Vol. 19(1), pp. 17-27, January 2025
DOI: 10.5897/AJBM2024.9587
Article Number: E0D6A9772978
ISSN: 1993-8233
Copyright©2025
Author(s) retain the copyright of this article
http://www.academicjournals.org/AJBM

ACADEMIC JOURNALS
expand your knowledge

African Journal of Business Management

Full Length Research Paper

The effects of financial distress on financial performance: An empirical analysis of SMEs in Sheema, Buhweju, Rubirizi, and Bushenyi districts

Eliab Byamukama Mpora[1]*, Anny Katabaazi-Bwengye[1], Emilly Atukunda[1] and Ngirababo Rwusira Dan[2]

[1]Department of Business Studies, Faculty of Economics and Management Science, Kabale University, Kabale, Uganda.
[2]School of Economics and Business Studies, Kigali Independent University (ULK), Kigali, Rwanda.

Received 25 October, 2024; Accepted 3 January, 2025

This study investigated the impact of financial distress on the performance of small and medium enterprises (SMEs) in Sheema, Buhweju, Rubirizi, and Bushenyi Districts, Uganda. Specifically, it examined the effects of excessive debt, inadequate capital, poor management practices, unwise expansion, intense competition, litigation, and unfavorable contracts on SMEs. Financial distress, if left unchecked, can lead to bank failures and severely harm the economy, emphasizing the need for close monitoring. This study aimed to determine the relationship between financial distress and SME performance. A descriptive research design was adopted, involving in-depth analysis of data collected from 180 respondents across the four districts. The findings revealed a significant negative correlation between financial distress and SME performance. As financial strain increased, financial performance declined, and vice versa. The study recommends that SMEs leverage technology to manage their financial records, ensuring ease of auditing and access to credit. Additionally, SMEs should employ skilled accountants for bookkeeping to enhance the quality of their financial records.

Key words: Financial distress, performance, **small and medium enterprises** (SME).

INTRODUCTION

Extensive literature exists on financial distress and the performance of Small and Medium Enterprises (SMEs) in both developed and developing countries, including Uganda. Financial distress, a commonly used term in corporate finance, refers to a situation where a company or enterprise struggles to meet its creditor obligations (Younas et al., 2021). While some SMEs overcome financial difficulties and recover, others succumb to insolvency. Each SME's life cycle is unique, influenced by various factors that impact their business. The life cycle of a business typically consists of four stages: establishment and promotion, growth, maturity and stabilization, and a stage of hardship or bankruptcy.

During the establishment and promotion stage, companies seek funding sources to support product development, marketing, and testing.

This study defines financial distress based on Kakuru and Paradza (2007) definition, which describes it as a state where a company must take corrective action due to insufficient operating cash flows to meet its current

*Corresponding author. E-mail: ebyamukamampora@kab.ac.ug.

Author(s) agree that this article remain permanently open access under the terms of the Creative Commons Attribution License 4.0 International License

obligations. Financial distress occurs when a business struggles to meet its obligations promptly and comfortably, often developing gradually over time. The severity of financial distress can vary.

According to Drescher (2013), financial challenges can be categorized, with a corporate crisis being an undesirable, sudden, and uncontrollable event that can have detrimental consequences. A corporate crisis severely and persistently threatens a company's regular operations or renders them impossible, negatively impacting its primary objectives and jeopardizing its survival and independence.

Several studies have linked financial performance with financial distress for SMEs (Hamzani and Achmad, 2018; Tinoco and Wilson, 2013; Kristanti et al., 2019; Yazdanfar and Öhman, 2020). For example, Hamzani and Achmad (2018) report profitability as an essential factor in determining the financial distress status of Indonesian SMEs. In a similar vein, Yazdanfar and Öhman (2020) confirm the significance of firm-specific attributes such as profitability on the state of financial distress. Additionally, Tinoco and Wilson (2013) confirm that a company's financial problems might be explained by low profitability. Consequently, there is a high correlation between financial distress and corporate performance (Yazdanfar and Öhman, 2020). Furthermore, a number of research assert that poor performance is a significant contributing factor to financial trouble (Konstantaras and Siriopoulos, 2011; Mselmi et al., 2017; Yazdanfar and Öhman, 2020).

Problem assessment

Despite the significant role played by SMEs in the several districts, they often face financial distress that adversely affect their performance and limit their potential to boost the economy as desired. Among the SMEs in Sheema, Buhweju, Rubirizi, Bushenyi Districts, 25% of which attributed financial distress to inadequate capital while 15% attributed it to inadequate managerial skills. For example, management may be unskilled and therefore matters pertaining marketing, finance or production may be a problem to restructuring of small and medium enterprises in Bushenyi district. In addition, they may fail to put credible and sensible accounting, budgeting, and control systems in place. Therefore, this article seeks to find the causes of financial distress on performance of small and medium enterprises in Sheema, Buhweju, Rubirizi, Bushenyi Districts, and how best these challenges can be addressed.

General objective

The general objective of the study was to investigate the determinants of financial distress and performance of small and medium enterprises in Sheema, Buhweju, Rubirizi, and Bushenyi Districts Uganda.

