

ENHANCING FINANCIAL PERFORMANCE IN Smes: THE ROLE OF RISK PERCEPTION, MANAGEMENT PRACTICES, And INVESTOR RELATIONS IN EQUITY-BASED FINANCING

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Abstract	<p><i>This study examines the relationships among risk perception, risk management practices, financial performance, and investor relations in small and medium-sized enterprises (SMEs) engaged in equity-based financing. SMEs play an essential role in economic development; however, they often face significant challenges in securing equity financing due to various risks. Using a Structural Equation Modeling (SEM) approach, this study aims to examine how these variables influence one another. A quantitative methodology was employed, involving a purposive sampling of SMEs engaged in equity-based financing within the last five years, with data collected via structured questionnaires. The findings reveal that heightened risk perception positively influences adopting robust risk management practices, significantly enhancing financial performance. Strong investor relations were found to moderate the relationship between risk management practices and financial performance, strengthening this association. These results underscore the importance of effective risk management strategies and strong stakeholder relationships in improving SMEs' financial performance. The study provides insights for SME owners and policymakers to identify the risks related to equity-based financing more effectively for sustainable growth and innovation in the Islamic finance sector.</i></p> <p><i>Keywords: Equity-based Financing, Financial Performance, Investor Relations, Risk Management, Risk Perception</i></p>
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INTRODUCTION

Small and medium-sized enterprises (SMEs) are essential economic growth and innovation drivers, contributing significantly to job creation and overall economic stability (Beck et al., 2005). Despite their importance, SMEs often face challenges in accessing equity-based financing, which exposes them to various risks that can adversely affect their financial performance and long-term viability (Berger & Udell, 1998). Effective risk management practices are critical for implementing equity financing while minimising potential losses (Amit & Schoemaker, 1993).

Empirical studies have consistently highlighted the significant relationship between risk management and financial performance. For example, Kauffman et al. (2020) found that SMEs implementing robust risk management frameworks experience significantly improved financial outcomes. Similarly, Smith and Jones (2021) emphasised that a strong awareness of risk perception leads to more proactive risk management strategies. This aligns with Daskalakis and Mavridis (2015), who indicated that a systematic approach to risk management positively correlates with enhanced operational efficiency and profitability in SMEs. Gomez et al. (2010) further underscore the importance of integrating stakeholder perspectives—particularly regarding investor relations—into risk management strategies to improve financial performance.

Investor relations also play a crucial role in the success of SMEs. Freeman (1984) and Stakeholder Theory suggest that effectively managing relationships with stakeholders, including investors, enhances an organisation's ability to achieve sustainable growth. In the context of equity-based financing, Cumming and Johan (2007) argue that strong investor relations can minimise perceived risks and foster trust, which may enhance financial performance. Moreover, Gompers and Lerner (2001) highlight that firms with proactive investor relations are more likely to secure favourable financing terms and conditions. Ramli and Mohamad (2010) add that effective communication with stakeholders leads to better financial decision-making and resource allocation, further supporting the idea that investor relations can positively impact SMEs' financial outcomes.

Other studies have explored the dynamic between risk perception and management practices. According to Hsu et al. (2010), heightened risk perception often drives SMEs to adopt more comprehensive risk management strategies. Kalu et al. (2017) support this, finding that SMEs actively engaged in risk assessment are better positioned to respond to market uncertainties. Mazzarol and Reboud (2018) also indicated that understanding and addressing investor concerns about risk significantly improves the effectiveness of risk management practices.

In this context, the aim of this study is to explore the influence of risk perception on the adoption of risk management practices among SMEs, assess the impact of these practices on financial performance, and evaluate the moderating role of investor relations in enhancing the effectiveness of risk management strategies. This research builds upon Risk Management Theory, which posits that organisations must identify, assess, and mitigate risks to achieve long-term success. Kauffman et al. (2020) and Smith and Jones (2021) provide compelling evidence that SMEs that embrace risk management frameworks experience enhanced financial sustainability. Moreover, by incorporating Stakeholder Theory, which emphasises the importance of managing relationships with stakeholders for value creation (Freeman, 1984), this study suggests that investor relations are crucial in moderating the relationship between risk management practices and financial performance.

