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Assessing Financial Risk Management Strategies among Small and Medium Enterprises (SMES) in Lusaka's Industrial Sector

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Abstract

This study examines financial risk management (FRM) strategies among Small and Medium Enterprises (SMEs) in Lusaka's industrial sector within a context of persistent macroeconomic volatility. SMEs are central to Zambia's economic structure, contributing approximately 97% of businesses, 70% of Gross Domestic Product (GDP), and 88% of employment. Despite this contribution, SMEs remain highly vulnerable to financial risks arising from inflation, exchange rate instability, high interest rates, and limited access to finance. These risks manifest in quantifiable outcomes including cash flow instability, declining profitability, and increased probability of business failure. Guided by a pragmatic research philosophy, the study adopts a cross-sectional mixed-methods design. Quantitative data were collected using structured questionnaires from industrial SMEs, while qualitative insights were obtained from key informant interviews. The study is anchored on Enterprise Risk Management (ERM) Theory, Contingency Theory, and the Resource-Based View (RBV), which collectively explain how SMEs identify, assess, and mitigate financial risks under dynamic conditions. Descriptive results indicate that SMEs face high exposure to market risks (interest rate, exchange rate, and inflation risks), alongside moderate-to-high exposure to liquidity and credit risks. Correlation and regression analyses reveal statistically significant positive relationships between financial risk management practices and financial outcomes ($R^2 = 0.49$), indicating that structured FRM improves financial resilience. However, qualitative findings reveal that most SMEs rely on informal and reactive strategies due to low financial literacy, high collateral requirements, and weak institutional support. The study concludes that inadequate and informal FRM practices significantly undermine SME sustainability. It recommends strengthening financial literacy, improving access to finance, and promoting structured risk management frameworks tailored to SMEs. The study contributes to the limited empirical literature on FRM in developing economies and provides practical insights for policymakers, financial institutions, and SME managers.

1. Introduction and Background

Small and Medium Enterprises (SMEs) are widely recognized as critical drivers of economic growth, employment creation, and industrialization in developing economies. In Zambia, SMEs account for approximately 97% of all businesses, contribute about 70% to Gross Domestic Product (GDP), and employ nearly 88% of the labour force. These figures underscore the strategic importance of SMEs in promoting inclusive growth, poverty reduction, and economic diversification. In Lusaka, the country's principal industrial hub, SMEs are concentrated in sectors such as metal fabrication, light engineering, and textile manufacturing. These sectors play a vital role in supporting supply chains in construction, agriculture, and mining while contributing to value addition and import substitution.

Despite their economic importance, SMEs operate in a highly volatile macroeconomic environment characterized by inflationary pressures, exchange rate fluctuations, and high interest rates. These conditions increase operational costs, reduce profit margins, and create uncertainty in financial planning. As a result, SMEs are exposed to multiple financial risks including liquidity risk, credit risk, and market risk.

Financial risk management (FRM) is therefore critical for ensuring SME sustainability. FRM involves the systematic identification, assessment, and mitigation of financial risks to minimize potential losses and stabilize financial performance. However, evidence suggests that SMEs in developing economies often lack formal risk management systems and rely on informal, reactive approaches.

This study therefore investigates financial risk management strategies among SMEs in Lusaka's industrial sector, evaluates their effectiveness, and proposes strategies for improving financial resilience.

1.2 Statement of the Problem

Despite their significant contribution to Zambia's economy, SMEs in Lusaka's industrial sector continue to experience high levels of financial vulnerability due to persistent exposure to liquidity, credit, and market risks. These risks are intensified by macroeconomic instability characterized by inflation, exchange rate volatility, and high interest rates, which increase operating costs and destabilize cash flows.

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Empirical evidence shows that unmanaged financial risks result in declining profitability, liquidity constraints, and increased business failure rates. However, existing studies in Zambia have largely focused on structural constraints such as access to finance, with limited attention given to internal financial risk management practices.

Furthermore, there is limited empirical evidence linking FRM practices to measurable financial outcomes such as profitability and cash flow stability. This creates a significant knowledge gap regarding the effectiveness of current risk management strategies.