Specific objectives

i) To examine the effects of internal factors on performance.
ii) To examine the effect of external financial stress factors on performance.

LITERATURE REVIEW

Theory

This study drew on Merton's (1974) Credit Risk Theory, which conceptualizes default as a process defined by parameters within structural models. Credit risk refers to the likelihood that a debtor will fail to make required payments. Firms experiencing financial distress often struggle to meet their maturing obligations. Additionally, this research was informed by Mao and Sarndal (1978) Cash Management Theory, which emphasizes the importance of managing cash inflows and outflows to maintain equilibrium and prevent financial distress. Furthermore, the Entropy Theory was applied to identify businesses experiencing financial hardship, utilizing data from the company's balance sheet.

Credit risk theory

Credit refers to the provision of goods or services to an individual or organization before payment, with the expectation of future settlement. However, creditors may not always receive timely payments from debtors, exposing them to credit risk (Nyunja, 2011). This risk represents the lender's potential loss, which can be monetary or non-monetary, occurring when a debtor fails to meet contractual obligations.

Merton (1974) developed the credit risk theory as a structural model, proposing that default occurs through a diffusion process influenced by external parameters. Default risk is inherent in these models, and default can occur at any point during the debt instrument's term.

According to Lin et al. (2014), three quantitative methods apply credit risk: the structural approach, reduced form appraisal, and incomplete information approach. Merton measures credit risk using credit spread and credit portfolio management techniques. The credit spread enables analysts to estimate default risk embedded in financial contracts by observing market prices of underlying assets. Credit portfolio management allows credit managers to examine tradeoffs among various asset types from a credit perspective.

In essence, credit risk represents the lender's risk of loss when a borrower defaults on payment. This concept

is crucial, as companies experiencing financial difficulties are more likely to default on maturing obligations, even if not all SMEs purchase items on credit.

Related literature

Financial distress (henceforth, distress) is common in emerging economies' small and medium-sized businesses (SMEs). A company has distress when it is unable to fulfill its financial commitments. Distress also includes a lack of liquidity, inadequate equity, and debt default. Bankruptcy is the ultimate result of prolonged misery (Samanta and Johnston, 2019; Younas et al., 2021). Using a comprehensive classification of endogenous and exogenous factors, Michalkova et al. (2018) present a number of reasons of corporate financial hardship from the literature. Firm-specific endogenous factors are frequently the consequence of poor performance and inadequate managerial control (Yazdanfar and Öhman, 2020). On the other hand, exogenous causes of distress emerge from external conditions, for example, mechanisms like market competition (MC).

Inadequate succession planning, bad resource management, poor accounting practices, and ineffective managerial efficiency are internal issues that contribute to financial trouble. A company may also experience financial difficulties as a result of external causes including competition, lending rates, natural disasters, government regulations, and changes in inflation and lending rates. Maina (2018) found that endogenous risk factors were the primary drivers of financial distress in comparison to exogenous factors, even if all of these factors had the potential to generate financial distress in a company.

A theoretical model developed by Gordon (1971) characterizes financial distress as a condition that lies between solvency and insolvency. Generally speaking, the word "financial distress" refers to a bad thing; it reflects the financial status of a business that is experiencing short-term cash flow issues. It can also be used to characterize a business that is struggling to fulfill its present or maturing commitments. He goes on to say that when businesses don't have enough revenue to pay their maturing debts, they are in financial hardship. An organization becomes insolvent when its debt commitments mature.

Financial distress and market competition, or competition for short, have been connected in the literature (Lord et al., 2021). SMEs today operate in a competitive environment with a narrow price-cost margin. In order to survive, there is a constant competition for cheaper prices, better and more varied items, and better service. Since SMEs are already vulnerable to distress in competitive situations, this competition may have an even greater impact on their current state of distress.

On the other hand, a different perspective from the body of existing literature confirms that competition can pressure businesses and their management to preserve company value and to act in a good manner (Moradi et al., 2017).

Businesses may lose market share if management does not perform due diligence (Maity et al., 2020). Furthermore, such a circumstance may raise the risk of liquidation and insolvency if it persists. As a result, the fear of potential liquidation may force the companies to implement sound business practices. It is yet unclear how competition affects listed SMEs' distress status, and more research is necessary.

Furthermore, by having detrimental long-term repercussions on industrial operations, agriculture, and the global workforce, macroeconomic crises like COVID-19 can impact enterprises' distress status (Maity et al., 2020).

Modern SMEs operate in a highly competitive environment, characterized by narrow price-cost margins. Although existing literature suggests a link between management characteristics (MC) and financial distress (Lord et al., 2021), this relationship lacks robust scientific evidence in the context of listed SMEs.

The COVID-19 pandemic has profoundly impacted the operations of SMEs and industries worldwide. Research indicates that internal processes and procedures within SMEs are often insufficient to maintain necessary checks and balances, leaving them vulnerable to adverse shocks (Ali et al., 2018). According to Maity et al. (2020), the pandemic has had a detrimental effect on industrial operations and output. Similarly, Sun et al. (2021) found that COVID-19 has significantly impacted SME performance. This study identifies a substantial research gap regarding the unknown effects of COVID-19 on explanatory factors, highlighting the need for further investigation.

