

Debt Financing and Financial Performance of Selected Small and Medium Scale Enterprises in Wakiso

District, Uganda

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Abstract

This study examined the relationship between debt financing and the financial performance of small and medium enterprises (SMEs) in Wakiso District, Uganda. Wakiso District; the most populous district in Uganda, surrounding Kampala and characterised by a dense concentration of SMEs across manufacturing, trade, services, and agro-processing — provided an ideal research context for examining debt financing dynamics given the diverse range of SME types, financing needs, and lender relationships present in the district. Drawing on a cross-sectional survey of 178 SME owner-managers, finance managers, and lenders across 84 selected SMEs in Wakiso District, the study employed descriptive statistics, Pearson correlation, multiple linear regression, and SEM path analysis to examine how short-term debt financing, long-term debt financing, and debt cost management influenced SME profitability, liquidity, and growth performance. Descriptive statistics revealed moderate levels of debt financing effectiveness across all dimensions (means 3.24–3.61). Pearson correlation confirmed significant relationships between all debt financing dimensions and financial performance ($r = 0.541\text{--}0.682$, $p < .001$). Multiple regression demonstrated that the three dimensions collectively explained 59.8% of variance in SME financial performance ($R^2 = 0.598$, $F = 29.74$, $p < .001$). SEM analysis revealed long-term debt financing as the strongest total effect predictor (total $\beta = 0.467$), with debt cost management partially mediating its relationship with performance. Recommendations address debt structure optimisation, interest cost reduction, and financial literacy strengthening for SME owner-managers.

Keywords: Debt Financing, SME, Financial Performance, Short-term Debt, Long-term Debt, Debt Cost Management, Wakiso District, SEM, Uganda

1.0 Background of the Study

Small and medium enterprises occupy a critical position in Uganda's economic architecture, contributing approximately 18% of GDP, accounting for 70% of private sector employment, and constituting 90% of registered businesses (Uganda Revenue Authority, 2022). In Wakiso District specifically, SMEs formed the economic backbone of a rapidly growing peri-urban economy characterised by manufacturing clusters in Namanve and Matugga, agricultural processing enterprises along the Kampala-Gulu highway corridor, and dense commercial trading activity in urban centres including Nansana, Bweyogerere, and Gayaza (Frank et al., 2023). Despite their economic significance, Ugandan SMEs faced persistent financing challenges, with the World Bank (2022) identifying access to affordable credit as the second-most significant business environment constraint after electricity supply (Julius et al., 2026). Interest rates from commercial banks averaged 21.4% per annum in 2023, substantially higher than the 8–12% benchmarks in comparable developing economies, creating a fundamental tension between debt financing's capital provision function and its cost burden on SME financial performance (Ahumuza et al., 2025).

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The relationship between debt financing and SME financial performance was theoretically ambiguous: on one hand, debt financing provided the capital necessary for investment in productive assets, working capital expansion, and market development that could generate returns exceeding debt costs and improving financial performance (Julius & Nancy, 2025). On the other hand, excessive or poorly structured debt created interest servicing burdens that reduced profitability, constrained operational flexibility, and created insolvency risks that undermined financial performance (Julius & Kazaara, 2026). Understanding the conditions under which debt financing contributed positively or negatively to SME financial performance in Wakiso District's specific economic context was the central research question motivating this study (Turyatamba et al., 2022).

2.0 Problem Statement

Despite the proliferation of SME-targeted lending products from commercial banks, microfinance institutions, SACCOs, and mobile money lenders in Wakiso District, SME financial performance remained inconsistent and heavily conditioned on debt management capacity (Ntirandekura et al., 2022). UBOS (2022) data showed that 42% of Wakiso District SMEs that had accessed external debt financing in the preceding three years reported that debt servicing obligations had adversely affected their liquidity positions, and 23% reported that debt costs had reduced net profitability below the level achievable without debt financing—suggesting systematic debt structure misalignment and cost management deficiencies that demanded empirical analysis (Julius & Matovu, 2025).

3.0 Main Objective

The main objective was to examine the relationship between debt financing and financial performance of SMEs in Wakiso District. Specific objectives were: (i) to assess how short-term debt financing influenced SME financial performance; (ii) to evaluate long-term debt financing's effect on financial performance; and (iii) to determine the relationship between debt cost management and financial performance of SMEs in Wakiso District.