This study therefore addresses the lack of empirical understanding of how financial risk management strategies influence financial outcomes among SMEs in Lusaka's industrial sector.

1.3 Research Objectives

The study was guided by the following objectives:

- To examine the types of financial risks faced by SMEs in Lusaka's industrial sector
- To assess the effectiveness of financial risk management strategies
- To identify strategies to improve financial risk management

2. Literature Review

2.1 Conceptual Understanding of Financial Risk

Financial risk refers to the possibility of quantifiable financial losses arising from uncertainty in economic and financial conditions. SMEs are particularly vulnerable to financial risks due to limited financial resources, weak internal controls, and constrained access to formal finance.

The major financial risks affecting SMEs include:

- Liquidity Risk: Inability to meet short-term obligations
- Credit Risk: Default by customers or inability to service debt
- Market Risk: Exposure to inflation, interest rates, and exchange rate fluctuations

2.2 Empirical Review

Empirical literature from developed and emerging economies consistently demonstrates that financial risk management (FRM) plays a critical role in enhancing the financial stability and performance of SMEs. However, the effectiveness of FRM is strongly influenced by institutional environments, managerial capabilities, and macroeconomic conditions.

Anton, Baba and Bucşoiu (2015) employed panel data analysis on manufacturing SMEs in Eastern Europe and found that exposure to market and liquidity risks significantly increases profit volatility. Their findings show that firms implementing structured financial risk management practices such as formal risk assessment and diversification experience improved return on assets (ROA) and reduced earnings variability. This suggests that FRM functions as both a protective mechanism and a performance-enhancing tool.

Similarly, Gatzert and Martin (2015) provide evidence from European SMEs indicating that firms adopting Enterprise Risk Management (ERM) frameworks exhibit lower earnings volatility and improved solvency ratios. Their study highlights that integrating risk management into strategic decision-making enhances long-term financial resilience.

Brustbauer (2016), using survey-based regression analysis on Austrian SMEs, established that financial risk awareness has a statistically significant positive effect on both cash flow stability and profitability. Importantly, the study found that SMEs without formalized risk management systems are more vulnerable to liquidity constraints and financial distress, underscoring the importance of structured risk management processes.

Further evidence is provided by Falkner and Hiebl (2015), who examined family-owned SMEs in Germany and found that weak financial planning and inadequate working capital management lead to declining equity levels, rising financing costs, and persistent payment delays. These findings emphasize the role of internal financial controls in mitigating risk exposure.

In the context of macroeconomic volatility, Mazzarol and Reboud (2017) demonstrated that SMEs with poor financial risk management practices experience sharper declines in sales revenues and operating margins during periods of inflation and rising interest rates. This indicates that FRM acts as a buffer against external economic shocks.

Studies from emerging economies reinforce these findings. Ferreira de Araújo Lima et al. (2020) found that exchange rate risk significantly increases production costs and reduces profitability among Brazilian manufacturing SMEs reliant on imported inputs. Similarly, Wang, Chen, and Li (2018) showed that excessive exposure to credit risk in Chinese SMEs leads to rising bad debts and weakened cash flows, while Kramoliš and Dobeš (2020) established that inflation and interest rate risks significantly erode profit margins among Czech SMEs.

Across global contexts, the empirical evidence consistently demonstrates that: Financial risks are directly linked to measurable financial outcomes (profitability, liquidity, solvency), Structured FRM improves financial stability and performance & Internal managerial capability and institutional support are critical success factors. However, these findings are largely derived from relatively stable and well-developed financial systems, limiting their direct applicability to developing economies such as Zambia.

African Evidence (Excluding Zambia)

Empirical studies in Africa highlight that financial risk exposure among SMEs is significantly amplified by structural and institutional constraints, including limited access to finance, weak regulatory systems, and macroeconomic instability.

Akinyomi and Olagunju (2017), in a study of Nigerian manufacturing SMEs, found a strong negative relationship between liquidity risk and profitability. Their results show that poor financial risk management practices are associated with cash flow volatility and high business failure rates. This suggests that liquidity risk is a critical determinant of SME survival in developing economies.