The conceptual framework (Figure 1) posits that financial distress is comprised of four key components: poor cash management, excessive debt, unwise expansions, and working capital challenges. Firm performance, on the other hand, is conceptualized as encompassing two dimensions: efficiency and profitability. Furthermore, firm size is introduced as a moderating variable, influencing the relationship between financial distress and firm performance.

Causes of financial distress

The primary causes of SMEs' failure and financial difficulty can be viewed from various angles, often involving a complex interplay of factors and symptoms. According to Chea (2020), financial distress can be attributed to two types of variables: endogenous and exogenous causes. Endogenous causes are firm-specific, unsystematic risk factors, whereas exogenous

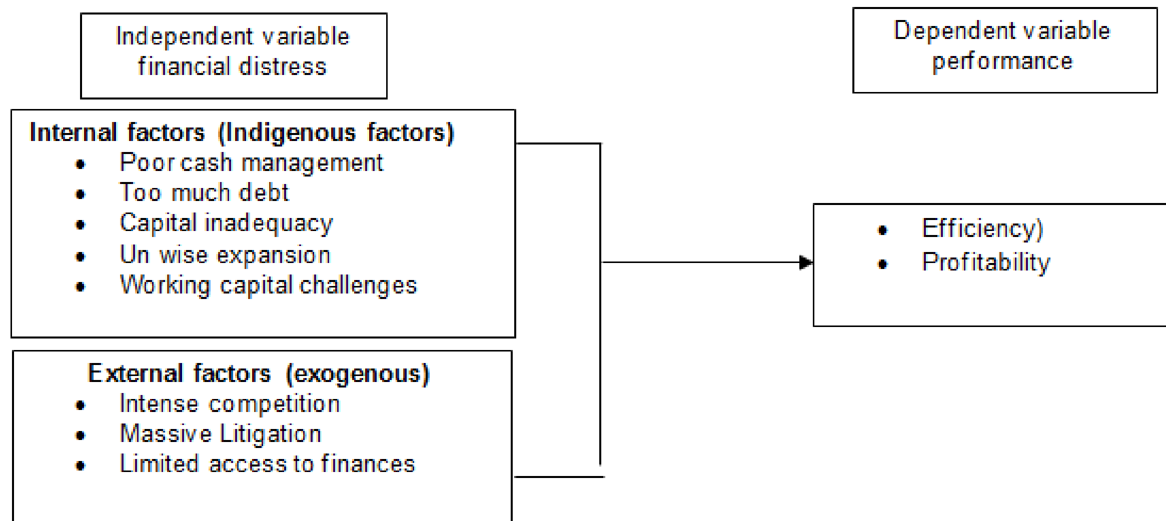

Figure 1. Conceptual framework.
Source: Adapted from Basel Committee (2020).

causes are external risk factors that affect all businesses in the economy, albeit unevenly. Notably, endogenous risk factors are the primary drivers of financial difficulty in most enterprises.

Adeyemi (2018) identifies insufficient capital as a major cause of financial distress. Capital serves as a buffer for losses, and a company's ability to absorb losses is directly impacted by its capital levels. Additional factors contributing to business failure include ownership structure, ineffective internal control systems, weak accounting systems, and inadequate management. Financial difficulty can manifest in various ways, such as high corporate loan default rates, difficulties paying dividends to shareholders, and management disputes.

According to Outecheva (2007), the primary causes of financial distress include inappropriate asset mix, corporate governance, and financial structure. Other contributing factors include high debt levels, unwise expansion, intense competition, and excessive legal fees. Moreover, inexperienced management can lead to poor decision-making, ultimately resulting in financial difficulties. Both direct and indirect costs are linked to financial strain. Legal fees, auditor fees, and other expenditures related to bankruptcy proceedings are included in the direct costs. Reduced sales and goodwill are examples of indirect costs, which are the loss of value before bankruptcy. Financial strain is caused by both direct and indirect expenditures.

Government policies, both favorable and unfavorable, significantly impact organizational growth, according to Hiatt et al. (2018). Governments shape the business environment by creating legislation, enforcing contracts, providing public amenities, protecting private property, and regulating external competition. Weak governments and high levels of political and civil unrest can lead to financially distressed businesses.

The implementation of oppressive policies, such as excessive taxation, inefficient public fund management resulting in inflation, and the removal of interest rate caps on loans, can culminate in financially troubled businesses (Hiatt et al., 2018). Financial distress can arise from various factors, including poor management, unwise expansion, intense competition, excessive debt, prolonged litigation, and unfavorable contracts. External factors, such as business cycles, global crises, and credit crunches, can also contribute to financial distress.

Notably, poor management is the primary cause of business financial difficulty. A Dun and Bradstreet survey attributed 94% of business failures to managerial incompetence, uneven experience, or lack of management experience. Other controllable factors contributing to financial distress include:

i) Unwise expansion: Overly optimistic industry forecasts and expansions driven solely by economies of scale can lead to financial difficulties.
2) Fierce competition: Price competitiveness resulting from marginal cost cutting can drive businesses to fail.
3) Excessive debt and poor financial management can exacerbate financial distress.

