

Effect of Financial Management Practices on the Performance of Small and Medium Enterprises (SMEs): A Case Study of Kampala Central Business District

Arinaitwe Julius¹, Dr Ariyo Gracious Kazaara², Dr Osman Mohamed Hassan³, Professor Emmanuel Cyeze Munyamasoko⁴, Kamugisha Nelson⁵

1,2,5 Metropolitan International University, 3 Daarua Salaam University, 4 Adventist University of Central Africa (AUCA)

Abstract

This study examined the effect of financial management practices on the performance of small and medium enterprises (SMEs) in Kampala Central Business District, Uganda. Given the critical role of SMEs in employment and economic growth and their high failure rates, the study investigated how working capital management, financial record-keeping, budgeting, and access to finance affect business performance measured in terms of profitability, sales growth, and survival. A descriptive and explanatory cross-sectional design with a mixed-methods approach was adopted, and data were collected from 150 SME owners and managers using structured questionnaires and interviews. Descriptive statistics, Pearson correlation, and multiple regression were used for analysis. The results revealed a strong positive and significant relationship between financial management practices and SME performance ($r = 0.67$, $p < 0.01$), with the practices jointly explaining 51.4% of the variance in performance ($R^2 = 0.514$). Working capital management and financial record-keeping were the strongest predictors. The study concludes that sound financial management practices significantly enhance SME performance and recommends training, adoption of proper record-keeping, and improved access to finance.

Keywords: financial management practices, SME performance, working capital, record-keeping, access to finance, Kampala

1.0 Introduction

Small and medium enterprises constitute the backbone of most economies, and in Uganda they are particularly vital, accounting for the majority of businesses, a substantial share of employment, and a significant contribution to gross domestic product(Christopher et al., 2024). SMEs drive innovation, foster entrepreneurship, distribute economic activity beyond large urban centres, and provide livelihoods for millions of people(Julius & Matovu, 2025). In recognition of their importance, governments and development partners have devoted considerable attention to promoting SME growth as a strategy for poverty reduction and inclusive economic development. Yet despite their significance, SMEs in Uganda are beset by a high rate of failure, with a large proportion of new enterprises collapsing within their first few years of operation(Alex et al., 2024).

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Among the many factors that determine whether an SME thrives or fails, financial management practices occupy a central place(Turyatemba et al., 2022). Financial management encompasses the planning, organising, directing, and controlling of an enterprise's financial resources. It includes the management of working capital, the keeping of accurate financial records, the preparation and use of budgets, the control of costs, and the sourcing and deployment of finance. Sound financial management enables a business to maintain liquidity, meet its obligations, make informed decisions, control costs, and mobilise the resources needed for growth(Deus, 2023). Conversely, poor financial management—manifested in inadequate record-keeping, weak cash-flow control, absence of budgeting, and reliance on personal or informal finances—frequently precipitates the liquidity crises and insolvency that drive SME failure(Annet et al., 2023).

The Kampala Central Business District represents the most concentrated commercial environment in Uganda, hosting a dense population of SMEs engaged in trade, services, and light manufacturing(Turyatemba et al., 2022). Businesses in this district operate in a highly competitive setting characterised by high rents, intense rivalry, and demanding customers, conditions under which effective financial management becomes especially consequential. The concentration and diversity of SMEs in the district make it an instructive setting for examining how financial management practices affect business performance, and the lessons drawn from it are relevant to SMEs across the country.

Business performance, the ultimate measure of an enterprise's success, is commonly assessed through indicators such as profitability, sales growth, market share, and survival(Sarah et al., 2024). The theoretical expectation is that sound financial management practices improve these outcomes by enhancing liquidity, informing decisions, and enabling growth. However, many SME owners in Uganda, particularly those with limited formal education or training, lack financial-management skills and neglect basic practices such as record-keeping and budgeting, often mingling business and personal finances(Nancy & Prudence, 2024). Whether and to what extent the adoption of sound financial management practices improves the performance of SMEs in the Kampala Central Business District is therefore an empirical question of practical importance(Julius & Matovu, 2025).