Oluyombo (2018) further demonstrated that SMEs in Kenya rely heavily on short-term and high-cost financing due to limited access to formal credit. This reliance increases financial risk exposure and reduces net profitability. The study highlights that financial constraints are not only external barriers but also drivers of financial vulnerability.

In Ghana, Abor and Quartey (2019) found that inflation and exchange rate volatility significantly increase operating costs and reduce gross margins among industrial SMEs. Similarly, Musah, Anokye, and Gakpetor (2021) established that weak internal financial controls increase SMEs' exposure to credit defaults and inventory mismanagement, leading to financial losses.

Fatoki (2020), using quantitative analysis in South Africa, found that liquidity risk has a statistically significant negative impact on return on investment (ROI) and cash flow adequacy. This reinforces the importance of liquidity management in maintaining financial stability.

Further evidence from East Africa supports these findings. Isaga (2018) found that inadequate financial planning and lack of risk monitoring systems are major contributors to SME failure in Tanzania. Mwangi and Ouma (2022) also found that Kenyan SMEs without formal risk assessment tools are more vulnerable to insolvency during periods of economic instability.

Synthesis:

African empirical studies reveal that:

- Financial risks have direct and severe impacts on SME performance and survival
- Structural constraints (finance, institutions) significantly amplify risk exposure
- Financial risk management practices are often informal and insufficient
- There is limited integration of FRM into strategic decision-making

Importantly, many African studies focus on access to finance rather than the broader dynamics of financial risk management, leaving a gap in understanding how internal FRM practices influence financial outcomes.

Zambian Evidence

Empirical research on financial risk management among SMEs in Zambia remains limited and largely descriptive, with a strong focus on structural constraints rather than internal risk management practices.

Chilembo (2021) found a significant relationship between credit rejection and lack of collateral among SMEs in Lusaka. The study shows that limited access to finance increases liquidity risk and constrains business growth. However, it does not examine how SMEs internally manage financial risks.

The Bank of Zambia MSME Finance Survey (2022) reports that less than 10% of SMEs have access to formal bank financing. This leaves the majority of SMEs dependent on informal financing sources, which increases exposure to cash flow instability and financial shocks.

Mwila and Phiri (2019) demonstrated that high interest rates significantly increase financing costs for SMEs, reducing profitability and increasing default risk. Similarly, Kalinda and Chisanga (2020) found that exchange rate volatility increases input costs for manufacturing SMEs, leading to declining profit margins.

ZIPAR (2021) reports that a significant proportion of SMEs in Zambia fail within the first five years due to financial distress rather than lack of market demand. This highlights the importance of financial management in business sustainability. Chibamba and Banda (2023) further found that low financial literacy limits SMEs' ability to identify, assess, and manage financial risks effectively, resulting in avoidable financial losses.

2.3 Research Gap

Despite extensive global research demonstrating that financial risk management (FRM) improves SME performance, much of this evidence is drawn from developed and institutionally stable economies, limiting its applicability to African contexts. In Africa, existing studies largely emphasize structural constraints such as limited access to finance, often treating financial risk as an external condition rather than a process shaped by internal managerial practices. Consequently, there is limited empirical attention on how SMEs actively identify, assess, and mitigate financial risks, as well as insufficient use of rigorous analytical methods to link FRM practices to measurable financial outcomes.

This gap is particularly evident in Zambia, where research has focused mainly on macroeconomic challenges and financing constraints, with minimal examination of internal financial risk management practices. Critically, there is a lack of empirical evidence connecting FRM to key financial outcomes such as profitability, liquidity stability, and financial resilience, alongside weak integration of theoretical frameworks such as Enterprise Risk Management into empirical studies. This study addresses these gaps by providing a context-specific, mixed-methods analysis of FRM among SMEs in Lusaka's industrial sector, thereby contributing to a more comprehensive and empirically grounded understanding of SME financial resilience in Zambia.

