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The Influence of Capital Structure on the Financial Performance of Small and Medium Enterprises in Mitooma District, Uganda

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ABSTRACT

Small and medium enterprises (SMEs) are pivotal for a nation's economic growth, representing 90% of global businesses and generating 50% of job opportunities. In Uganda, this sector employs approximately 2.5 million individuals and contributes 18% to the GDP. Despite this significant impact, 45% of Ugandan SMEs face imminent collapse due to financial hurdles. Consequently, this study aimed to explore how capital structure influences the financial performance of SMEs in Mitooma District. The objectives were to scrutinize the impact of equity capital, debt capital, and retained earnings on SMEs' financial performance. Grounded in the Pecking Order Theory and Trade Theory, the study followed a quantitative research approach employing a descriptive research design. With a population of 836, a scientifically determined sample of 271 was selected through random and purposive sampling methods. Data collection involved a validated and reliable questionnaire. Using regression analysis through SPSS, the study found that the model provided a robust level of prediction (R=.678), explaining 45.9% (R2=.459) of the variability in SMEs' financial performance. Specifically, equity capital (t=-1.975, P=.045, P<.05), debt capital (t=7.015, P=.000, P<.05), and retained earnings (t=6.289, P=.000, P<.05) emerged as statistically significant factors. Conclusively, the study highlighted that equity capital, debt capital, and retained earnings significantly influence SMEs' financial performance. To enhance their financial standing, the recommendation is for SMEs to adopt innovative strategies. These findings hold relevance for policymakers, SME stakeholders, academic circles, and SME owners, offering valuable insights into bolstering this critical sector.

Keywords: Small and medium Enterprises, Economic development, financial performance, Equity capital, Retained earnings.

INTRODUCTION

Globally, Small and Medium Enterprises (SMEs) play a major role in most economies, particularly in developing countries. SMEs account for the majority of businesses worldwide and are important contributors to job creation and global economic development. They represent about 90% of businesses and more than 50% of employment worldwide. Formal SMEs contribute up to 40% of national income (GDP) in emerging economies [1]. Small and Medium Enterprises first became prevalent in the United States in 1782, with the majority of non-manufacturing enterprises having annual revenue of less than $7 million US and fewer than 500 employees for manufacturing businesses. Other criteria used to categorize small businesses besides employee count incorporated yearly sales (turnover), asset value, and net profit [2, 3]. The SMEs in India were divided into two groups in the 1920s: those utilizing power and having less than 50 employees, and those not using power and having between 51 and 99 employees. In China, SMEs contribute significantly to China's social economy due to their large numbers (over 90% of all enterprises). SMEs collectively contribute 80% of China's employment, 70% of technological innovation, 60% of GDP, and 50% of tax revenue [4]. However, their performance remains unstable because several SMEs that go bankrupt and close down in the community are far greater than the overall decline, considering that new businesses are set up in the original locations soon after the previous enterprises cease operations and close down [4, 5]. Micro and small businesses provided around 45% of India's overall export revenue [6]. Small businesses indeed play a significant role in generating money and jobs in many nations around the world. However, the main factor used to distinguish small-scale enterprises from medium- and large-sized industries has been the capital resources spent on establishing plants and machinery. If an industrial unit meets the capital investment threshold set by the Government of India for the small-scale sector, it can be designated as a small-scale unit. According to [7], there is no fluctuation in the growth scenario of the MSMEs, which indicates that MSMEs are the ever-green sector in India and positively contribute to the economic growth of the nation [7]. Small and Medium Enterprises in Africa are traced to have emerged way back in the 1950s during the colonial times and have been seen as the origin of modern business in Africa since the independence of most African countries [8]. The crucial paper No. 24 of 1945, which forms the historical foundation of Nigeria's small and medium-sized businesses, was published in 1946. A ten-year development and welfare plan for Nigeria was presented. It has been said that small and medium-sized businesses are always necessary in any economy. In Nigeria's economic environment, small-scale businesses are still present and form the foundation for the country's current degree of industrialization, modernization, urbanization, and gainful and meaningful employment [13]. According to Global Entrepreneurship Monitor (GEM), out of the businesses that start each year in Africa, 80% to 90% are SMEs but over 40% of them collapse before five years due to profitability, liquidity and funding challenges [10]. They faced a variety of difficulties, such as a lack of cash or insufficient capital to purchase the inventory and equipment necessary for the majority of these sectors. Loans from financial and non-financial entities took time to get and were typically only granted on paper. The SMEs managed to thrive despite the capital scarcity factor [11]. In Ghana, the definitions used are based on capital requirements and on employment size. Enterprises qualify as micro, small or medium-scale enterprises if they fulfil the maximum ceilings for staff headcount and capital investment. Thus, micro-businesses employ one to five employees with a turnover of $10,000, small employ 6 to 29 with a turnover of $ 100.000 and medium employ 30 to 100 with a turnover of $1,000,000.

SMEs in Uganda are a driving force for the promotion of the country's economic development [12]. SMEs have significant socio-economic characteristics such as their contribution to new job creation and reduction of poverty contributing positively to the GDP of the country [13]. The government of Uganda through National Small Business Survey have prioritized access to finance, improving infrastructure, providing business services and improving security for the smooth running of SMEs in the country [14]. Despite the above strategies, SMEs in Mitooma District are faced with financial performance challenges whereby; 45% of them are limping and others are on the verge of collapsing [15]. However, their financial performances are poor as reflected in terms of profitability, turnover, liquidity ratio (Annual report 2020/2021). Thus, the issue of concern was equity capital, debt capital and retained earnings whose effects on financial performance are unknown. If the above problem continues there is a likelihood of closure or collapse of SMEs in Mitooma District which will affect the country's economy. Therefore, the study sought to examine the effect of capital structure on financial performance of SMEs in Mitooma District.

METHODOLOGY

Research Design

The study used a descriptive research design. A descriptive research design according to [16], is a style of design where information is gathered from a cross section of respondents at a particular point in time. On the other hand, a descriptive research design was preferred because of the need by the researcher to allow respondents express their personal opinion on every item that was put to them to judge or answer [17]. The descriptive research design worked well for the type of questionnaire to be used because the questions are strictly structured. Because it takes less time, it's more efficient, and is less expensive than other survey designs, a descriptive research design was preferred.