Although the general importance of financial management for business success is widely accepted, empirical evidence quantifying its effect on the performance of Ugandan SMEs, and disaggregating the effects of specific practices, remains limited(Julius & Matovu, 2025). This study addresses that gap by examining, through correlation and regression analysis, how working capital management, financial record-keeping, budgeting, and access to finance affect SME performance in the Kampala Central Business District(David et al., 2023). The findings are significant for SME owners, business-support organisations, financial institutions, and policymakers seeking to reduce SME failure and promote enterprise growth. The article continues with the problem statement, objectives, literature review, methodology, results and interpretation, and conclusions.

2.0 Statement of the Problem

Small and medium enterprises in the Kampala Central Business District play a vital role in generating employment and income, yet a large proportion of them fail within a few years of establishment (Ariyo, 2023). This high failure rate persists despite various support initiatives, and it undermines the contribution of SMEs to employment, income, and economic growth. While many factors contribute to SME failure, weak financial management is frequently cited as a leading cause, manifested in poor record-keeping, inadequate cash-flow and working-capital management, absence of budgeting, and difficulty accessing appropriate finance (Sophie & Crispus, 2024). However, the precise extent to which financial management practices affect SME performance in the district has not been clearly established through rigorous empirical research (Sarah & Audrey, 2024).

Many SME owners and managers in the district lack formal training in financial management and neglect basic practices, often failing to keep proper records, mixing business and personal funds, and operating without budgets or plans (Akankwasa et al., 2022). These deficiencies impair their ability to monitor performance, control costs, maintain liquidity, and make informed decisions, potentially exposing their businesses to crises that lead to failure (Julius & Matovu, 2025). Yet without clear evidence on which financial management practices most strongly influence performance, efforts to support SMEs—through training, advisory services, or financing—risk being poorly targeted and less effective than they could be. If the effect of financial management practices on SME performance is not clearly established and addressed, SMEs in the district will continue to fail at high rates, with adverse consequences for employment, incomes, and economic development. This study therefore sought to determine the effect of financial management practices on the performance of SMEs in the Kampala Central Business District and to identify which practices most strongly affect performance, so as to inform effective support and policy.

3.0 Main Objective

The main objective of the study was to examine the effect of financial management practices on the performance of small and medium enterprises in the Kampala Central Business District, Uganda.

3.1 Specific Objectives

- i. To assess the financial management practices adopted by SMEs in the Kampala Central Business District.
- ii. To establish the relationship between financial management practices (working capital management, financial record-keeping, budgeting, and access to finance) and SME performance.
- iii. To determine the relative contribution of each financial management practice to SME performance.

4.0 Literature Review

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Research on financial management and firm performance draws on several theoretical perspectives, including the pecking order theory, the trade-off theory of capital structure, and agency theory, together with the resource-based view of the firm (Polycarp et al., 2023). The pecking order theory holds that firms prefer internal financing and resort to external finance only when necessary, a pattern especially pronounced among SMEs that face constraints in accessing formal credit (Alex & Moses, 2024). The trade-off theory concerns the balance between the benefits and costs of debt, informing decisions about financing that affect performance. Agency theory highlights the potential conflicts and information asymmetries that financial management practices such as record-keeping and reporting help to mitigate (Kiplagat Ngetich & Matanda Wepukhulu, 2017). The resource-based view suggests that financial management capabilities can constitute a valuable resource that supports competitive advantage and superior performance. Collectively, these perspectives frame financial management as a determinant of firm success.

Empirical studies consistently link sound financial management practices to improved SME performance. Research across developing economies finds that SMEs that manage working capital effectively, keep proper records, prepare budgets, and access adequate finance tend to be more profitable, grow faster, and survive longer than those that do not (Gloria et al., 2023). Studies in East Africa report that poor financial management is a leading cause of SME failure, and that the adoption of even basic practices markedly improves outcomes. Ugandan studies similarly find that financial management skills and practices are positively associated with SME profitability and growth, while the neglect of such practices correlates strongly with business collapse (Jallow et al., 2022).

Working capital management is a recurrent theme. The effective management of current assets and liabilities—cash, inventory, receivables, and payables—is critical to maintaining liquidity and operational continuity (Akankwasa et al., 2022). Studies show that SMEs with sound working-capital management avoid the cash-flow crises that frequently precipitate failure, and that efficient management of inventory and receivables enhances profitability (Uchechukwu et al., 2017). Poor working-capital management, by contrast, leaves businesses unable to meet obligations even when they are nominally profitable, a phenomenon commonly observed among failing SMEs.