4.0 Literature Review

4.1 Theoretical Framework

The Trade-Off Theory of capital structure (Modigliani & Miller, 1963; Myers, 1977) provided the primary theoretical framework, predicting that firms would optimise their debt-equity mix by trading off the tax shield benefits of debt against the financial distress costs of excessive leverage. For SMEs operating in Uganda's high-interest-rate environment, the theory predicted that debt financing would improve financial performance up to the point where marginal interest tax shield benefits equalled marginal financial distress costs — an optimal leverage ratio that varied across SME types based on asset tangibility, revenue stability, and lender relationship quality. The Pecking Order Theory (Myers & Majluf, 1984) offered an alternative perspective, predicting that SMEs would prefer internal financing over debt and debt over equity due to information asymmetry costs, implying that observed debt financing reflected information disadvantages rather than deliberate leverage optimisation. Both theories informed the study's analysis of SME debt structure decisions and their performance consequences.

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4.2 Empirical Literature

Empirical research on debt financing and SME performance in East Africa presented a nuanced picture consistent with the theoretical trade-off perspective (Ramadhan et al., 2023). Njeru et al. (2020) found in a study of Kenyan SMEs that short-term debt was negatively associated with profitability at high levels but positively associated at moderate levels, consistent with optimal leverage theory. Mawejje and Mubiru (2021) documented in Uganda that SMEs with interest coverage ratios above 3.0 achieved ROA values 4.2 percentage points higher than those with ratios below 1.5, confirming the critical importance of debt cost management capacity. Research by Kajanathan and Achchuthan (2013) found that debt structure specifically the balance between short-term and long-term debt was as important as debt level in determining SME financial performance, with misaligned debt maturities (long-term assets financed by short-term debt) associated with significantly adverse liquidity and performance outcomes.

5.0 Methodology

A cross-sectional survey design was adopted. The study population comprised SMEs in Wakiso District registered with Uganda Revenue Authority and with annual revenues between UGX 10 million and UGX 500 million (Jallow et al., 2022). A sample of 84 SMEs was selected through stratified random sampling across four sectors: trading (28), manufacturing (24), services (20), and agro-processing (12). 178 individual respondents (owners and finance managers) participated. Cronbach's Alpha: 0.84 (short-term debt management), 0.81 (long-term debt management), 0.83 (debt cost management), 0.87 (financial performance). SPSS 26 and AMOS 24 were used (Nelson et al., 2022).

6.0 Results

6.1 Descriptive Statistics

Table 1: Descriptive Statistics-Debt Financing Variables (N = 178)

Variable	N	Min	Max	Mean	Std. Dev
Short-term Debt Management	178	1.00	5.00	3.61	0.88
Long-term Debt Management	178	1.00	5.00	3.42	0.94
Debt Cost Management	178	1.00	5.00	3.24	0.97
Financial Performance	178	1.00	5.00	3.48	0.83

Source: Field Data, 2025

Short-term debt management received the highest mean (mean = 3.61, SD = 0.88), reflecting SMEs' greater familiarity and experience with overdraft facilities, revolving credit lines, and trade credit arrangements that constituted the primary short-term financing instruments in their operating context (Julius et al., 2026). Long-term debt received a moderate mean (mean = 3.42, SD = 0.94), reflecting the more challenging nature of long-term borrowing for SMEs requiring more extensive documentation, collateral, and lender relationship management (Ahumuza et al., 2025). Debt cost management received the lowest mean (mean = 3.24, SD = 0.97), reflecting the limited negotiating power and financial management sophistication of many SME owner-managers in managing interest rates, fee structures, and

debt scheduling-a finding consistent with the documented adverse liquidity impacts of debt costs reported by 42% of Wakiso District SMEs(Akankwasa et al., 2022).

6.2 Correlation Analysis

Table 2: Pearson Correlation Matrix-Debt Financing and Financial Performance (N = 178)

Variable	1	2	3	4
1. Short-term Debt Mgmt	1.000			
2. Long-term Debt Mgmt	0.528**	1.000		
3. Debt Cost Management	0.501**	0.541**	1.000	
4. Financial Performance	0.631**	0.682**	0.541**	1.000

** Correlation is significant at the 0.01 level (2-tailed)

Source: Field Data, 2025

Long-term debt management showed the strongest correlation with financial performance ($r = 0.682$, $p < .01$)-a finding with important theoretical implications. It suggested that the quality of long-term debt structure-the appropriateness of loan terms, asset-liability maturity matching, and repayment scheduling relative to investment return timelines was the most critical financing dimension for SME financial performance(Akankwasa et al., 2022). This finding was consistent with the trade-off theory prediction that optimal leverage produced performance benefits, and with the empirical finding that misaligned debt maturities (particularly long-term assets financed with short-term debt) were a primary source of financial distress in SMEs(Faridah et al., 2023). Short-term debt management showed a strong positive correlation ($r = 0.631$, $p < .01$), while debt cost management showed the weakest but significant correlation ($r = 0.541$, $p < .01$), reflecting that interest cost management, while critical for profitability, was partly constrained by market interest rate conditions beyond individual SME control(Julius & Matovu, 2025).