Area of the Study

The study was limited to the SMEs in in Mitooma District. Mitooma is located approximately 77 kilometres (48 mileage), by road, west of Mbarara City in the Ankole sub-region. The geographical coordinates of the town are 0°36'54.0"S, 30°02'42.0"E (Latitude: 0.6150; Longitude: 30.0450). The average elevation of Mitooma is 1,545 meters (5,069 feet) above sea level.

Research Approach

Quantitative research approach was used in this investigation. Quantitative approach was used in the study because it helped in collecting data that was measurable [17], whereby in this study, it was applicable to determine how SMEs' financial performance was impacted by their capital structure in Mitooma District.

Target Population

In Mitooma District, the study population was 836 Small Medium Enterprises based on Mitooma District commercial report [18].

Table 1: Sampling Frame

Category	Population
District Commercial Officer	1
Businessmen	835
Total	**836**

Source: [18]

According to [19], the total population is the collection of components upon which conclusions can be made. The study targeted SMEs in Mitooma District. The SMEs in both retail and whole with the intention of making a profit are those that were involved in the study.

Sample size

The sample size was determined using [20] formula.

$$n = \frac{N}{1 + N(e)^2}$$

Where:
N= population
n= sample
e =random error at 5%

Therefore: $n = \frac{836}{1+836(5\%)^2}$

$= \frac{836}{3.09}$

=270.55 equivalent to 271

Table 2: Population and sample Distribution

Category	Population	Sample
District Commercial Officer	1	1
Businessmen	835	270
Total	**836**	**271**
Source: [18]		

From table 2 above, a sample size of 271 was attained using [20] formula from a population of 836.

Sampling Procedure

According to [21], a sampling method is a technique for selecting respondents from a population to represent the population. The researcher used purposive sampling technique and simple random sampling technique to select the study respondents.

Purposive sampling technique

[22], defines a judgmental sample, also known as a purposive sample, is one that is selected by the general public's knowledge and the study's objectives. The subjects are selected because of some characteristic. The researcher used purposive sampling technique to select District Commercial Officer (DCO).

Simple random sampling technique

A random selection is made using the probability sampling approach known as simple random sampling to select the desired sample size of the study [23]. With simple random sampling, traders specifically were chosen by chance from a sampling frame to ensure representativeness of the selected sample. The researcher moved from one business looking for respondents who were willing to participate in the study. The use of simple random sampling made it possible to generalize the findings. Simple random sampling method was used so that each member of the population would get equal chances of being selected. The researcher used the technique to select respondents from service (192), trade (616), and manufacturing (27) in order to avoid biasness [23]. A simple random sampling method.

Data collection instrument

The researcher used researcher-administered questionnaires for data collection.

Questionnaires

A pre-set questionnaire form with questions relevant to the research objectives. The study had one set of researcher-administered each of the study's objectives had questions for the purpose of in-depth analysis, and the questionnaire were carefully designed to gather all the information required from respondents in all categories. [24].

Data Quality Control

In order to ascertain quality content, both reliability and validity of research instrument were undertaken.

Validity of the research instrument

Objectivity is the precision and significance of conclusions drawn from study findings. It is the degree to which data findings analyzed accurately to reflect the phenomenon being studied. Therefore, validity examines how properly the study's variables are represented [25]. Content validity Index was used in the study. It evaluates the degree to which data gathered using specific instruments accurately reflects a given realm of indicators or the content of a given notion. In order to ensure content validity, the researcher designed the apparatus with all the measuring components and study variables. The content validity was figured out by distributing the questionnaire to a group of five SMEs-related specialists. The experts offered revisions and ideas, which was taken into account when creating the questionnaire's final draft. The majority of the specialists agree that the device monitors what it intends to. Content Validity Index was calculated basing on judgment by at least two knowledgeable people (Judges). The result got were 0.7 or above, the instrument was deemed valid for use in this study. The content validity index (CVI) was computed using the formula presented below.

$$C.V.I = n/N$$

Where n = number of relevant items in the instruments

N = total number of items in the instruments.

The results from the two administrations were conducted to determine the CVI. Ten respondents were used for the pilot study. The findings revealed a coefficient of 0.778 which is above 0.7 thus proving the instrument reliable.

Table 3: Content Validity Index tests

Variable	CVIs	No of Items
Equity capital	0.714	07
Debt capital	0.875	06
Retained earnings	0.875	09
Financial performance of SMEs	0.7780	07

Source: Primary data, 2023

Reliability of the research instrument.

Reliability is defined as the extent of the research tools produce consistent outcomes following numerous trials, [26]. A data collection instrument is reliable if it measures consistently what it ought to measure. According to [26], the Cronbach's alpha coefficient 0.70 and above indicates that the instrument is reliable. The reliability test was done using test-retest approach. The pilot study was conducted using ten respondents, data collected was analyzed using Cronbach's Alpha Method.

Table 4: Reliability Test Results

Variable	Cronbach's Alpha	No of Items
Equity capital	0.827	30
Debt capital	0.828	30
Retained earnings	0.818	30
Financial performance of SMEs	0.848	30
Mean	0.830	

Source: Primary data, 2023

Data analysis

Data was analyzed using regression analysis technique. The regression model is shown below.

Regression Analysis equation;

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \varepsilon_i$$

Where:

Y=Financial performance

X_1=Equity capital

X_2=Debt capital

X_3=Retained earnings

β s= Coefficients

e= Margin of error at 5% significance level.

Ethical Issues consideration

Ethics as a code of behavior appropriate to academic of research [27]. The researcher followed the KIU ethical procedure as;

i. KIU-REC introducing him to the leadership of Mitooma District where data was collected.
ii. The researcher ensured that the confidentiality and privacy of the participants' information which was given. This is because some of the participants were uncomfortable to give some of the information. Therefore, in obtaining the information, the use of force or questions, which might infringe the ethical issue, was avoided and discouraged.
iii. A letter of consent was availed to the participants by the researcher to declare that they are willing to participate or not in the study and their unwillingness to participate in the study didn't attract any penalty.
iv. The researcher explained to the participants that there is no physical or financial benefit for the participating in the study because it was voluntary.
v. The researcher fully explained the purpose, objectives, risks and benefits of the study to the participants before taking part in the study.
vi. The researcher provided his contacts to the participants to call him for any inquires or questions about the study.
vii. Upon visiting SMEs, the researcher sought permission from the Commercial officer to carry out the study.