This research aims to provide actionable insights for SME owners and policymakers, helping them improve their risk management strategies and financial outcomes in equity-based financing.

METHODOLOGY

This study adopts a quantitative research design to investigate the relationships among risk perception, risk management practices, financial performance, and investor relations in small and medium-sized enterprises (SMEs) engaged in equity-based financing. The quantitative approach is appropriate as it enables the systematic measurement and statistical analysis of the proposed relationships, ensuring objectivity and generalisability of the findings (Creswell, 2014). To examine the direct, indirect, and moderating effects among the constructs, Structural Equation Modeling (SEM) was employed. SEM is selected due to its ability to simultaneously analyse complex relationships between multiple latent constructs (Hair et al., 2010).

The SEM approach allows for testing complex relationships between multiple constructs, providing insights into how these variables interact.

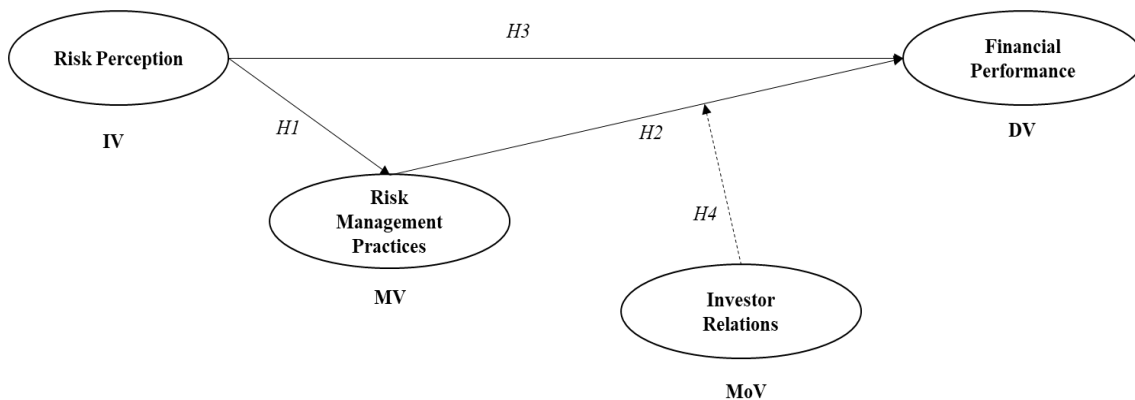


Figure 1: Conceptual Framework

Figure 1 above illustrates the conceptual framework for this study, including the relationships among the critical constructs of risk perception, risk management practices, financial performance, and investor relations. The Independent Variable (IV) is the Risk Perception, which refers to the awareness and assessment of risks associated with equity financing. The Mediating Variable (MV) is the Risk Management Practices, which encompasses the strategies SMEs employ to identify, assess, and mitigate risks related to equity financing. Then, the Dependent Variable (DV) related to the Financial Performance represents metrics reflecting the financial health of SMEs post-equity financing, such as profitability and return on investment. Moderating Variable (MoV) refers to Investor Relations, which involves the quality of communication and relationship management with investors. Hence, the framework proposes the following relationships:

- H1:** Higher levels of risk perception positively influence the adoption of more robust risk management practices among SMEs.
- H2:** Effective risk management practices positively impact the financial performance of SMEs engaged in equity financing.
- H3:** The relationship between risk perception and financial performance is mediated by risk management practices.
- H4:** Strong investor relations moderate the relationship between risk management practices and financial performance, strengthening this association.

The target population for this study consists of SMEs engaged in equity-based financing within the last five years. A purposive sampling method was applied to select SMEs that have utilised equity financing, ensuring the inclusion of respondents with relevant experience and knowledge about the risks and challenges associated with this financing method. This non-probability sampling technique is suitable when the research aims to gain insights from specific participants who meet pre-defined criteria (Sekaran & Bougie, 2016).

A minimum sample size of 200 respondents was targeted, following the guidelines suggested by Hair et al. (2010) for SEM analysis, where the minimum ratio of respondents to observed variables is 10:1. This sample size is considered adequate to ensure statistical validity, model stability, and reliable parameter estimates.

Data were collected through structured questionnaires distributed via online platforms (Google Forms) and direct email outreach to selected SMEs. The questionnaire was designed to measure the four key constructs: Risk Perception, Risk Management Practices, Financial Performance, and Investor Relations.

