

UNIVERSITE ABDERRAHMANE MIRA DE BEJAIA



Faculté des sciences économiques, commerciales et des Sciences de Gestion.

Département des Sciences économiques.

MEMOIRE

En vue d'obtention du diplôme de

MASTER EN SCIENCES ECONOMIQUES.

Option : Economie Monétaire et Financière.

L'INTITULE DU MEMOIRE

THE FINANCING OF SMES IN KENYA: CHALLENGES FACING SMES.

Préparé par :

MAGANGA PETER MUSONI

Dirige par :

Pr. NACER-EDDINE MOUFFOK

Date de soutenance : 19/06/2025

Jury:

Président : RACHID Mohamed

Examineur : HAMMAMI Cylia

Rapporteur : MOUFFOK Nacer-Eddine

Année universitaire : 2024/2025

DEDICATIONS

This thesis is dedicated to my beloved family, whose unwavering support and encouragement have been my foundation throughout this journey. To my parents, thank you for your endless sacrifices and belief in my dreams. To my mentors, professors and teachers, your guidance has been invaluable. To my friends, who stood by me with patience and understanding during difficult times, I am truly grateful. This work is also dedicated to those who dare to dream and persevere against all odds. May this be a small tribute to the power of persistence. Lastly, I dedicate this thesis to all those who inspired and supported me along the way. To the late nights, quiet struggles, and small victories—each step has brought me here. Thank you all for being part of my story.

ACKNOWLEDGEMENTS

First of all, I am grateful to the Almighty God for enabling the successful completion of this work through granting me strength, good health and wisdom. It was only possible due to this gift of life and opportunity he has given me.

Secondly, I would like to express my deepest gratitude to my supervisor, Pr. Nace-Eddine MOUFFOK, for his invaluable guidance, constant support, and insightful feedback throughout the course of my research. His encouragement and expertise have been essential in shaping this work. I am also thankful to the faculty lecturers and all the staff members of the Department of Economic Sciences at the University of Béjaïa for providing a stimulating academic environment. The resources and facilities made available to me during my study were crucial to the completion of this thesis.

I am sincerely heartfelt gratitude to my family for their unwavering love, patience, and support during this journey through prayers and encouragement. Their belief in my capabilities gave me the strength to overcome numerous challenges. I would also like to acknowledge my friends and peers, whose help and intellectual exchange made this experience enriching and enjoyable.

Finally, I thank the countless researchers, scholars, and authors whose work laid the groundwork for my study. The wealth of knowledge I discovered in the literature has broadened my perspectives and inspired me to delve deeper for a more comprehensive understanding of my Study.

LIST OF ABBREVIATIONS

CBK	Central Bank of Kenya.
SMEs	Small and Medium-sized Enterprises.
MSMEs	Micro, Small and Medium-sized Enterprises.
LLCs	Limited Liabilities Companies.
SACCO's	Savings and Credit Cooperatives societies.
KBA	Kenya Bankers Association.
YIC	Young Innovation Companies.
DBK	Development Bank of Kenya
GDP	Gross Domestic Product.
OECD	Organisation for Economic Co-operation and Development.
KCB	Kenya Commercial Bank.
EAC	East African Community.
EC	European Commission.
KSHS	Kenya Shillings.
CRB	Credit Reference Bureau.
KIA	Kenya Investment Authority.

SUMMARY

DEDICATIONS.....	ii
ACKNOWLEDGEMENTS	iii
LIST OF ABBREVIATIONS	iv
GENERAL INTRODUCTION	1
CHAPTER 1: THEORETICAL FRAMEWORK OF SMALL AND MEDIUM SIZED ENTREPRISES.....	5
Section 1: Theoretical Framework on SMEs.....	5
Section 2: Overview of SMEs in Kenya	11
CHAPTER 2: BANKING SYSTEM IN KENYA.....	16
Section 1: Kenya’s banking system: development, classification, and regulatory framework	16
Section 2: Historical evolution of the banking system in Kenya	21
Section 3: Overview of the SMEs financing landscape in Kenya.....	28
CHAPTER 3: METHODOLOGY AND RESEARCH ANALYSIS.	27
Section 1: Methodology	27
Section 2: Results and Analysis.....	29
Section 3: Summary, Conclusion, and Recommendation:	38
GENERAL CONCLUSION.....	41

GENERAL INTRODUCTION

Background.