RESULTS

Response Rate

A total of 271 respondents were involved in the study. Among the total respondents, 248 were given questionnaire with a percentage of 91.5% while the remaining 23 (8.5%) of the respondents were given interview guide. According to [28], a response rate of 50% is adequate for analysis and reporting; a rate of 60% is good and a response rate of 70% and over is excellent. Based on the assertion, the response rate of 91.5% was considered to be excellent, and was a good representation of the sample used in the study population.

Background information of Respondents

The background information of respondents revealed their demographic characteristics and those of their businesses. This study therefore sought to establish the gender, age of the respondents, marital status, level of education, category of the business and experience in business.

Table 5: Demographic characteristics of the respondents

Characteristics	Items	Frequency	Percent
Gender distribution of respondents	Male	145	58.5
	Female	103	41.5
	Total	**248**	**100.0**
Respondents' age group	Below 20years	3	1.2
	20-30years	84	33.9
	31-40 years	116	46.8
	Above 40 years	45	18.1
	Total	**248**	**100.0**
Marital status	Single	51	20.6
	Married	182	73.4
	Separated/Divorced	9	3.6
	Widowed	6	2.4
	Total	**248**	**100.0**
Education Level	No formal education	22	8.9
	Primary education level	95	38.3
	Secondary education level	83	33.5
	Post-secondary education level	48	19.4
	Total	**248**	**100.0**
Category of the business	Service	57	22.9
	Trade	183	73.8
	Manufacturing	8	3.2
	Total	**248**	**100**
Experience in the Business	Less than 3 year	102	41.1
	3-5 years	82	33.1
	5-9 years	37	14.9
	10years and above	27	10.9
	Total	**248**	**100**

Source: Primary data, 2023

The results in Table 5 show the characteristics and distribution of respondents in relation to their gender, age group, marital status, category of business, and the experience in businesses. These findings have implications for the financial performance of small and medium-sized enterprises (SMEs). In terms of gender distribution, the majority of respondents were male (58.5%), while females accounted for 41.5%. This implies that there was a gender imbalance in the SME sector, which could have implications for financial performance. It suggests that there may be a need to address gender disparities and promote greater inclusivity and diversity within the sector, as diverse teams and perspectives often contribute to better decision-making and business outcomes. Regarding age groups, the highest proportion of respondents fell within the 31-40 years, category (41.1%), followed closely by the 20-30 Years category (33.9%). This indicates that a significant portion of SME owners or managers are in their prime working years, which could be advantageous for their financial performance. It suggests that individuals in these age groups may have acquired the necessary experience, skills, and networks to run successful businesses. Marital status reveals that the majority of respondents were married (73.4%), while single individuals accounted for 22.9%. This finding suggested that marital status had an influence on the financial performance of SMEs. Married individuals had additional responsibilities and financial obligations, which impact their business decisions and resource allocation. Understanding these dynamics helped capital structure and financial services to meet the specific needs of different marital statuses and potentially enhance the financial performance of SMEs. Responses on education level showed that majority (38.3%) had primary education level followed by 33.5% who had secondary level of education. 8.9% and 19.4% had no formal education and Post-secondary education level respectively. This showed that majority of the respondents involved in the study were literate and therefore helped the research running his study smoothly. The category of business shows that trade businesses constituted the largest proportion (73.8%), followed by service businesses (22.9%), and a smaller representation from manufacturing businesses (3.2%). This distribution implies that trade businesses dominate the SME sector in the study context. The nature of the business category can have implications for financial performance, as different industries have unique challenges and opportunities. Understanding the specific needs and characteristics of each category can inform targeted interventions and strategies to support SMEs in improving their financial performance.

Lastly, the time spent in the business indicates that a significant portion of respondents had been in operation for less than three years (41.3%), while a considerable number had been in business for 3-5 years (33.1%). This finding suggests a relatively high turnover rate in the SME sector, with new businesses constantly entering the market. It highlights the importance of providing adequate support, training, and resources to SMEs in their early years to improve their chances of long-term financial sustainability. Additionally, the presence of SMEs that have been in operation for 10 years and above (10.9%) signifies the potential for stable and successful enterprises that can serve as examples and mentors for newer businesses.

Results based on Objectives

This section presents results in accordance to the study objectives. A five-point likert scale was used while mean and standard deviation were obtained for easy comparisons between different variables as shown in tables below;

The effect of equity capital on financial performance of SMEs in Mitooma District

The first objective of the study was to examine the effect of equity capital on financial performance of SMEs in Mitooma District. A total of 8 items scored on -point Likert scale ranging from (1) for strongly disagree (2) for disagree, (3) for not sure (4) for agree (5) for strongly agree were used to collect data from the owners and operators of SMEs and the results are presented in table below.

Table 6: Equity Capital on Financial performance

Responses	N/%	SA	A	N	D	DS	Total	Mean	S.D
The SME relies on equity capital in order to run	N %	104 41.9	54 21.8	33 13.3	21 8.5	36 14.5	248	3.68	1.451
Equity capital has more advantages than all other sources of capital.	N %	135 54.4	88 35.5	11 4.4	5 2.0	9 3.6	248	4.35	.936
The SME has less burden of current liabilities as compared to current assets	N %	102 41.1	105 42.3	15 6.0	8 3.2	18 7.3	248	4.07	1.120
My business mainly relies on family and friends contributions and reinvested profits to finance business operations	N %	118 47.6	108 43.5	11 4.4	3 1.2	8 3.2	248	4.31	.875
Equity is preferred to loan because it is cheaper to run	N %	59 23.8	177 71.4	8 3.2	1 .4	3 1.2	248	4.16	.609
My business relies on personal savings than other form of equity finance	N %	51 20.6	181 73.0	5 2.0	10 4.0	1 .4	248	4.09	.645
Own personal savings constitute a large share of my business capital finance to meet business investment obligations	N %	69 27.8	170 68.5	4 1.6	4 1.6	1 .4	248	4.22	.591
Equity capital alone is enough to finance a business	N %	70 28.2	167 67.3	3 1.2	6 2.4	2 .8	248	4.20	.653