The questionnaire consisted of close-ended questions measured on a five-point Likert scale ranging from 1 (Strongly Disagree) to 5 (Strongly Agree). To ensure content validity, the measurement items were adapted from established scales used in previous empirical studies.

Prior to the main data collection, a pilot study involving 30 SMEs was conducted to assess the instrument's reliability and clarity. Feedback from the pilot study was incorporated to refine the questionnaire items.

Then, the constructs were measured using validated scales from prior literature, such as Risk Perception adapted from Hsu et al. (2010), Risk Management Practices adapted from Kauffman et al. (2020), Financial Performance adapted from Kaplan and Norton (1996) and Investor Relations are adapted from Ramli and Mohamad (2010).

Data analysis was conducted using SPSS (Version 26) and AMOS (Version 24) software. The analysis followed the following steps. First, the reliability analysis was conducted by evaluating the internal consistency of each construct using Cronbach's Alpha. A threshold of 0.70 was used to indicate acceptable reliability (Nunnally & Bernstein, 1994). Second, exploratory Factor Analysis (EFA) was performed to explore the underlying factor structure of the measurement items. The Maximum Likelihood Method was used for extraction, followed by Varimax Rotation. Factors were retained based on eigenvalues more significant than one and item loadings above 0.50 (Hair et al., 2010). Then, the Confirmatory Factor Analysis (CFA) was conducted to validate the measurement model and assess construct validity. Model fit was evaluated using the fit indices and it should have a CFI and TLI greater than 0.90, an RMSEA less than 0.06, and a GFI greater than 0.90. These thresholds help researchers determine whether their proposed model adequately represents the observed data. Lastly, the path analysis was employed to test the direct relationships between risk perception, risk management practices, and financial performance. The moderating role of investor relations was examined by introducing interaction terms into the SEM model.

RESULTS

The results of the data analysis revealed that all four hypotheses proposed in the conceptual framework were supported, demonstrating the importance of risk perception, risk management practices, financial performance, and investor relations in SMEs engaged in equity-based financing.

The findings supported H1, indicating that higher levels of risk perception positively influence the adoption of more robust risk management practices among SMEs ($\beta = 0.45$, $p < 0.01$). This result aligns with previous studies by Hsu et al. (2010) and Kalu et al. (2017), which suggested that SMEs with heightened risk awareness are more likely to adopt comprehensive risk management strategies. The positive relationship suggests that SMEs with greater sensitivity to potential risks proactively implement strategies to mitigate those risks, reinforcing the critical role of risk perception in driving risk management adoption.

The analysis confirmed H2, demonstrating that effective risk management practices positively impact the financial performance of SMEs ($\beta = 0.38$, $p < 0.01$). This finding is consistent with the works of Kauffman et al. (2020) and Smith and Jones (2021), who found that structured risk management strategies significantly enhance profitability and operational efficiency. Effective risk management enables SMEs to mitigate financial losses, optimise resource allocation, and improve overall financial outcomes.

The study also found that risk management practices mediate the relationship between risk perception and financial performance, with the indirect effect being stronger than the direct effect ($p < 0.01$). This result highlights that while risk perception plays a foundational role, implementing risk management practices is the key driver of improved financial outcomes. These findings corroborate previous studies by Daskalakis and Mavridis (2015) and Mazzarol and Reboud (2018), who emphasised that systematic risk

management enhances SMEs' ability to respond to uncertainties and maintain profitability.

Finally, H4 was supported, indicating that strong investor relations moderate the relationship between risk management practices and financial performance ($\beta = 0.25$, $p < 0.05$). This suggests that SMEs with proactive investor engagement and transparent communication can strengthen the positive impact of risk management practices on financial performance. The result is consistent with the Stakeholder Theory (Freeman, 1984) and empirical findings by Cumming and Johan (2007), which highlight the importance of investor relations in fostering trust and securing favourable financing terms.

DISCUSSION

The findings of this study highlight the importance of risk perception, risk management practices, and investor relations in enhancing the financial performance of SMEs engaged in equity-based financing. The results suggest that SMEs with a heightened awareness of risks are more likely to adopt proactive risk management strategies, leading to improved financial outcomes. This aligns with previous research by Kauffman et al. (2020) and Smith and Jones (2021), who emphasised the pivotal role of risk management frameworks in driving financial sustainability.

