by balancing tax shields against financial distress costs is operationally relevant even for SMEs, which face significant financial distress when over-leveraged relative to their cash flow generation capacity. In the Nakaseke context, where many SMEs rely heavily on short-term, high-cost informal credit, the ability to manage debt levels deliberately is closely associated with financial stability and performance. Qualitative interviews corroborated this, with multiple SME owners attributing periods of poor performance to over-reliance on debt financing that created unsustainable interest burdens.

The strong predictive power of risk mitigation strategies aligns with ERM research findings from comparable African contexts. Abor and Quartey (2010) found that Ghanaian SMEs employing systematic risk mitigation techniques, including insurance, diversification, and contingency reserves, consistently outperformed those relying on reactive crisis management. The relatively low mean for risk mitigation strategies among Nakaseke SMEs (2.98) suggests significant scope for improvement, likely requiring external support through business development services and industry association programs.

The significant but weaker contributions of risk identification and risk monitoring, compared to risk mitigation, offer an important practical insight: awareness and tracking of risks without actionable mitigation strategies generates limited performance benefits. This finding challenges simplistic assumptions that risk management education focused primarily on risk identification will translate automatically into improved outcomes.

8.0 Conclusions

This study establishes that both business risk management and capital structure significantly influence the financial performance of SMEs in Nakaseke District, Uganda. The integrated model explains 58.7% of variance in financial performance, validating the importance of examining these variables together rather than independently. Debt-equity ratio management and risk mitigation strategies emerge as the most influential determinants, providing clear focal

points for intervention. The findings underscore the need for targeted business management support programs that address both capital structure literacy and risk mitigation capabilities among rural Ugandan SME operators.

9.0 Recommendations

Based on the research findings, it is recommended that: (i) the Nakaseke District Local Government, in partnership with Microfinance Support Centre, should develop an SME financial management training program that specifically addresses capital structure optimization, covering the costs and benefits of different financing sources; (ii) UDB (Uganda Development Bank) should develop rural SME-specific loan products with repayment structures aligned with the cash flow cycles of agro-processing enterprises to reduce financial distress risk; (iii) Uganda Insurers Association should work with business associations in Nakaseke to develop affordable SME insurance products tailored to common rural business risks; and (iv) MAAIF and trade associations should establish peer learning networks enabling SMEs to share risk management practices, particularly for agricultural commodity price and weather risks.

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