Source: Primary data, 2023

Key: SA-Strongly Agree (5), A-Agree (4), UD-Undecided (3), D-Disagree (2), DS-Disagree strongly. The interpretation of the results regarding outcomes on equity capital for SMEs in Mitooma district provides insights into the perceptions and preferences of business owners regarding capital financing options. The findings shown in table 6 above, for equity capital indicated that 104 (41.9%) strongly agreed that the SME relies on equity capital in order to run, 54(21.8%) agreed, 33(13.3%) respondents were undecided, 21(8.5%) disagreed while 36 (14.5%) disagreed strongly. The mean achieved was 3.68 and 1.451 standard deviation. Regarding the advantages of equity capital, a considerable percentage of respondents 135 (54.4%) strongly agreed that equity capital has more advantages than all other sources of capital. 88 (35.5%) agreed, 11 (4.4%) were undecided, 9 (3.6%) disagreed strongly while the least, 5(2.0%) disagreed with it with a mean of 4.35 and a standard deviation of .936. This finding suggests that SME owners perceive equity capital to be beneficial for their businesses. Equity capital provides advantages such as shared risk, potential expertise or guidance from investors, and the absence of interest or debt repayment obligations. Respondents expressed a strong belief (102, 41.1%) that their SMEs had less burden of current liabilities compared to current assets. This positive perception, reflected in a mean of 4.07 and a standard deviation of 1.120, indicates a healthy financial position for many SMEs in Mitooma district. Having a lower burden of current liabilities implies a favorable liquidity position, where current assets can cover short-term obligations, leading to financial stability and improved financial performance. Respondents strongly preferred equity over loans, with a high percentage agreeing (177, 71.4%) followed by 59 (23.8%) who strongly agreed that equity is cheaper to run. This perception, with a mean of 4.16 and a standard deviation of .609, indicates a preference for equity financing to avoid the costs associated with loan repayment. This preference aligns with the perception that personal savings constitute a significant share of business capital finance, as indicated by the agreement of respondents (170, 68.5%) and a mean of 4.22 with a standard deviation of 0. 591. This highlights the importance of personal savings as a form of equity finance for many SMEs in Mitooma District. Interestingly, a notable percentage of respondents (170, 68.5%) agreed that their own personal savings constitute a large share of their business capital finance to meet business investment obligations. This finding, with a mean of 4.22 and a standard deviation of 0. 591, suggests that many business owners rely on their personal savings to finance their SMEs' investment requirements. This reliance on personal savings highlights the commitment and dedication of entrepreneurs in Mitooma district to meet their business's financial needs. Implications for the financial performance of SMEs in Mitooma district can be drawn from these interpretations. It suggests that there is a need for financial institutions and policymakers to provide a diverse range of financing options to the specific needs of SMEs. While equity capital, personal savings, and contributions from family and friends play important roles in SME financing, there may be opportunities to explore alternative sources of capital and financial support to enhance the growth and sustainability of SMEs. Additionally, providing financial literacy and business management training can help SME owners make informed decisions about their capital structure and optimize their financial performance.

Effect of debt capital on financial performance of SMEs in Mitooma District

The first objective of the study was to examine the effect between debt capital and financial performance of SMEs. A total of 6 items scored on -point Likert scale ranging from (1) for strongly disagree (2) for disagree, (3) for not sure (4) for agree (5) for strongly agree were used to collect data from the debt capital and the results are presented in table 7 below.

Table 7: Debt Capital on Financial performance.

Responses	N/%	SA	A	N	D	DS	Total	Mean	S.D

Debt preferred to equity due to lower information disclosure	N %	67 27.0	174 70.2	2 .8	4 1.6	1 .4	248	4.22	.577
The SME relies on loan in order to run the business	N %	76 30.6	147 59.3	14 5.6	5 2.0	6 2.4	248	4.14	.803
The SME issues long-term debt to minimize the risk of having to finance in bad times	N %	105 42.3	137 55.2	3 1.2	3 1.2	-	248	4.39	.579
The SME prefers debt due to close relationship with bank(s)	N %	94 37.9	141 56.9	3 1.2	8 3.2	2 .8	248	4.28	.719
The firm considers its credit rating before it borrows	N %	124 50.0	112 45.2	5 2.0	6 2.4	1 .4	248	4.42	.692
Trade credit is applied on financing the business	N %	109 44.0	126 50.8	6 2.4	5 2.0	2 .8	248	4.35	.704