Excessive debt can exacerbate financial hardship due to high borrowing costs, resulting in a substantial interest payment burden. When the cost of bankruptcy surpasses the tax benefit, borrowing costs escalate. If the interest coverage ratio is too low due to excessive debt, businesses may struggle to service their debt using Earnings Before Interest and Tax (EBIT) alone.

Massive litigation can also contribute to financial distress. Conflicts with competitors, suppliers, customers,

employees, or the public can arise from various factors, including trading practices, technology, working conditions, and environmental concerns. These disputes can lead to accrual obligations, potentially pushing businesses toward bankruptcy. Other factors, such as faulty contracts, negligence, disasters, poorly conceived strategies, and fraud, can also precipitate financial hardship.

When a company is unable or unwilling to pay creditors as stipulated in contracts, two primary options are available: liquidation or restructuring. Liquidation involves selling the company's assets at salvage value, effectively ending the business as a going concern. The net proceeds, after transaction costs, are allocated to creditors in accordance with the established priority.

Reorganization is a viable strategy for maintaining a company's viability. This process may involve replacing outdated securities with new ones. While bankruptcy can facilitate formal reorganization and liquidation, it is often costly and time-consuming, prompting financially troubled companies to explore out-of-bankruptcy restructuring options first.

A company can restructure its liabilities, whether within or outside bankruptcy, through various means. These include repurchasing existing securities for cash, obtaining security holders' consent to modify investment terms, or exchanging new securities for existing ones. Each approach requires convincing security holders to alter their investment terms.

The likelihood of successful out-of-court restructuring diminishes with the complexity of the debtor's structure. In cases where reorganization prospects are extremely low, liquidation in bankruptcy becomes the sole viable option. Under bankruptcy law, the company or its creditors may submit a petition. Liquidation is preferred over reorganization when the value of the debtor's assets sold during liquidation exceeds the value of the debtor's reorganization.

Time and risk are often the most critical factors in determining the value of a debtor's assets. For instance, financial advisors may believe that the debtor's realizable economic value will eventually exceed its liquidation value. However, if the time required to achieve this value is highly uncertain, the anticipated present value of the debtor's assets as a going concern may be lower than their currently realizable liquidation values. It is essential to distinguish between the liquidation value and the amount that could be realized through a forced sale of the debtor's assets. The liquidation value represents the amount that could be obtained through an organized sale.

Typically, the reorganization value exceeds the liquidation value. For example, during liquidation, product inventories covered by manufacturer warranties are often significantly discounted. This discount represents a substantial indirect cost of financial distress. In most cases, it's necessary to assess the liquidation value for each asset class. The reorganization values are then compared to the total liquidation value of all the debtor's assets, net of liquidation procedure expenses.

METHODOLOGY

The study employed a descriptive research design to gather information on the characteristics of the issue at hand (Kothari, 2008). This design was chosen to describe and understand the current nature and extent of the impact of financial distress on the performance of Small and Medium Enterprises (SMEs) in Sheema, Buhweju, Rubirizi, and Bushenyi Districts, Uganda. A descriptive design allowed the researcher to discover patterns in respondents' thinking and describe issues from their perspective.

Sample size

The target population consisted of SMEs operating in the designated business areas of Sheema, Buhweju, Rubirizi, and Bushenyi Districts, Uganda. Using the Krejcie and Morgan table (1970), a sample size of 180 respondents was selected to ensure representation of the total population. This sample size was chosen for its manageability and sufficiency to produce reliable results that could be extrapolated to a larger population.

Data collection Instruments

This study employed both primary and secondary data collection methods. Structured questionnaires were used to collect primary data, with respondents' opinions captured on a Five Point Likert Scale. According to Burns and Burns (2012), a questionnaire is a systematic collection of statements or questions designed to assess attitudes, opinions, beliefs, biographical data, and other information. Questionnaires were chosen as the primary data collection tool due to their cost-effectiveness, anonymity, standardized questions, uniform procedures, and ease of administration and scoring (Kothari, 2018). Additionally, most members of the target population were literate, making questionnaires a suitable option.

Since the study focused on intangible factors such as respondents' views, opinions, perceptions, and feelings, questionnaires were deemed the most effective data collection method (Oso and Onen, 2018). Secondary data were sourced from the financial information of small and medium-sized enterprises' annual reports, as not all business owners maintain detailed records of their accounts and bookkeeping.

Data analysis

The coded quantitative data from the surveys was analyzed using the Statistical Package for Social Scientists (SPSS) software, specifically version 21 (Cheng et al., 2021). Descriptive statistics, including cross-tabulation, percentages, and frequencies, were employed to examine the quantitative data. Frequency tables were used to present the study's findings.