Financial record-keeping constitutes a second major theme. Accurate and systematic record-keeping provides the information base for monitoring performance, controlling costs, making decisions, and accessing finance (District et al., 2023). Research indicates that SMEs that keep proper records perform better and are more likely to obtain credit, since lenders require financial information to assess creditworthiness. Many SMEs, however, keep inadequate records or none at all, impairing both their internal management and their access to external finance.

Budgeting and access to finance form further themes. Budgeting supports planning, cost control, and performance monitoring, and studies associate its use with improved SME outcomes. Access to finance is widely identified as a binding constraint on SME growth; SMEs that can access adequate and appropriate finance are better able to invest, expand, and withstand shocks, while those excluded from credit remain constrained (Winny et al., 2023). The literature

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also notes that these practices are interrelated—good record-keeping, for instance, facilitates both budgeting and access to finance. Despite broad agreement on the importance of financial management, relatively few Ugandan studies quantify and compare the effects of specific practices within a single analytical framework, a gap this study addresses (Derrick et al., 2023).

5.0 Methodology

5.1 Research Design

The study adopted a descriptive and explanatory cross-sectional research design employing a mixed-methods approach. The descriptive element characterised the financial management practices and performance of SMEs, while the explanatory element tested the relationships between practices and performance (A. Nafiu et al., 2012). Data were collected at a single point in time, and the combination of quantitative and qualitative methods supported both measurement and interpretation.

5.2 Study Population and Area

The study was conducted in the Kampala Central Business District. The target population comprised owners and managers of small and medium enterprises operating in the district across trade, services, and light manufacturing (Kazaara et al., 2024). Owners and managers were selected because they make and implement financial-management decisions and are best placed to report on practices and performance.

5.3 Sample Size and Sampling Techniques

A sample of 150 SME owners and managers was drawn from enterprises in the district. The sample size was determined with reference to the Krejcie and Morgan guidelines and considerations of statistical power (Turyatamba et al., 2022). Stratified sampling was used to represent different sectors, and simple random sampling was used to select enterprises within strata, while a few key informants were selected purposively for interviews.

5.4 Data Collection Instruments

A structured questionnaire measured the financial management practices—working capital management, financial record-keeping, budgeting, and access to finance—and business performance (profitability, sales growth, and survival) on a five-point Likert scale. Interview guides were used with selected owners and managers to obtain qualitative insights into practices and challenges.

5.5 Validity and Reliability

Content validity was established through expert review, producing a content validity index above 0.70. A pilot study confirmed reliability, with the Cronbach's alpha for the financial management practices scale at 0.86, indicating strong internal consistency.

5.6 Data Analysis

Data were analysed using SPSS(Nelson et al., 2022). Descriptive statistics summarised the practices and performance. Pearson correlation established the strength and direction of relationships, and multiple regression assessed the combined and relative effects of the financial management practices on SME performance. Qualitative data were analysed thematically to complement the statistical findings.

5.7 Ethical Considerations

Informed consent was obtained from all respondents, participation was voluntary, and the confidentiality and anonymity of respondents and their businesses were maintained throughout the study.

6.0 Results and Interpretation

6.1 Descriptive Statistics

Table 1 presents the descriptive statistics for the financial management practices and SME performance based on responses from the 150 participants.

Variable	Mean	Std. Dev.	Interpretation
Working capital management	3.12	0.84	Moderate
Financial record-keeping	2.89	0.92	Moderate
Budgeting	2.74	0.95	Low
Access to finance	2.66	0.98	Low
Overall financial management	2.85	0.78	Moderate
SME performance	3.01	0.73	Moderate

Source: Primary Data, 2026

The descriptive results in Table 1 indicate that financial management practices among SMEs in the Kampala Central Business District were, on the whole, moderate to low, with an overall mean of 2.85 and a standard deviation of 0.78. Working capital management recorded the highest mean (3.12), suggesting that SMEs paid relatively more attention to managing day-to-day liquidity than to other practices, though still only at a moderate level. Financial record-keeping (2.89) was rated moderately, reflecting inconsistent maintenance of proper records, while budgeting (2.74) and access to finance (2.66) attracted low ratings, revealing that many SMEs operate without formal budgets and struggle to

obtain adequate finance. SME performance recorded a moderate mean of 3.01, consistent with the mixed fortunes of enterprises in the district. The large standard deviations, particularly for budgeting and access to finance, indicate wide variation among enterprises, distinguishing better-managed businesses from those with weak practices.