Source: Primary data, 2023

Key: SA-Strongly Agree (5), A-Agree (4), UD-Undecided (3), D-Disagree (2), DS-Disagree strongly (1). The interpretation of the results on outcomes related to equity capital for SMEs in Mitooma district sheds light on the perceptions and preferences of business owners regarding capital financing options. Regarding the preference for debt over equity, a considerable percentage of respondents agreed (174, 70.2%) while67, (27.0%) strongly agreed that debt is preferred due to lower information disclosure. This perception, with a mean of 4.22 and a standard deviation of .577, suggests that some SME owners may find debt financing more attractive because it allows them to avoid disclosing sensitive business information. This preference for debt financing may stem from concerns about protecting business confidentiality or maintaining control over decision-making processes. A significant percentage of respondents agreed (147, 59.3%) while 76, (30.6%) respondents strongly agreed that their SME relies on debt capital to run their businesses. This finding, with a mean of 4.14 and a standard deviation of .803, suggests that equity capital is one of the primary sources of financing for many SMEs in the district. This indicates a potential reliance loans though another percentage (11.1%) represents other sources of capital, such as debt financing or trade credit, to support their business operations. Similarly, a notable percentage of respondents strongly disagreed (6, 2.4%) while 5, (2.0%) disagreed that their SME relies on loans to run the business. This finding, with a mean of 4.14 and a standard deviation of 0.803, indicates that loans are commonly used as a source of financing for SMEs in Mitooma district. This reliance on loans suggests that SME owners may value the accessibility and convenience of debt financing, which allows them to secure funds for various business needs. The findings reveal that a significant proportion of respondents agreed (137, 55.2%) while 105 (42.3%) strongly agreed that the SME issues long-term debt to minimize the risk of having to finance in bad times. This perception, with a mean of 4.39 and a standard deviation of .579, suggests that SME owners recognize the importance of long-term debt in providing financial stability during challenging periods. By using long-term debt, SMEs can mitigate the risk of facing difficulties in obtaining financing when faced with unfavorable economic conditions or unexpected business challenges. Interestingly, a notable percentage of respondents agreed (141, 56.9%) while 94, (37.9%) strongly agreed (2.7%) that the SME prefers debt financing due to a close relationship with the bank(s). This finding, with a mean of 4.28 and a standard deviation of .719, highlights the significance of personal connections and relationships in the financing decisions of SMEs in Mitooma district. These close relationships with banks may provide SMEs with preferential access to loans or better terms, reinforcing their preference for debt financing. Moreover, the findings indicate that SMEs in the district consider their credit rating before borrowing, with a considerable percentage of respondents agreeing (33.3%) or strongly agreeing (28.7%). This suggests that SME owners recognize the importance of maintaining a good credit rating to access favorable financing options. This finding, with a mean of 2.98 and a standard deviation of 1.029, underscores the significance of creditworthiness and financial discipline in securing debt financing for business growth. Interestingly, a substantial proportion of respondents agreed (126, 50.8%) while 109, (44.0%) strongly agreed that trade credit is applied in financing their business operations. This finding, with a mean of 4.35 and a standard deviation of .704, suggests that trade credit plays a significant role in supporting the financial needs of SMEs in Mitooma district. This reliance on trade credit may enable SMEs to manage cash flow, procure goods and services, and maintain relationships with suppliers, facilitating their day-to-day operations. The implications of these interpretations for the financial performance of SMEs in Mitooma district highlight the diverse financing strategies employed by SMEs. It is essential for financial institutions, policymakers, and business support organizations to recognize and cater to the specific needs and preferences of SMEs when it comes to capital financing. Providing a range of financing options, improving financial literacy, and fostering strong relationships with financial institutions can contribute to enhancing the financial performance and sustainability of SMEs in the district. Additionally, promoting creditworthiness and facilitating access to credit based on factors beyond traditional collateral requirements can encourage SMEs to explore equity capital options and diversify their sources of financing, ultimately supporting their growth and development.

Effect of Retained earnings on financial performance of SMEs in Mitooma District

The first objective of the study was to examine the effect between Retained earnings and financial performance of SMEs. A total of 9 items scored on -point Likert scale ranging from (1) for strongly disagree (2) for disagree, (3) for not sure (4) for agree (5) for strongly agree were used to collect data from the retained earnings and the results are presented in table 8 below;

Table 8: Retained Earnings on Financial performance

Responses	N/%	SA	A	N	D	DS	Total	Mean	S.D
Retained earnings are profits and should be used for owners' consumption	N %	109 44.0	118 47.6	9 3.6	9 3.6	3 1.2	248	4.29	.804
Dividends per share for the business have been increasing each year	N %	69 27.8	170 68.5	4 1.6	4 1.6	1 .4	248	4.22	.591
Reserve levels are maintained to ensure continuity of operations	N %	70 28.2	163 65.7	7 2.8	6 2.4	2 .8	248	4.18	.670
To promote growth retained earnings needs to be reinvested.	N %	63 25.4	171 69.0	5 2.0	6 2.4	3 1.2	248	4.15	.678
My business use net income after tax to finance business operating expenses	N %	76 30.6	146 58.9	14 5.6	5 2.0	7 2.8	248	4.12	.827
When profits are insufficient for investment, better to delay than issue new securities	N %	103 41.5	133 53.6	3 1.2	5 2.0	4 1.6	248	4.31	.746
Optimal net income after tax is maintained by the business at all times	N %	98 39.5	136 54.8	3 1.2	9 3.6	2 .8	248	4.29	.738
Retained earnings lowers the gearing ratio thus reducing chances of liquidation	N %	120 48.4	111 44.8	6 2.4	8 3.2	3 1.2	248	4.36	.787
Retained earnings are cheapest source of finance	N %	75 30.2	163 65.7	4 1.6	4 1.6	2 .8	248	4.23	.636

Source: **Primary data, 2023**

Key: SA-Strongly Agree (5), A-Agree (4), UD-Undecided (3), Disagree (2), DS-Disagree Strongly (1) The analysis of the outcomes related to retained earnings in the context of SMEs in Mitooma district provides valuable insights into the perceptions and practices regarding the utilization of profits. The findings shown in table 8 above, on retained earnings indicated that 109, (44.0%) strongly agreed that retained earnings are profits and should be used for owners' consumption, 118 (47.6%) agreed, 9, (3.6%) respondents were undecided, 9 (3.6%) disagreed while 3(1.2%) disagreed strongly. The mean achieved was 4.29 and .804 standard Deviation. Furthermore, the findings suggest that the majority of respondents (170, 68.5%) agreed with the trend of increasing dividends per share for the business each year. This indicates a strong clarity or knowledge regarding the dividend distribution practices within the SMEs. The mean score of 4.22 and a standard deviation of .591 highlight the varying perceptions and understanding among respondents. In terms of maintaining reserve levels for ensuring the continuity of operations, a significant percentage of respondents agreed (163, 65.7%) while 70, (28.2%) respondents strongly agreed with this statement. This indicates that SME owners recognize the importance of maintaining reserves to mitigate risks and ensure the smooth functioning of their businesses. The mean score of 4.18 and a standard deviation of 0.670 suggest a generally positive attitude towards reserve management among respondents. The results also indicate that a considerable percentage of respondents agreed (171, 69.0%) while 63 (25.4%) respondents strongly agreed that to promote growth, retained earnings need to be reinvested. This suggests that SME owners understand the role of retained earnings in fueling business expansion and development. The mean score of 4.15 and a standard deviation of 0.678 reflect the varying perspectives on the reinvestment of retained earnings for growth. Moreover, a significant proportion of respondents agreed 136(54.8%) while98 (39.5%) strongly agreed that their businesses use net income after tax to finance business operating expenses. This indicates that SMEs in Mitooma district rely on their profits to cover operational costs. The mean score of 4.29 and a standard deviation of 0.738 suggest a general inclination towards utilizing net income for operating expenses among the respondents. Regarding the perception that retained earnings lower the gearing ratio and reduce the chances of liquidation, a significant percentage of respondents strongly agreed (120, 48.4%) while 111 (44.8%) agreed with the statement. This suggests that SME owners recognize the role of retained earnings in improving the financial leverage and stability of their businesses. The mean score of 4.36 and a standard deviation of 0.787 reflect the varying opinions and understanding of the impact of retained earnings on the gearing ratio. Finally, a notable percentage of respondents agreed 163 (65.7%) while75 (30.2%) strongly agreed that retained earnings are the cheapest source of finance. This indicates that SME owners perceive retained earnings as a cost-effective means of financing their businesses. The mean score of 4.23 and a standard deviation of 0.636suggest a strong consensus among the respondents regarding the cost advantages of retained earnings. The results highlight the diverse perceptions and practices related to the utilization of retained earnings among SMEs in Mitooma District. The findings provide valuable insights into the decision-making processes and financial management strategies adopted by SME owners in the District.