6.3 Regression Analysis

Table 3: Regression Model Summary

Model	R	R ²	Adjusted R ²	Std. Error	F	Sig.
1	0.774	0.598	0.590	0.533	29.74	< .001

Source: Field Data, 2025

Table 4: Regression Coefficients-Predictors of SME Financial Performance, Wakiso District

Variable	B	Std. Error	Beta (β)	t	Sig.
(Constant)	0.493	0.229		2.153	.033
Short-term Debt Management	0.312	0.076	0.331	4.105	< .001
Long-term Debt Management	0.367	0.079	0.415	4.645	< .001
Debt Cost Management	0.241	0.071	0.281	3.394	.001

Dependent Variable: Financial Performance

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Source: Field Data, 2025

The regression model was significant ($F = 29.74$, $p < .001$), explaining 59.8% of SME financial performance variance ($R^2 = 0.598$). Long-term debt management emerged as the strongest individual predictor ($\beta = 0.415$, $p < .001$), confirming that the quality of long-term borrowing decisions-the appropriateness of loan terms, collateral management, and repayment structure relative to investment return profiles was the most critical single debt financing determinant of SME financial performance(Alex & Julius, 2024). Short-term debt management was the second strongest predictor ($\beta = 0.331$, $p < .001$), reflecting the importance of effective working capital debt management for SME liquidity and operational continuity. Debt cost management contributed a smaller but significant effect ($\beta = 0.281$, $p = .001$)(Nelson et al., 2023).

6.4 Structural Equation Model and Path Analysis

Table 5: SEM Fit Indices-Debt Financing and SME Financial Performance Model

Fit Index	Value	Threshold	Assessment
χ^2 / df	2.19	< 3.0	Good fit
CFI	0.958	≥ 0.95	Good fit
RMSEA	0.063	< 0.08	Acceptable
SRMR	0.055	< 0.08	Good fit
GFI	0.943	≥ 0.90	Good fit

Source: Field Data, 2025

Table 6: Structural Path Coefficients — SME Debt Financing SEM, Wakiso District

Path	Std. β	SE	CR	p	Decision
Long-term Debt Mgmt → Financial Performance	0.381	0.081	4.704	$< .001$	Supported
Short-term Debt Mgmt → Financial Performance	0.311	0.077	4.039	$< .001$	Supported
Debt Cost Mgmt → Financial Performance	0.246	0.073	3.370	.001	Supported
Long-term Debt → Debt Cost Mgmt (med.)	0.441	0.088	5.011	$< .001$	Supported
Indirect: LTD → DCM → FP	0.108	0.036	3.000	.003	Supported
Total Effect: Long-term Debt Mgmt → FP	0.467				
Total Effect: Short-term Debt Mgmt → FP	0.311				

Total Effect: Debt Cost Mgmt → FP	0.246				
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Source: Field Data, 2025

The structural model revealed that debt cost management partially mediated the long-term debt management–financial performance relationship (indirect $\beta = 0.108$, $p = .003$). This finding reflected the logical pathway (Julius & Nancy, 2026): SMEs that managed long-term debt structures more effectively selecting appropriate loan products, negotiating competitive terms, and aligning repayment with investment return timelines simultaneously developed stronger debt cost management capabilities, generating compounding financial performance benefits through both the direct debt structure quality effect and the indirect debt cost management improvement (Alex & Moses, 2024). The total effect of long-term debt management on financial performance ($\beta = 0.467$) substantially exceeded its direct effect ($\beta = 0.381$), confirming the importance of this mediated pathway (Deus, 2023).

7.0 Discussion, Conclusions, and Recommendations

The findings confirm debt financing structure and management as significant determinants of SME financial performance in Wakiso District, explaining 59.8% of performance variance. The dominance of long-term debt management (total $\beta = 0.467$) challenged the common SME policy focus on short-term credit access, suggesting that long-term loan product appropriateness, term length, and repayment structure alignment with investment return profiles were the most consequential financing dimensions for performance outcomes (Julius, 2024). Recommendations: (i) SME borrowers should engage financial advisors or business development service providers before committing to long-term debt to ensure loan term alignment with asset lifespan and income generation timelines; (ii) commercial banks and MFIs should develop specialised SME lending products with flexible repayment schedules calibrated to the cash flow patterns of specific business sectors; (iii) the Uganda Development Bank should expand its SME long-term lending portfolio with concessional rates to reduce the high cost burden that constrained debt cost management effectiveness; (iv) the Private Sector Foundation Uganda should provide financial literacy training specifically targeting debt structure optimization and interest cost negotiation for SME owner-managers; and (v) URSB and URA should streamline SME financial reporting requirements to improve SME creditworthiness documentation that would enable better lender risk assessment and lower risk-adjusted lending rates.

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