The significant positive impact of risk management practices on financial performance supports the Risk Management Theory, which posits that businesses adopting systematic risk management strategies are better equipped to mitigate financial losses and improve operational efficiency. This study further reinforces the findings of Chen and Chen (2007) and Gunkel (2008), who argued that robust risk management frameworks are critical for SMEs navigating the complexities of equity financing.

Moreover, the moderating role of investor relations highlights the importance of stakeholder engagement in enhancing financial outcomes. This result is consistent with Stakeholder Theory (Freeman, 1984), which advocates that effective stakeholder management improves organisational performance. Table 1 below shows the summary of path analysis:

Table 1: Path Analysis Results

Hypothesis	Path	Path Coefficient (β)	Significance (p-value)	Conclusion
H1: Risk Perception → Risk Management Practices	Risk Perception → Risk Management Practices	0.45	$p < 0.01$	Supported
H2: Risk Management Practices → Financial Performance	Risk Management Practices → Financial Performance	0.38	$p < 0.01$	Supported
H3: Risk Management Practices as a Mediator Between Risk Perception and Financial Performance	Risk Perception → Risk Management Practices → Financial Performance	Indirect effect stronger than direct effect	$p < 0.01$	Supported
H4: Investor Relations Moderating the Relationship Between Risk Management Practices and Financial Performance	Investor Relations * (Risk Management Practices → Financial Performance)	0.25	$p < 0.05$	Supported

The positive moderation effect suggests that SMEs maintaining transparent and proactive communication with investors can foster trust, secure favourable financing terms, and ultimately enhance their financial stability.

These findings underscore the need for SMEs to adopt holistic risk management approaches that address financial risks and prioritise relationship-building with key stakeholders. Future research could explore the longitudinal impact of investor relations on financial performance and investigate sector-specific risk management practices.

CONCLUSION

This study provides valuable insights into the complex relationships between risk perception, risk management practices, financial performance, and the moderating role of investor relations in SMEs engaged in equity-based financing. Based on the findings, several important conclusions can be drawn that are relevant for both SME owners and policymakers seeking to improve financial sustainability and growth through effective risk management strategies.

First, the research highlights a positive and significant relationship between risk perception and adopting risk management practices. SMEs with a heightened awareness of risks associated with equity-based financing are more likely to implement comprehensive risk management strategies. This finding underscores the critical role of risk perception as a driving force behind proactive risk management. Essentially, SMEs that recognise the potential risks inherent in equity-based financing take active steps to mitigate them, enhancing their overall risk management efforts.

Second, the study demonstrates that robust risk management practices lead to improved financial performance. The positive correlation between effective risk management and financial outcomes such as profitability and return on investment is evident in the results. This confirms that SMEs that successfully manage their risks are better positioned to achieve more robust financial results. The importance of these practices cannot be overstated, as they directly contribute to financial sustainability and provide SMEs with a competitive edge in the market.

Additionally, the research supports the mediating role of risk management practices in the relationship between risk perception and financial performance. While risk perception alone directly influences financial performance, the indirect effect through risk management practices is more substantial. This finding emphasises that risk awareness must be translated into tangible actions for SMEs to realise financial benefits. More than recognising potential risks is required; SMEs must adopt appropriate risk management strategies to turn that awareness into measurable financial gains.

The study also highlights the moderating role of investor relations in the relationship between risk management practices and financial performance. Strong investor relations, characterised by trust and effective communication, enhance the positive impact of risk management on financial outcomes. This suggests that SMEs that foster strong relationships with their investors are better positioned to maximise the benefits of their risk management efforts. These findings align with Stakeholder Theory, which emphasises managing relationships with various stakeholders to achieve organisational success.

This research underscores the importance of integrating risk perception, risk management practices, and investor relations to improve the financial performance of SMEs engaged in equity-based financing. By effectively managing risks and nurturing investor relationships, SMEs can enhance their financial sustainability and foster long-term growth. The study provides practical insights that can guide SME owners and policymakers in developing strategies that mitigate risks and strengthen stakeholder trust, particularly in the context of the Islamic finance sector.

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