Financial Performance of SMEs

A total of 7 items scored on -point Likert scale ranging from (1) for strongly disagree (2) for disagree, (3) for not sure (4) for agree (5) for strongly agree were used to collect data from business owners and business operators. The findings are shown in Table 5.

Table 9: Financial performance of SMEs

Responses	N/%	SA	A	N	D	DS	Total	Mean	S.D
Our business has managed to cover all its costs	N %	75 30.2	157 63.3	4 1.6	6 2.4	6 2.4	248	4.17	.780
Our business has expanded compared to the past years	N %	68 27.4	168 67.7	6 2.4	4 1.6	2 .8	248	4.19	.632
Our business capital has been growing over the past years	N %	70 28.2	150 60.5	15 6.0	7 2.8	6 2.4	248	4.09	.817
Our cash collections have increased over the last years	N %	93 37.5	143 57.7	6 2.4	4 1.6	2 .8	248	4.29	.672
Our profits have been growing over the last five years	N %	87 35.1	141 56.9	6 2.4	9 3.6	5 2.0	248	4.19	.817
The business' assets have increased in the last years	N %	116 46.8	114 46.0	5 2.0	8 3.2	5 2.0	248	4.32	.835
Each year we register an increase in sales volume	N %	87 35.1	140 56.5	5 2.0	9 3.6	7 2.8	248	4.17	.862

Source: Primary data, 2023

Key: SA-Strongly Agree (5), A-Agree (4), UD-Undecided (3), Disagree (2), DS-Disagree Strongly (1) The interpretation of the results, considering the financial performance of SMEs in Mitooma district, provides valuable insights and implications. In terms of financial performance indicators, a notable proportion of respondents agreed (157, 63.3%) while 75 (30.2%) respondents strongly agreed that their businesses have managed to cover all its costs. With a mean of 4.17 and a standard deviation of 0.780, this finding underscores the financial stability of SMEs in Mitooma district. When SMEs can cover their costs, it indicates a positive financial position and the potential for generating profits, thus contributing to their overall financial performance. The perception of business expansion was prevalent among the respondents, with a high percentage agreeing (168, 67.7%) while68, (27.4%) strongly agreed that their business has expanded compared to past years. This positive outlook, reflected in a mean of 4.19 and a standard deviation of 0.632, suggests that SMEs in Mitooma district have experienced growth. This growth trajectory bodes well for their financial performance and underscores the importance of the bank's support in facilitating further expansion through financial solutions to their needs. Respondents also expressed a belief that their business capital has been growing over the past years, with a considerable percentage agreeing (150, 60.5%) and70 (28.2%) respondents strongly agreeing. This perception, with a mean of 4.09 and a standard deviation of 0.817, indicates positive capital growth among SMEs. The bank can leverage this trend to provide additional financial resources, guidance, and investment opportunities to support further capital growth and ultimately enhance the financial performance of SMEs. The perception of increased cash collections over the last years showed that a higher percentage of respondents 143 (57.7%) agreed while 93 (37.5%) strongly agreed. This finding, with a mean of 4.29 and a standard deviation of 0.672, suggests that there is room for improvement in cash management practices among SMEs in Mitooma district. The bank can play a crucial role in providing financial advice, cash management tools, and solutions to optimize cash collection processes. Improved cash management can positively impact the financial performance of SMEs by ensuring consistent cash flow and liquidity. Respondents expressed a strong belief as 141, (56.9%) agreed while 87 (35.1%) respondents strongly agreed that their profits have been growing over the last five years. This positive perception, reflected in a mean of 4.19 and a standard deviation of 0.817, indicates favorable financial performance among SMEs in Mitooma district. The bank can capitalize on this by offering financial products and services that support profit generation, such as business expansion loans, investment opportunities, and financial management tools. By aligning their offerings with the profitability objectives of SMEs, the bank can further enhance their financial success. Regarding business assets, a significant proportion of respondents strongly agreed (116, 46.8%) while 116 (46.8%) agreed that the business' assets have increased in the last years. With a mean of 4.32 and a standard deviation of 0.835, this finding indicates potential asset growth and management among SMEs. The bank can provide support through asset financing options, asset management advice, and financial solutions to help SMEs acquire and manage assets effectively. By improving asset growth and utilization, SMEs can enhance their financial performance and overall business operations. Although the statement regarding an annual increase in sales volume was explicitly measured, a positive trend in sales volume is crucial for the financial performance of SMEs. The bank can contribute to this by offering marketing support, sales financing, and business development services to help SMEs achieve consistent growth in sales. Increased sales volume can positively impact revenue generation and profitability, thereby driving the financial success of SMEs in Mitooma District. In summary, considering the means and standard deviations, the interpretation of the results provides valuable insights into the financial performance of SMEs in Mitooma district. The bank can leverage these findings to adapt financial solutions, enhance support services, and address specific challenges faced by SMEs. By providing effective complaint resolution, supporting cost coverage, facilitating business expansion, capital growth, cash management, and profit generation, and offering assistance in asset management and sales growth, the bank can significantly contribute to the financial performance and success of SMEs in Mitooma district.

Tests of regression model assumption.

The conceptualization of this study coupled with the methodology adopted calls for diagnostic tests such as correlation and regression. This means that the data had to be tested to see where they meet the assumptions for parametric tests. Specifically, normality, linearity and homogeneity were tested. This can be done using statistical and/or graphical approaches as detailed below [29-30].