2.4 Theoretical Framework

The study integrates three complementary theories:

- Enterprise Risk Management (ERM): Emphasizes systematic risk identification and mitigation
- Contingency Theory: Suggests that risk management strategies must align with environmental conditions
- Resource-Based View (RBV): Highlights internal capabilities such as financial literacy and managerial expertise

Theoretical Framework Intergration

This study integrates Enterprise Risk Management (ERM) Theory, Contingency Theory, and the Resource-Based View (RBV) to provide a comprehensive explanation of financial risk management (FRM) among SMEs. ERM forms the foundational framework by conceptualizing FRM as a structured process of risk identification, assessment, and mitigation, which directly informs the study's core variables. However, recognizing that SMEs operate in dynamic and often unstable environments, Contingency Theory is incorporated to explain how external factors such as inflation, exchange rate volatility, and access to finance influence the effectiveness of these practices. This highlights that the success of FRM strategies depends on their alignment with prevailing environmental conditions.

Complementing this, RBV emphasizes the role of internal organizational capacity such as financial literacy, managerial expertise, and systems in determining how effectively SMEs implement risk management practices. The integration of these theories provides a holistic framework in which FRM practices influence financial resilience, moderated by both internal capabilities and external conditions. This combined perspective strengthens the study by offering a mechanism-based explanation of how and why financial risk management affects SME performance in Lusaka's industrial sector.

2.5 Conceptual Framework

The purpose of this study's conceptual framework was to investigate the connection between financial risk management techniques and the industrial sector's SMEs' financial resilience in Lusaka. It incorporates important elements from pre-existing models and places them in the context of Zambian SMEs.

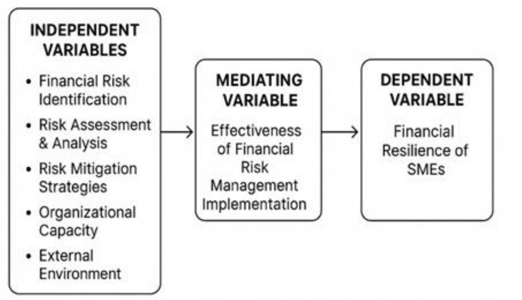

Figure 1: Conceptual Framework

Table 1: Core Constructs

Component	Description
Risk Identification	Recognition of financial threats
Risk Assessment	Evaluation of likelihood and impact
Risk Mitigation	Strategies to reduce exposure
Organizational Capacity	Skills, systems, financial literacy
External Environment	Economic volatility, access to finance
Financial Resilience	Ability to withstand financial shocks

3 Research Methodology and Design

This study adopted a pragmatic research philosophy, which supports the integration of quantitative and qualitative methods to address complex, real-world problems. The choice of pragmatism was appropriate given that financial risk management among SMEs involves both measurable financial relationships and context-specific managerial experiences.

A cross-sectional mixed-methods design was employed, using a convergent approach in which quantitative and qualitative data were collected concurrently, analyzed separately, and integrated during interpretation. The study was conducted among industrial SMEs located in Lusaka, particularly within key industrial zones such as Chinika and Emmasdale, where firms are highly exposed to financial risks arising from macroeconomic volatility.

The target population consisted of approximately 5,000 industrial SMEs, from which the sample size was determined using Yamane's (1967) formula at a 95% confidence level and 5% margin of error. A total of 370 SMEs were sampled, and 315 valid responses were obtained, representing a response rate of 85.1%, which is considered adequate for statistical analysis.

Sampling involved a combination of purposive and simple random techniques. Purposive sampling ensured the inclusion of SMEs operating within relevant industrial subsectors (metal fabrication, light engineering, and textile manufacturing), while simple random sampling was used to select respondents within these groups. For the qualitative component, 15 key informants were purposively selected based on their involvement in financial decision-making and SME support systems.

Primary data were collected using structured questionnaires and semi-structured interviews. The questionnaire captured quantitative data on financial risk exposure, financial risk management practices, and financial outcomes using Likert-scale measures. Interviews provided qualitative insights into managerial practices, institutional constraints, and contextual factors influencing financial risk management.