To test the hypotheses, multiple regression, correlation analysis, and analysis of variance (ANOVA) were conducted. A cross-sectional analysis was also performed to compare similar financial ratios of the small and medium-sized businesses under study, clarifying the relationship between financial distress and business performance. Given the use of the 5-Likert Scale, an ordinal scale of measurement, the Spearman rank correlation coefficient was applied to examine the direction and magnitude of correlations. The study adhered to ethical standards, obtaining permission from the university and the local council of SMEs in the Ankole Sub-region. This chapter presents the study's findings and discusses their implications. The first section analyzes the results in light of recent

Table 1. Reliability test cronbach's alpha N of items.

N/A	Cronbach's alpha	No. of items
1	0.958	25

literature, providing a comprehensive understanding of the study's contributions.

FINDINGS

A reliability test was conducted using Cronbach's Alpha to assess the internal consistency of the questionnaire. This analysis enabled the evaluation of the extent to which the questions were related to each other. The overall index generated provided insight into the repeatability or internal consistency of the scale as a whole, while also identifying problematic items that required exclusion. As presented in Table 1, the Cronbach's Alpha coefficient for the 25 items in Part C of the questionnaire was computed to be 0.958. This result indicates that the questionnaire exhibits a relatively high internal consistency, thereby establishing its reliability, as the Cronbach's Alpha value exceeds the recommended threshold of 0.70.

Demographic profile of respondents

Table 2 shows the profile of respondents. Majority of the respondents in terms of gender, male (77.7%) and female (22.2%) mostly are at the range of age 46 to 55 years old (41.66%). Majority of participants were Bushenyi respondents (85.71%) followed by Buhweju (10.7%), Sheema (2.8%) and Rubirizi (0.714%).

General profile of respondents

The overall participation indicates that 77.7% were females while 22.2% were males. This implies that the study was dominated by males more than females. The dominance of men over women derives from the fact that men have higher access to financial services than women do. Men have the required collateral security compared to women, who struggle to identify potential guarantors. Most of the participants of 41.66% belonged to the 46 to 55 years age bracket, followed by 21.11% who belonged to the 25 years age bracket and below. Little adults, followed by the youths, dominated the study. This is a variation in the participation of ages at which Ugandans accumulate financial wealth to engage in business. Most of the youths do not have adequate financial capital to start a business. According to participation by educational level, the majority (43.3%) had only completed secondary school, followed by those with a diploma (30%) and postgraduate education (2.22%).

Due to the effects of the Lord's Resistance Army war, which severely damaged many people's educational opportunities, participants with secondary educations predominate. A participant with more education than a secondary school diploma, however, points to a tendency of people shifting their expectations from white-collar to blue-collar occupations. Others have the greatest percentage of 88.8% in terms of race, suggesting that Ugandans are shifting from the custom of working for a living to working for themselves, which is the way to progress in the modern world.

Respondents’ satisfaction on their financial situation

Table 3 shows the results of five-point Likert scale statements ranging from 1= not agree at all to 5 = strongly agree. In general, the respondents are found to be not satisfied with their present financial situation (mean = 2.85). They do not agree on the statement saying that their financial situation does not make them stressed all (mean = 2.83). In other words, we can say that their financial situation makes them feel stressed. On average, they feel not very secure with their personal finances for retirement (mean = 2.95). They do not also feel that they are very well off financially (mean = 2.94). Table 4 shows the financial distress.

Financial distress

The study reveals that financial distress is a significant factor in the restructuring of SMEs in Western Uganda's districts.

While competition and insufficient capital are less likely to cause financial distress, lending rates, high debt, and poor planning have a moderate impact. The study's data exhibited high standard deviations, ranging from 1.128 for significant debt to 0.612 for severe distress, indicating diverse perspectives on financial difficulty and its causes, particularly high debt levels significantly impact financial distress, a key determinant of credit risk. Conversely, large debt has a minimal impact, suggesting that SMEs may not accumulate substantial debt, but their creditworthiness is contingent upon modest financial commitments. Ultimately, this indicates that SMEs in the region have undergone limited restructuring. Table 5 shows the type of variable, measurement indicators and statistical test for dependent variable (Performance).

Table 2. Demographic profile of respondents.

Variable		N	Percentage
Gender	Female	40	22.2
	Male	140	77.7
Age	25 or below	38	21.11
	26-35	32	17.77
	36-45	35	19.4
	46-55	75	41.66
Analyzed districts	Sheema	4	2.8
	Buhweju	15	10.7
	Rubirizi	1	0.714
	Bushenyi	120	85.71
Marital status	Single/Divorced/Separated	68	37.77
	Married	112	62.22
Education level	No formal education	9	5
	Primary school	10	5.55
	Secondary school	78	43.33
	Diploma	54	30
	Bachelor degree	25	13.88
	Post graduate	4	2.22
Job position	Executive	12	6.66
	Non-executive	150	83.33
	Owner	10	5.55
	Employee	4	2.22
Average monthly income	< 1,000,000	7	
	1,000,000-2,000,000	10	5.555
	2,000,000-3,000,000	120	66.667
	3,000,000-4,000,0000	20	11.111
	4,000,000-5,000,000	8	4.444
	5,000,000and above	15	8.33
Total amount of debt/loan	< 10,000,000	130	72.22
	10,000,000-20,000,000	30	16.667
	20,000,000-30,000,000	5	2.77
	30,000,000 and above	15	8.33

Table 3. Respondents' satisfaction on their financial situation.