Small and Medium Enterprises (SMEs) are a cornerstone of Kenya's economic fabric, mirroring their importance across many emerging economies. These enterprises are instrumental in creating employment opportunities, driving innovation, and bolstering national output. Data from the Kenya Investment Authority (KIA) shows that SMEs make up more than 90% of businesses in the private sector, contribute approximately 20% to the country's GDP, and provide jobs to over 80% of the non-agricultural labor force. Despite their economic significance, SMEs face numerous obstacles, the main one among them being limited access to financing.

Accessing adequate financial support remains a major Challenge for many SMEs in Kenya. Start-up capital, working capital for operations and funds for expansion are all critical for business survival and growth. However, the World Bank (2020) highlights that a large number of SMEs in Kenya are either underfunded or entirely excluded from formal financial institutions. This financial exclusion severely affects their ability to innovate, scale up operations, and compete both locally and internationally.

One of the main issues is the high cost of borrowing. Financial institutions (Banks) in Kenya often charge interest rates that are among the highest in the region, as noted by (Beck T. C., 2010). This makes credit unaffordable for many small businesses. Elevated interest rates raise the cost of capital, diminishing returns on investment and discouraging entrepreneurs from seeking formal loans, thereby reinforcing the cycle of limited financial access.

Another significant obstacle is the demand for collateral. Most SMEs operate with limited tangible assets and therefore struggle to meet the strict collateral requirements set by commercial banks. Research by (Patricof, 2005) emphasizes that this issue is prevalent across developing nations, including Kenya. Without sufficient guarantees, SMEs are perceived as high-risk borrowers, and as a result, they are often sidelined by financial institutions. The problem is made worse by the underdevelopment of alternative funding avenues, such as venture capital or angel investment networks.

Creditworthiness is a key factor affecting loan approvals for Kenyan SMEs, many of which operate informally without proper financial documentation. This lack of verifiable credit histories creates distrust between lenders and borrowers, often resulting in loan rejections even for viable businesses. Additionally, internal factors such as weak management, limited market access, and competition from larger firms further diminish SMEs' appeal to financial institutions. These operational challenges increase the perceived risk for lenders, making it harder for SMEs to secure financing despite their potential.

To combat these issues, the Kenyan government and international partners have launched initiatives like financial literacy programs, entrepreneurship training, and credit guarantee schemes to reduce lending risks. However, despite these efforts, significant financing gaps remain, indicating the need for deeper reforms and more diverse funding sources. Overall, while SMEs are vital to Kenya's economic growth, persistent barriers—such as high borrowing costs, strict collateral demands, and inconsistent performance—continue to restrict their access to capital. This study aims to examine these obstacles closely and recommend strategies to improve SME financial inclusion, fostering a stronger and more inclusive economy.

Objectives of the study.

This study investigates the challenges Kenyan SMEs face in accessing financial services from banks, focusing on structural, regulatory, and operational barriers. It examines how these obstacles affect SME growth and sustainability while analyzing their financial needs and demand for banking services. The research explores institutional issues like collateral demands, credit history, and banks' risk perceptions. It also evaluates the suitability of current financial products for SMEs. Ultimately, the study offers practical strategies and policy recommendations to enhance SME access to formal financing in Kenya.

Problem Statement.

Small and Medium Enterprises (SMEs) play a vital role in Kenya's economic growth by creating jobs, generating income, and reducing poverty. Despite their importance, SMEs face major challenges in accessing finance due to strict collateral requirements, high interest rates, limited credit histories, and being labeled high-risk by lenders. These obstacles create a financing gap that hinders their growth, investment, and competitiveness.

Additionally, financial products often do not align with the specific needs of SMEs, further limiting access. Consequently, SMEs struggle to achieve their full potential in driving inclusive growth and innovation. This study explores the underlying causes of credit access limitations and proposes strategies to improve financial inclusion for Kenyan SMEs.

Given these challenges, this perplexity leads us to a pivotal inquiry that forms the fundamental essence of our research: **What are the key challenges faced by Small and Medium Enterprises (SMEs) in Kenya regarding access to bank financing.**

In addition, this central question is then accompanied by the following secondary questions:

- ❖ **What are the primary institutional and market-based factors limiting access to finance for SMEs in Kenya?**
- ❖ **How do high interest rates and collateral requirements affect the financing decisions of SMEs?**
- ❖ **To what extent do internal SME performance issues influence their access to formal bank financing?**
- ❖ **What is the effectiveness of existing government and donor interventions in bridging the SME financing gap?**

Financing constraints remain a major hurdle for SMEs in Kenya, limiting their growth potential. This research seeks to explore these financial barriers in depth. It also aims to offer practical solutions to enhance financial inclusion for SMEs.

Research hypotheses.