6.2 Correlation Analysis

Pearson correlation was used to establish the relationships between the financial management practices and SME performance, as shown in Table 2.

Variable	SME Performance (r)	Sig. (p)
Working capital management	0.62	0.000
Financial record-keeping	0.59	0.000
Budgeting	0.51	0.000
Access to finance	0.47	0.000
Overall financial management	0.67	0.000

Source: Primary Data, 2026

The correlation results in Table 2 show that all financial management practices were positively and significantly related to SME performance at the 0.01 level. Overall financial management had a strong positive correlation with performance ($r = 0.67$, $p < 0.01$), affirming that sounder financial management is accompanied by better business outcomes (Nelson et al., 2023). Working capital management recorded the strongest individual association ($r = 0.62$), underscoring the centrality of liquidity and cash-flow management to SME survival and profitability. Financial record-keeping followed ($r = 0.59$), reflecting the importance of accurate information for decision-making and access to credit. Budgeting ($r = 0.51$) and access to finance ($r = 0.47$) were also significantly correlated, though more moderately, indicating that planning and financing support performance but exert a somewhat weaker direct association than working-capital management and record-keeping. The consistently positive pattern strongly supports the study's central proposition.

6.3 Regression Analysis

Multiple linear regression assessed the combined and relative effects of the financial management practices on SME performance. Tables 3 and 4 present the results.

Model Summary	Value
R	0.717
R Square	0.514
Adjusted R Square	0.501

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Std. Error of Estimate		0.478	
F (4, 145)		38.34 (p = 0.000)	
Predictor	Beta (β)	t	Sig. (p)
Working capital management	0.33	4.72	0.000
Financial record-keeping	0.29	4.05	0.000
Budgeting	0.17	2.63	0.009
Access to finance	0.13	2.02	0.045

Source: Primary Data, 2026

The regression model summary in Table 3 indicates that the four financial management practices jointly explained 51.4% of the variance in SME performance ($R^2 = 0.514$), a substantial proportion that establishes financial management as a major determinant of business performance. The model was highly significant ($F(4, 145) = 38.34$, $p < 0.01$), confirming its predictive validity. The remaining 48.6% of variance is attributable to other factors such as market conditions, managerial competence, competition, and the broader business environment that lie outside the model (Nelson et al., 2023).

The standardised coefficients in Table 4 clarify the relative importance of each practice. Working capital management was the strongest predictor ($\beta = 0.33$, $p < 0.01$), confirming that the effective management of cash, inventory, and receivables is the most influential financial practice for SME performance, consistent with the observation that liquidity crises are a leading cause of failure. Financial record-keeping followed ($\beta = 0.29$, $p < 0.01$), demonstrating that maintaining accurate records materially improves performance by informing decisions and facilitating access to credit. Budgeting ($\beta = 0.17$, $p < 0.01$) and access to finance ($\beta = 0.13$, $p < 0.05$) contributed positively but more modestly, indicating that while planning and financing matter, their impact operates substantially through the sound working-capital management and record-keeping they support. Overall, the results suggest that interventions to strengthen SME performance should prioritise building capacity in working-capital management and record-keeping, complemented by budgeting skills and improved access to finance.

7.0 Conclusion and Recommendations

The study concludes that financial management practices have a strong, positive, and significant effect on the performance of SMEs in the Kampala Central Business District, with working capital management and financial record-keeping being the most influential practices. It is recommended that SME owners and managers adopt sound working-capital and record-keeping practices, separate business and personal finances, and prepare and use budgets; that business-support organisations provide targeted financial-management training; and that financial institutions and policymakers improve SMEs' access to appropriate and affordable finance. Future research could employ objective

financial data and longitudinal designs to further establish causality and to examine sectoral differences in the effects of financial management.

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