Respondents' satisfaction	Mean	Std Dev
I'm very satisfied with my present financial situation	2.85	0.931
My financial situation does not make me feel stressed at all	2.83	0.872
I feel very secure with my personal finances for retirement	2.95	0.9
I'm very well off financially	2.94	0.919
I've always been receiving financial assistance from my family or others during the past 12 months	2.37	1.020
I feel that my health has been affected by my financial problem	2.42	0.973
The stress from my money problems always interfered with my work	2.53	1.067

Table 4. The financial distress.

Variable	Mean	Std Dev
Financial distress	4.10	0.612
Inadequate capital	2.96	0.706
Poor succession planning and governance	3.01	1.019
Large debts	3.10	1.128
Inadequate managerial skills	3.05	0.973
Poor management practices	3.01	1.056
Competition	2.47	0.713
Lending rates	3.04	0.980

Source: Primary Data (2023).

Table 5. Type of variable, measurement indicators and statistical test for dependent variable (performance).

Variable	Measurement indicator	Statistical test
Profitability	Profit margin Return on asset Return on equity Loss ratio Premium growth	T-test
Efficiency	Fixed assets turnover ratio Current assets turnover ratio Net worth turnover ratio	T-test
Firm size	Total assets Age of a firm	ANOVA (F-test)

Establish the relationship between financial distress and performance of small and medium enterprises

To understand how financial distress influences performance of SMEs, it was important to understand the state of financial distress in Bushenyi District. This paper adopted descriptive measures of the mean and standard deviation to examine the state of financial distress in Bushenyi District. The mean scores above 3.5 indicated challenges that affect SMEs the most, and the mean scores below 3.5 indicated challenges that affect SMEs the least while the mean scores from 2.5 to 3.4 indicated challenges that affect SMEs moderately.

Financial distress

The statistics indicate that most of the participants find it easy to make payments to their financial service providers (mean = 4.23; Std. = 0.839), they have easy access to automatic teller machines (mean = 4.21; Std. = 0.865), and they find it easy switching from one bank to another (mean = 4.21; Std. = 0.909). These statistics imply that financial inclusion has simplified their business operations. However, participants seem not to find it easy using available financial services (mean = 2.53; Std. = 1.342). The statistics imply that some of the financial services are technical and not user-friendly, or they are user friendly but users lack acquaintance to using them. Generally, the results indicate a high level of financial distress in Bushenyi District (mean = 3.96).

The findings reveal a weak correlation between SMEs' performance and financial difficulties. According to the data, a change in financial distress is associated with a marginal change in SMEs' performance contribution. To investigate the impact of financial inclusion on SMEs' performance in the region, the study employed linear regression analysis. Linear regression is a mathematical function that illustrates the relationship between the dependent variable (SMEs' performance) and the independent variable (financial distress).

DISCUSSION

In the empirical review, Fund mismanagement may be

caused by inadequate accounting processes, a lack of administrative expertise, or mishandled funds, according to Jahur and Quadir (2012). The results of the study show that financial distress is positively impacted by poor managing abilities. It indicates that the organization's management must develop the essential abilities to keep the business viable and out of financial trouble.

Bank loans have a good or negative impact on SMEs' financial performance, according to Ombongi and Long (2019). The study backs up such conclusions by demonstrating that loan rates significantly affect an organization's degree of financial difficulty. Managers of SMEs should avoid taking on more debt than they can afford (Kanugi and Gichira, 2018). According to the study, high debt levels have no discernible effect on SMEs' financial distress levels when it comes to restructuring.

The study's findings corroborate those of Mwangi (2017), who found that rapid technological advancements, restricted market access, a lack of money, a lack of knowledge and skills, and inadequate infrastructure were the main reasons why SMEs experienced financial difficulties when they had to restructure. Additionally, corruption and government policies pertaining to imports and taxes created additional obstacles for Uganda's financially troubled SMEs.

Conclusion

The study concludes that there is a strong relationship (R=0.536) between financial distress and financial performance of SMEs in Bushenyi District. Consequently, variables under the study determine up to 28.8% of financial distress in SMEs. The study also comes to the conclusion that financial distress in the SMEs sector is influenced by a number of factors, including a lack of capital, poor succession planning and governance, high debt levels, weak managerial abilities, poor government policies, competitiveness, and lending rates.

However, a large portion of financial crisis was caused by weak government policies, lending rates, succession planning and governance, and a lack of enough capital. However, financial distress is not significantly impacted by managerial abilities, high debt levels, or competitiveness. Consequently, a company's performance is not always correlated with having competent management. Therefore, a company's and its competitors' high debt levels do not always result in financial trouble.

SMEs in Uganda are crucial to the economic development and expansion of the nation. Therefore, it is necessary to identify and resolve the financial difficulties associated with SMEs' reorganization. Restructuring has been observed to be significantly impacted by government policy. Therefore, policies that increase the value of SMEs must be developed by the government.