Primary Hypothesis

- SMEs in Kenya face significant challenges in accessing finance from financial institutions due to stringent lending criteria.

Alternative Hypotheses.

- Collateral requirements by banks significantly limit the ability of SMEs in Kenya to access credit.
- High-interest rates on bank loans negatively impact SMEs' ability to obtain financing in Kenya.
- Bank lending procedures and documentation requirements act as barriers to SMEs accessing credit facilities in Kenya.

Methodology Announcement.

This study adopts a mixed-methods approach, integrating both quantitative and qualitative techniques to investigate the financial challenges faced by Kenyan SMEs. It is descriptive, measuring the scope of these issues, and exploratory, uncovering their underlying causes. The research targets SMEs in Nairobi, Mombasa, Kisumu, and Nakuru which are key economic hubs, using stratified random sampling to reflect various sectors like trade, agriculture, services, and manufacturing. Approximately 150 SMEs are surveyed, providing rich data on finance accessibility. This dual strategy enables a blend of statistical trends and contextual perspectives. Both primary and secondary data sources contribute to a fuller picture.

Quantitative data is gathered through structured questionnaires focusing on funding sources, loan rejections, and application processes, while qualitative insights are gained from interviews with SME owners, bank officials, and institutional representatives. Additional context comes from reports by the Central Bank of Kenya, the World Bank, and government policies. Ethical research practices, including informed consent and confidentiality, are emphasized throughout. Statistical tools such as regression analysis examine correlations between SME characteristics and financing access. Thematic analysis of qualitative data highlights recurring patterns and narratives. Altogether, the study provides policy-relevant insights to strengthen SME financial inclusion and foster economic growth.

Structure of the Study.

The study summarizes three chapters focusing on SME financing challenges in Kenya. Chapter one outlines theoretical frameworks, SME definitions, and barriers like poor records and collateral needs, while analyzing Kenya's SME landscape. Chapter two explores the role and evolution of Kenya's banking system, including CBK regulations and the sector's impact on SME financing. Chapter three presents the research methodology, analyzes data on financing barriers, and interprets findings tied to systemic financial issues. It highlights key constraints like interest rates and creditworthiness. The chapter concludes with recommendations for more inclusive and flexible lending policies to support SME.

CHAPTER 1: THEORETICAL FRAMEWORK OF SMALL AND MEDIUM SIZED ENTREPRISES.

Introduction

Small and Medium Enterprises (SMEs) are essential to Kenya's economic development through innovation, job creation, and GDP contribution. Despite their impact, SMEs face major financial access challenges, especially from financial institution. This chapter introduces a framework to investigate these financial hurdles and the potential role of private banks in addressing them. It is structured into a literature review, definitions of key terms, and an overview of Kenya's SME landscape. The literature review identifies common financing barriers and suggested remedies. The definitions section explains crucial concepts for clarity. The SME overview highlights their economic importance, operational issues, and financial context. These elements set the stage for deeper analysis in later chapters.

Section 1: Theoretical Framework on SMEs

The theoretical framework on SMEs offers a structured approach to understanding factors that affect their growth and sustainability. It draws from economic, management, and entrepreneurship theories to explain SME operations. This framework supports research and policy-making to enhance SME development.

1.1 Literature Review Summary

This study analyzes existing research on factors affecting SME access to finance, noting that many studies generalize results nationally, overlooking regional differences. This lack of localized focus creates a contextual gap, limiting the practical application of findings. The literature reveals various barriers to finance, yet highlights an ongoing search for effective determinants. Although several empirical studies have investigated predictors, critical aspects like financial statement quality and collateral availability remain underexplored in Kenya. These gaps point to the need for a more targeted investigation of SME financing challenges. (Abdulsaleh, 2013)

The study proposes that access to finance for Kenyan SMEs is strongly influenced by the quality of financial records and the availability of collateral, with firm age acting as a moderating factor. Limited research has examined how such moderators affect the link between financial traits and financing access. By exploring this intersection, the study aims to fill both conceptual and contextual research voids.

It focuses on how specific financial characteristics impact financing, especially when combined with firm age. This approach seeks to provide a more nuanced understanding of SME financing dynamics in Kenya. (Abdulsaleh, 2013)

1.2 Generalities on SMEs

1.2.1 Definitions of SMEs

While the global significance of SMEs is widely recognized, arriving at a single, universally accepted definition remains challenging. Definitions tend to vary across countries and often depend on the specific criteria applied. (Beck T. D.-K., 2002) SMEs definitions typically follow two broad approaches:

- **Endogenous criteria**, which refer to internal company features such as number of employees and revenue.
- **Exogenous criteria**, which consider external factors like sector of operation or legal structure.