Quantitative data were analyzed using SPSS (Version 28). Descriptive statistics were used to summarize the data, while correlation and regression analyses were employed to examine relationships between financial risk management practices and financial outcomes. Qualitative data were analyzed using thematic content analysis, allowing for the identification of recurring patterns and explanatory insights.

To ensure methodological rigor, the study employed triangulation, integrating quantitative findings, qualitative evidence, and existing literature. This approach enhanced the validity and reliability of the results by providing a comprehensive understanding of financial risk management practices among SMEs.

Ethical considerations were strictly observed, including informed consent, confidentiality, and voluntary participation.

4 Results and Findings

4.1 Objective 1: To examine the types of financial risks faced by SMEs in Lusaka's industrial sector

Table 2: Descriptive Statistics for Financial Risk Exposure

Financial Risk Type	N	Mean	Std. Deviation	Interpretation
Interest Rate Risk	120	4.30	0.72	High
Exchange Rate Risk	120	4.12	0.68	High
Inflation Risk	120	4.25	0.70	High
Liquidity Risk	120	3.90	0.75	Moderate-High
Credit Risk	120	3.85	0.73	Moderate-High

Source: Field Data (2026)

The results in Table 2 indicate that SMEs in Lusaka's industrial sector experience high exposure to market-related risks, particularly interest rate, inflation, and exchange rate risks. The mean scores above 4.0 suggest that these risks are consistently perceived as significant across firms. Liquidity and credit risks also show relatively high mean values, reflecting challenges related to cash flow management and debt obligations.

Qualitative findings support these results, with respondents highlighting rising input costs, unstable exchange rates, and high borrowing costs as major constraints affecting financial stability. Overall, the findings demonstrate that financial risk exposure among SMEs is both high and multi-dimensional, driven largely by macroeconomic conditions.

4.2 Objective 2: To assess the effectiveness of financial risk management strategies among SMEs

Table 3: Descriptive Statistics for Financial Risk Management Practices

FRM Practice	N	Mean	Std. Deviation	Interpretation
Budgeting	120	4.20	0.65	High
Cost Control	120	4.10	0.68	High
Cash Flow Monitoring	120	3.80	0.72	Moderate
Diversification	120	3.20	0.80	Moderate-Low
Hedging	120	2.10	0.90	Low

Source: Field Data (2026)

Table 3 shows that SMEs primarily rely on basic financial management practices, particularly budgeting and cost control, which have high mean scores. However, more advanced financial risk management strategies such as diversification and hedging are minimally adopted, indicating limited sophistication in risk management approaches.

Table 4: Correlation Matrix

Variable	Financial Performance
Risk Identification	0.52**
Risk Assessment	0.48**
Risk Mitigation	0.57**

Note: $p < 0.01$

Source: Field Data (2026)

The correlation results indicate positive and statistically significant relationships between financial risk management practices and financial performance, suggesting that improved risk management is associated with better financial outcomes.

Table 5: Regression Analysis Results

Variable	Beta (β)	t-value	Sig.
Risk Identification	0.28	2.45	0.016
Risk Assessment	0.22	2.10	0.038
Risk Mitigation	0.35	3.20	0.002

Model Summary: $R^2 = 0.49$

Source: Field Data (2026)

The regression results show that financial risk management practices have a statistically significant positive effect on financial performance, with risk mitigation having the strongest influence. The model explains approximately 49% of the variation in financial outcomes, indicating moderate explanatory power.

Qualitative findings reveal that despite this positive relationship, most SMEs adopt informal and reactive approaches, limiting the overall effectiveness of financial risk management.

4.3 Objective 3: To identify strategies to improve financial risk management among SMEs

Table 6: Strategies for Improving Financial Risk Management

Strategy	Frequency	Percentage (%)
Improve Access to Finance	95	79%
Financial Literacy Training	88	73%
Adoption of FRM Systems	82	68%
Government Support Policies	76	63%
Use of Financial Technologies	60	50%

Source: Field Data (2026)

The findings in Table 4.5 indicate that SMEs prioritize access to finance and financial literacy as key strategies for improving financial risk management. A significant proportion of respondents also emphasize the importance of adopting structured financial management systems and strengthening institutional support.