Furthermore, the government ought to establish a business climate that improves the performance of SMEs. Financial strain results from SMEs' inability to meet banks' requirements for debt funding since they rarely maintain sound financial records. It implies that SMEs will experience financial difficulties on a regular basis. According to the report, SMEs should manage their records using technology so that they may be readily audited and, consequently, obtain financing. Therefore, to improve the caliber of financial records maintained, SMEs should employ qualified accountants for bookkeeping.

Financial distress was found to be significantly impacted by inadequate succession planning and governance. When the firm grows, SMEs are unable to distinguish between the manager and the entrepreneur. Because of this, the entrepreneur lacks the abilities necessary to function in the new business environment, which results in poor decision-making and eventual financial difficulties. Additionally, SMEs hardly ever plan for the people who will take over operations. They don't teach those who could take over the business; they operate on a day-to-day basis. According to the report, SMEs should create strategies that guarantee that there are individuals who are familiar with all aspects of the company's operations, can manage it with ease, and can guarantee its long-term viability.

SMEs managers should try not to load the business with more loans than their capacity to pay (Kanugi and Gichira, 2018). The study makes the recommendation that SMEs need to understand their capacity and their business needs before taking up additional loans that would otherwise lead to restructuring of SMEs.

The findings of this research are encouraging and useful for SMEs in resource limited settings, say local communities in developing countries as they are on both theoretical and practical viewpoints with an acceptable sample size (n = 180) of respondents. However as with any research, this research has some limitations. First of all, the participants in the sample frame came from a single region in Uganda and were selected using largely purposive and convenience sampling technique. This sampling technique limits the capacity to extrapolate the findings to all SMEs in Uganda.

CONTRIBUTION OF THE STUDY

The necessity of effective systems to address corporate financial hardship has been highlighted by the recent financial crises in numerous emerging nations. More significantly, figuring out how to spot banks that are experiencing issues that might eventually cause them to fail is vital. Therefore, the most crucial query that emerges is how to forecast financial distress. The majority of the research on financial hardship focuses on survival strategies for businesses and how to forecast failure brought on by financial distress. Predicting financial trouble is crucial for all parties involved since it allows for better decision-making when assessing businesses. The rate of bankruptcy has increased

recently, and as businesses grow more sophisticated and the knowledge gap between banks and organizations widens, it is getting more difficult to quantify.

Therefore, management can take preventive action by using a trustworthy model that can predict financial collapse. In order to save money, bank managers, for instance, can cut back on R&D expenditures, drop unsuccessful projects, and make other investments as soon as they see financial difficulties.

Since banks are among the most leveraged companies, they can use this model to help them make lending decisions and keep an eye on their accounts receivable, reducing their lending during difficult times. In the event of a bank failure, forecasting financial turmoil can help investors and creditors protect their capital. An auditor may also find value in a model that predicts financial failure. Determining audit methods and deciding whether the business will continue as a going concern can both benefit from it. Third parties, including creditors, shareholders, and investors, hold the auditor's report in high respect, particularly when they are making choices about a particular company. To verify financial facts, they rely on the auditor's report.

AREAS OF FUTURE STUDY

Most financial hardship assessment algorithms rely on readily manipulated financial data. The adoption of questionable financial ratios from modified yearly accounts may lead to inconsistency problems. More research may be done on alternate models of diagnosing distress that do not rely on financial data or that use non-accounting data because financial data can be readily manipulated to provide deceptive representations.

It makes sense that larger companies will have a lower failure rate than smaller ones because they usually perform better. This is a result of the many advantages that large corporations have. As a result, size-and industry-specific models are needed. Additionally, the failure rate of new enterprises is higher than that of existing ones. The influence that older businesses have on learning could may be the cause of this. Therefore, further study could be conducted to develop age-specific models.

Ratios are important and cannot be entirely disregarded, even though their ability to detect financial problems has been criticized. There is disagreement over the best ratios to use for predicting financial difficulties, though. Whether accrual-based or cash flow-based metrics are better, or if profitability ratios are better than liquidity ratios, is up for debate. More research needs to be done to determine the best ratios to use in order to detect financial hardship.

LIMITATIONS OF THE STUDY

The limitation of this study was that some of the small and medium enterprises that were being studied were under liquidation process or under receivership and therefore, the researcher had to rely on the secondary data. More so other SMEs were not keeping records this made it hard for the research to obtain secondary data and this delayed the research process.

CONFLICT OF INTERESTS

The authors have not declared any conflict of interests.

ACKNOWLEDGEMENTS

The authors sincerely appreciate the article adviser Mr. Mugalula George for his continuous support, patience, motivation, and guidance throughout the study and research and fellow learned friends for their cooperation in the accomplishment of this article.

REFERENCES

Adeyemi B (2018). Bank failure in Nigeria: a consequence of capital inadequacy, lack of transparency and non-performing loans? Banks and Bank Systems 6(1):12-14.

Ali H, Omar EN, Nasir HA, Osman MR (2018). Financial literacy of entrepreneurs in the small and medium enterprises. In Proceedings of the 2nd Advances in Business Research International Conference: ABRIC2016. pp. 31-38.