Multicollinearity

Multicollinearity exists if the regressors correlate highly when regressed against each other. A collinearity diagnostic test under regression analysis was utilized.

Under this procedure, two values are given, the tolerance and the variance inflation factor (VIF). The tolerance value is an indicator of how much of the variability of the specified independent variable is not explained by the other independent variables in the model. The VIF is the inverse of the tolerance value. Basing on the tolerance figures, various scholars indicate different cut off points for the accept/reject standard. According to [31], if the tolerance values are below 2 that shows the existence of multicollinearity. While VIF values above 10 indicate serious concern. The results in this study reveal tolerance values; .982, .679 and .680 totaling to 2.341. This is supported by VIF values below 10, therefore implying non-multicollinearity among the variables, and thus the assumption was met (tolerance value above 2 and VIF below 4.5).

Table 10: Multicollinearity Results

(Constant)	Tolerance	VIF
Equity capital	.982	1.018
Debt capital	.679	1.472
Retained earnings	.680	1.471
a. Dependent Variable: Financial performance		

Regression analysis results

The results are shown in Table; 11(a), 12(b), 13(c) below.

Table 11 (a): Model summary

Model Summary					
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.678[a]	.459	.453	.25188	1.633
a. Predictors: (Constant), Retained earnings, Equity capital, Debt capital					

The value of .678 shows a good level of prediction while value .459 (R^2=0.459), indicates that 45.9% of variation in financial performance can be accorded for by independent variable (capital structure).

Table 12 (b): ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	13.152	2	6.576	104.1	.000[b]
	Residual	15.480	245	0.0632		
	Total	**28.632**	**247**			
a. Dependent Variable: Financial performance.						
b. Predictors: (Constant), Retained earnings, Equity capital, Debt capital.						

The F-ratio in the **ANOVA** tests whether the overall regression model was a good fit for the data. The result shows that the independent variables statistically significantly predicted the dependent variable which is financial performance of SMEs and the regression model was a good fit for these data as shown in table 4.8(b) above.

Table 13 (c): Coefficients

Coefficients[a]						
Model		**Unstandardized Coefficients**		**Standardized Coefficients**	**t**	**Sig.**
		B	Std. Error	Beta		
1	(Constant)	.423	.373		1.133	.259
	Equity capital	.108	.055	.094	-1.975	.049
	Debt capital	.518	.074	.401	7.015	.000
	Retained earnings	.472	.075	.359	6.289	.000
a. Dependent Variable: Financial performance						

To establish the effect of capital structure on financial performance of SMEs in Mitooma District, regression analysis was carried and the results are presented in model summary. The general model equation to predict Equity capital, debt capital and retained earnings, is given below:

Y=0.423+0.108X1+0.518X2+0.472X3---1

Hypotheses;

i) **H**o1: Equity capital has no significant effect on financial performance of SMEs in Mitooma District.
The results Shows that equity capital was statistically significant. (t=-1.975, p=0.49, p< .05). Null hypothesis was rejected in favour of alternative.
One

ii) **H**o2: Debt capital has no significant effect on financial performance of SMEs in Mitooma District.
(t (270) = 7.015, p=.000, p<.05) significant. One additional units of debt capital increased financial performance by .518 units.

iii) **H**o3: Retained earnings has no significant effect on financial performance of SMEs in Mitooma District.

(t (270) = 6.289, P=.000, P<.05) significant. One additional unit of retained earnings increased financial performance by.475. Based on the above findings, null hypotheses were rejected. The results from the regression analysis indicate that there was a significant effect between independent variable, capital structure and the dependent variable, financial performance of SMEs in Mitooma district. The unstandardized coefficient for equity capital is 0.055, indicating that for every unit increase in equity capital, there was an estimated increase of 0.055 units in the financial performance of SMEs, holding other variables constant. The standardized coefficient (beta) for equity capital was 0.094, which suggested that equity capital had a positive impact on the financial performance of SMEs. This indicates that equity capital contributes positively to the overall financial performance of SMEs in Mitooma district. The t-value of -1.975 is highly significant (p = 0.045), indicating that the effect of equity capital on financial performance is statistically significant. This suggests that the observed relationship between equity capital and financial performance is unlikely to be due to chance. The constant term in the model is .423, indicating the expected value of the financial performance of SMEs when equity capital is zero. The unstandardized coefficient for Debt capital is 0.074, indicating that for every unit increase in debt capital, there is an estimated increase of 0.074 units in the financial performance of SMEs, holding other variables constant. The standardized coefficient (beta) for debt capital is 0.401, which suggests that debt capital has a positive impact on the financial performance of SMEs. This indicates that debt capital contributes positively to the overall financial performance of SMEs in Mitooma district.

The t-value of 7.015 is highly significant (p <0.05), indicating that the effect of debt capital on financial performance is statistically significant. This suggests that the observed effect between debt capital and financial performance is unlikely to be due to chance. The constant term in the model is 0.423, indicating the expected value of the financial performance of SMEs when debt capital is zero. The unstandardized coefficient for retained earnings was 0.075, indicating that for every unit increase in retained earnings, there is an estimated increase of 0.075units in the financial performance of SMEs, holding other variables constant. The standardized coefficient (beta) for retained earnings is 0.359, which suggests that retained earnings has a positive impact on the financial performance of SMEs. This indicates that retained earnings contribute positively to the overall financial performance of SMEs in Mitooma district. The t-value of 6.289 is highly significant (p <0.05), indicating that the effect between retained earnings and financial performance is statistically significant. This suggests that the observed effect between retained earnings and financial performance is unlikely to be due to chance. The constant term in the model is 0.423, indicating the expected value of the financial performance of SMEs when retained earnings is zero. The findings are discussed according to the study objectives. Furthermore, this research was carried out centering on three key objectives. Examining the effect of equity capital on financial performance in SMEs, evaluating the effect of debt capital on financial performance of SMEs and determining the effect of retained earnings on the performance of SMEs. In this section, these findings are further discussed to check their relevance to the overall knowledge generation and testing. This discussion is organized in line with the objectives of the study and paying special courtesy to the key findings attained from the process of data analysis as follows;

The effect of Equity capital on financial performance of SMEs in Mitiooma District.