Qualitative results reinforce these findings, highlighting that SMEs require both internal capacity building and external support mechanisms to enhance financial resilience.

4.4 Integrated Synthesis of Findings

The combined quantitative and qualitative findings indicate that SMEs in Lusaka's industrial sector operate under high financial risk exposure, particularly from macroeconomic factors such as inflation and exchange rate volatility. While financial risk management practices are present, they are largely basic, informal, and insufficiently developed to effectively mitigate these risks.

Statistical analysis confirms that financial risk management practices have a significant positive impact on financial performance, but their effectiveness is constrained by limited financial literacy, restricted access to finance, and weak institutional support. Overall, the findings demonstrate that improving SME financial resilience requires a holistic approach, integrating structured risk management practices with enhanced organizational capacity and supportive external environments.

5 Conclusions and Recommendations

5.1 Conclusion

This study examined financial risk management (FRM) among SMEs in Lusaka's industrial sector, focusing on the types of financial risks faced, the effectiveness of risk management strategies, and potential approaches for improvement. The findings reveal that SMEs operate in a highly volatile financial environment characterized by significant exposure to market risks, particularly inflation, exchange rate fluctuations, and interest rate volatility. These risks are further compounded by liquidity and credit constraints, resulting in unstable cash flows and increased financial vulnerability.

The study establishes that although SMEs implement financial risk management practices such as budgeting, cost control, and cash flow monitoring, these practices are largely informal and reactive. Regression results confirm that financial risk management has a statistically significant positive effect on financial outcomes, indicating that improved risk management practices contribute to enhanced financial stability. However, the effectiveness of these practices is limited by structural and internal constraints, including low financial literacy, limited access to finance, and weak institutional support systems.

Overall, the study concludes that financial risk management is a critical determinant of SME financial resilience, but its potential remains underutilized due to inadequate capabilities and unfavorable external conditions. Effective financial risk management among SMEs therefore requires not only improved internal practices but also a supportive financial and policy environment.

5.2 Recommendations

Based on the findings of the study, the following recommendations are proposed:

Strengthening Financial Literacy and Managerial Capacity

SME owners and managers should be supported through targeted training programs aimed at improving financial literacy, particularly in areas such as risk identification, financial planning, and cash flow management. Enhanced financial knowledge will enable SMEs to adopt more structured and proactive risk management practices.

Improving Access to Affordable Finance

Financial institutions and policymakers should develop financing mechanisms tailored to SMEs, including flexible loan products and reduced collateral requirements. Improved access to finance will reduce liquidity constraints and enable SMEs to better manage financial risks.

Promotion of Structured Financial Risk Management Systems

SMEs should be encouraged to adopt formal financial risk management frameworks, including budgeting systems, financial forecasting tools, and risk assessment models. This will enhance the ability of firms to anticipate and mitigate financial risks effectively.

Strengthening Institutional and Policy Support

Government agencies and SME support institutions should enhance programs that provide financial and technical support to SMEs. Policies aimed at stabilizing the macroeconomic environment, particularly inflation and interest rates, will also contribute to reducing financial risk exposure.

Adoption of Financial Technologies (FinTech)

SMEs should leverage digital financial tools to improve financial monitoring, record-keeping, and decision-making. The use of financial technologies can enhance efficiency and support more effective risk management practices.

5.3 Areas for Further Research

This study provides valuable insights into financial risk management among SMEs; however, several areas require further investigation. Future studies may adopt a longitudinal design to examine how financial risk management practices evolve over time and their long-term impact on SME performance. Additionally, further research could explore sector-specific differences in financial risk exposure and management practices, as well as the role of digital financial innovations in enhancing SME resilience.

Declaration of Competing Interests

The author(s) declare that they are not aware of any competing financial interests or personal relationships that may have influenced the work described in this document.

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Ethical considerations

The article followed all ethical standards appropriate for this kind of research.

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