Chea ID (2020). The role of cash flow information in predicting financial distress among commercial banks in Kenya (Unpublished MBA project). University of Nairobi.

Cheng CEW, Janang JS, Sin KY, Baharuddin NN (2021). Effect of Financial Crisis on Firm Performance in Malaysia. International Journal of Academic Research in Business and Social Sciences 11(9):1725-1734.

Drescher F (2013). Insolvency timing and managerial decision-making. Springer Science and Business Media.

Gordon MJ (1971). Towards a Theory of Financial Distress. The Journal of Finance 26(2):347-356.

Hamzani U, Achmad D (2018). Bankruptcy prediction: SMEs case study in Pontianak, Indonesia. Accounting and Financial Review 3(1):09-15.

Hiatt SR, Carlos WC, Sine WD (2018). Manu Militari: The institutional contingencies of stakeholder relationships on entrepreneurial performance. Organization Science 29(4):633-652.

Jahur MS, Quadir SN (2012). Financial distress in small and medium enterprises (SMES) of Bangladesh: Determinants and remedial measures. Economia. Seria Management 15(1):46-61.

Kakuru DM, Paradza GG (2007). Reflections on the use of the life history method in researching rural African women: Field experiences from Uganda and Zimbabwe. Gender and Development 15(2):287-297.

Kanugi JN, Gichira R (2018). Factors Influencing the Perfomance of Growth Oriented Small and Medium Enterprises in Thika Sub-county. Strategic Journal of Business & Change Management 18:25-28.

Konstantaras K, Siriopoulos C (2011). Estimating financial distress with a dynamic model: Evidence from family owned enterprises in a small open economy. Journal of Multinational Financial Management 21(4):239-255.

Kristanti MS, Effendy C, Utarini A, Vernooij-Dassen M, Engels, Y (2019). The experience of family caregivers of patients with cancer in an Asian country: A grounded theory approach. Palliative Medicine, 33(6), 676-684.

Lin L, Lou T, Zhan N (2014). Empirical Study on Credit Risk of Our

Listed Company Based on KMV Model. Applied Mathematics 5(13):2098-2106.
Lord J, Weech-Maldonado R, Blackburn J, Carroll N (2021). Examination of nursing home financial distress via Porter's five competitive forces framework. Health Care Management Review 46(3):E50-E60.
Maina LM (2018). A Study on the Determinants of Financial Distress in Small and Medium Enterprises: a Case Study of Nairobi County Doctoral dissertation, university of nairobi), Kenya.
Maity S, Sen N, Sahu TN (2020). COVID-19: Triggers fear psychosis among private sector employees. Journal of Labor and Society 23(4):503-513.
Mao JCT, Sarndal CE (1978). Cash management: Theory and practice. Journal of Business Finance and Accounting 5(3):329-338.
Michalkova L, Adamko P, Kovacova M (2018). The analysis of causes of business financial distress. In Third International Conference on Economic and Business Management (FEBM 2018). Atlantis Press. pp. 49-52.
Moradi M, Bagherpour Velashani MA, Omidfar M (2017). Corporate governance, product market competition and firm performance: evidence from Iran. Humanomics 33(1):38-55.
Mselmi N, Lahiani A, Hamza T (2017). Financial distress prediction: The case of French small and medium-sized firms. International Review of Financial Analysis 50:67-80.
Mwangi (2017). SMES are growing Kenya's economy. Daily Nation, P 22.
Nyunja F (2011). Credit Risk. KASNEB News line 1:39-45.
Ombongi PN, Long W (2019). Factors Affecting Financial Performance of Small and Medium Enterprises (SMEs): A Case of Manufacturing SMEs in Kenya. International Journal of Research in Business Studies and Management 5(1):37-45.
Oso WY, Onen D (2009). A general guide to writing research proposal and report. Jomo Kenyatta Foundation.
Outecheva N (2007). Corporate financial distress: An empirical analysis of distress risk (Doctoral dissertation, Verlag nicht ermittelbar).
Samanta N, Johnston A (2019). Shareholder primacy corporate governance and financial market growth. Corporate Governance: The International Journal of Business in Society 19(5):845-848.
Sun T, Zhang WW, Sorin Dinca M, Raza M (2022). Determining the impact of Covid-19 on the business norms and performance of SMEs in China. Economic Research-Ekonomska Istraživanja 35(1):2234-2253.
Tinoco MH, Wilson N (2013). Financial distress and bankruptcy prediction among listed companies using accounting, market and macroeconomic variables. International Review of Financial Analysis 30:394-419.
Yazdanfar D, Öhman P (2020). Financial distress determinants among SMEs: empirical evidence from Sweden. Journal of Economic Studies 47(3):547-560.
Younas N, UdDin S, Awan T, Khan MY (2021). Corporate governance and financial distress: Asian emerging market perspective. Corporate Governance: The International Journal of Business in Society 21(4):702-715.
Yussuf (2017). Factors Causing Corporate Financial Distress in Commercial Banking Sector in Kenya: A Case of Chase Bank. (Master's Thesis).
Zammel M (2016). The Causes of Tunisian SME Failure. Arabian Journal of Business and Management Review 6(6):1-9.