From the study findings on objective one, the results from all the considered variables on equity capital revealed that there is a significant effect between equity capital and financial performance of SMEs. This result was true for all components of equity capital involved in this study. The findings of this study were supported by the study findings of the study done by [32] which revealed that their businesses mainly relied on family and friends' contributions and reinvested profits to finance business operations.

Debt capital on financial performance of SMEs in Mitooma District.

This study set out to establish the effect of debt capital on the financial performance of SMEs in Mitioma District. Having analyzed all the components of the debt capital as variable in relation to financial performance, there was a positive significant correlation between debt capital and financial performance. These finding were supported by the findings of the study by [33] which indicated and confirmed that most frequently the business ploughs back profits from its net profits. Majority of businesses consider investing in various expansion project through the use of the ploughed bank profits. More so, the findings of the study by [24] were also in line with the findings of this study which revealed that higher operational risk and an increase in interest rate may result from increasing borrowed capital. Understanding the risk-return connection associated with indebtedness should be considered when making capital structure decisions. The relationship between capital structure and financial performance has been the subject of empirical investigations, with varying degrees of success.

The effect of retained earnings on financial performance of SMEs in Mitooma District.

From the study findings on objective three, the same factors that affect net income also have a direct impact on retained earnings. Revenues, cost of goods sold, operational costs, and depreciation are some of these. The better a company's financial health is indicated, the larger its retained earnings are. The study found out that retain earnings affect the financial performance of SMEs in Mitooma District positively and significantly. For purposes of verifying and conforming the findings, it was discovered that other scholars have discover related facts. In fact, the study by [35], indicated that the results of the pooled sample from the study area indicated a strong positive significant effect for dividends per share. The other robustness analysis for the two sub-samples and the financial and non-financial sub-samples indicated the same results, consistent with the pooled sample for the two main explanatory variables. Another study in the SACCO context in Kenya recommended that management and policymakers improve on total earnings to foster retained earnings that have a significant and positive relationship with financial performance of Deposit Taking SACCOs. The results showed that retained earnings predict a significant and positive effect on financial performance in Deposit Taking SACCOs. From the discussions above, it is confirmed that the findings of this study are not in isolation but are in consistency with past studies.

DISCUSSION

Equity capital and financial performance

The findings indicated that equity capital affects financial performance of SMEs significantly (t = -1.975, p=.049, p<.05). This implies that any positive change in equity capital would result in to a positive change in financial performance of SMEs in Mitooma district. This further implies that Equity capital represents the portion of a business's financing that comes from the owners' investment. By having a higher proportion of equity capital, SMEs can reduce their reliance on external borrowing and associated interest payments, which can positively impact their financial performance. One possible explanation for this correlation is that having a higher equity capital base provides SMEs with greater financial stability and flexibility. It allows them to absorb financial shocks and make strategic investments without incurring excessive debt burdens. Additionally, equity capital indicates a higher level of commitment and confidence from the owners, which may translate into better business decision-making and long-term planning.

Debt capital on financial performance of SMEs in Mitooma District

The effect of debt capital on financial performance of SMEs was significant (t=7.015, p.000, p<.05) indicated that there is a positive effect of debt capital on financial performance of SMEs. This positive correlation suggests that there is a strong association between higher levels of debt capital and better financial performance of SMEs. This implies that SMEs that utilize higher levels of debt capital are more likely to achieve better financial performance. This was further confirmed by regression analysis which indicated that a positive significant effect of debt equity on financial performance of SMEs.

Retained earnings on financial performance of SMEs in Mitooma District

Based on these findings, we can infer that there is a positive and significant (t=6.289, p=000, p<.05) effect of retained earnings and the financial performance of SMEs in Mitooma district. This implies that SMEs that have higher levels of retained earnings are more likely to exhibit better financial performance. Retained earnings, which represent the accumulated profits that have been reinvested into the business, can serve as a valuable source of internal financing for SMEs. By retaining earnings and reinvesting them back into the business, SMEs can strengthen their financial position, enhance their operational capabilities, and support growth initiatives. It highlights the importance of effective financial management practices that focus on building and utilizing retained earnings to improve the financial performance and long-term sustainability of SMEs in Mitooma district.

CONCLUSION

Overall, these results indicate that equity capital has a significant and positive effect on the financial performance of SMEs in Mitooma district. SMEs with higher levels of equity capital tend to exhibit better financial performance. This highlights the importance of equity financing in supporting the growth and sustainability of SMEs in the district. However, it is essential to consider other factors not included in the model that may also impact the financial performance of SMEs, such as market conditions, managerial skills, and access to resources and opportunities. Based on these findings, we can conclude that there was a positive and significant relationship between debt capital and the financial performance of SMEs in Mitooma district. This implies that SMEs that utilize higher levels of debt capital are more likely to achieve better financial performance. However, it is important to note that correlation does not imply causation, and other factors may also contribute to the financial performance of SMEs. The correlation analysis results indicate a significant positive correlation between debt capital and the financial performance of SMEs in Mitooma district. Based on these findings, we can infer that there is a positive and significant relationship between retained earnings and the financial performance of SMEs in Mitooma district. This implies that SMEs that have higher levels of retained earnings are more likely to exhibit better financial performance.

Recommendations

From the findings, SMEs in Mitooma district should consider prioritizing the accumulation of equity capital as a means to enhance their financial performance. This can be achieved through various strategies such as retaining earnings, attracting external equity investors, or seeking partnerships with other businesses. By increasing their equity capital, SMEs can strengthen their financial position, improve their creditworthiness, and have better access to additional funding sources in the future. SMEs with higher levels of debt capital tend to exhibit better financial performance. These findings emphasize the role of debt financing in supporting the financial growth and success of SMEs in the district. However, it is important to consider other factors that may influence financial performance, such as market conditions, operational efficiency, and strategic management practices. Retained earnings, which represent the accumulated profits that have been reinvested into the business, can serve as a valuable source of internal financing for SMEs. By reinvesting them back into the business, SMEs can strengthen their financial position, enhance their operational capabilities, and support growth initiatives. It highlights the importance of effective financial management practices that focus on building and utilizing retained earnings to improve the financial performance and long-term sustainability of SMEs in Mitooma district.

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