1.2.2 Endogenous Criteria-Based Definitions

These definitions categorize SMEs using internal company characteristics and fall into two categories:

1.2.2.1 Quantitative Indicators

Also known as the statistical approach, this method defines SMEs based on measurable data. Common quantitative indicators include: (Beck T. D.-K., 2002)

- Number of employees
- Annual turnover
- Capital investment

1.2.2.2 Qualitative Indicators

This approach considers qualitative traits inherent in SMEs, aligning more with economic realities and organizational behavior. These indicators include: (Beck T. D.-K., 2002)

- Quality of management and workforce size
- Strategic goals and managerial practices
- Market limitations, credit access difficulties, dependence on local supply chains, and limited access to capital markets. These qualitative and quantitative indicators, while distinct, are complementary in understanding SMEs characteristics. (Beck T. D.-K., 2002)

1.2.3 Exogenous Criteria-Based Definitions

This classification relies on external aspects of the company to define SMEs, such as:

- Legal status
- Nature of business operations

- Sector-specific characteristics (Beck T. D.-K., 2002)

I.2.3.1 Legal Classification of Enterprises

a. Private Companies

Private firms are characterized by ownership through individuals, families, or partnerships.

Common forms include:

- ***Sole Proprietorships***: Easy to establish but expose owners to unlimited liability.
- ***General Partnerships***: Partners are jointly and individually liable for debts.
- ***Limited Liability Companies (LLCs)***: Liability is limited to shareholders' contributions.
- ***Joint Stock Companies***: Equity is divided into shares that can be traded under specific conditions.
- ***Single-Member LLCs***: Owned by one individual or entity, offering personal asset protection.

Among these, LLCs and joint stock companies are often favored for SME formation due to operational flexibility and capital structuring advantages (Ayyagari, 2003).

b. Public Enterprises

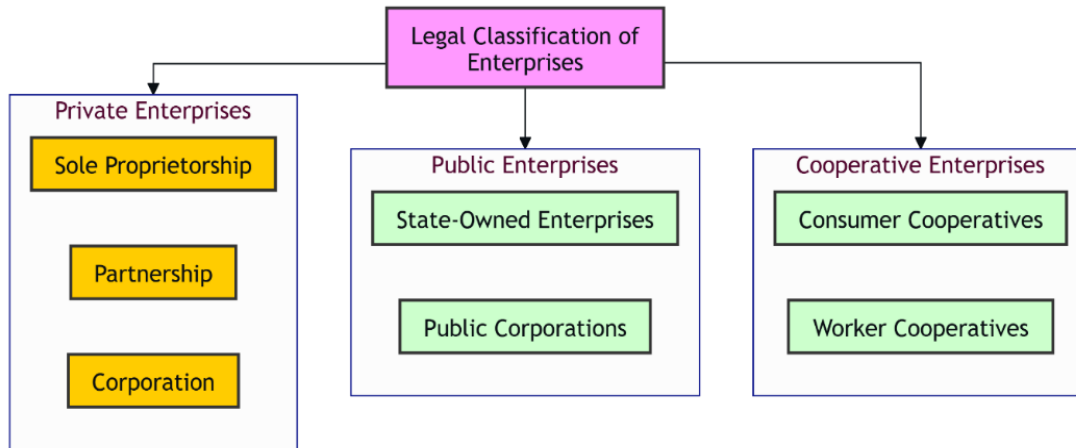
These are owned wholly or predominantly by government bodies. They include:

- ***Administrative Bodies***: Operated directly by civil servants
- ***Public Establishments***: Legally autonomous institutions such as universities or hospitals
- ***National Companies***: Fully owned by the state and managed by appointed boards
- ***Mixed Economy Companies***: Feature joint public-private ownership (Ayyagari, 2003).

c. Cooperative Enterprises

These are collectively owned by members who share resources to meet mutual needs. Profit maximization is not their primary objective. They operate in diverse fields such as agriculture, retail, insurance, and construction. While legal classifications are helpful, they should not be the sole basis for SME identification, as they overlook operational and sector-specific nuances (Ayyagari, 2003).

Figure 1: Legal Classification of Enterprises



Source: Government printer 2010, Nairobi

I.2.4 Classification by Sector of Activity

I.2.4.1 Traditional Sectoral Classification

This approach groups businesses into three primary sectors:

- **Primary Sector:** Agriculture, mining, forestry
- **Secondary Sector:** Manufacturing and industrial processing
- **Tertiary Sector:** Service provision

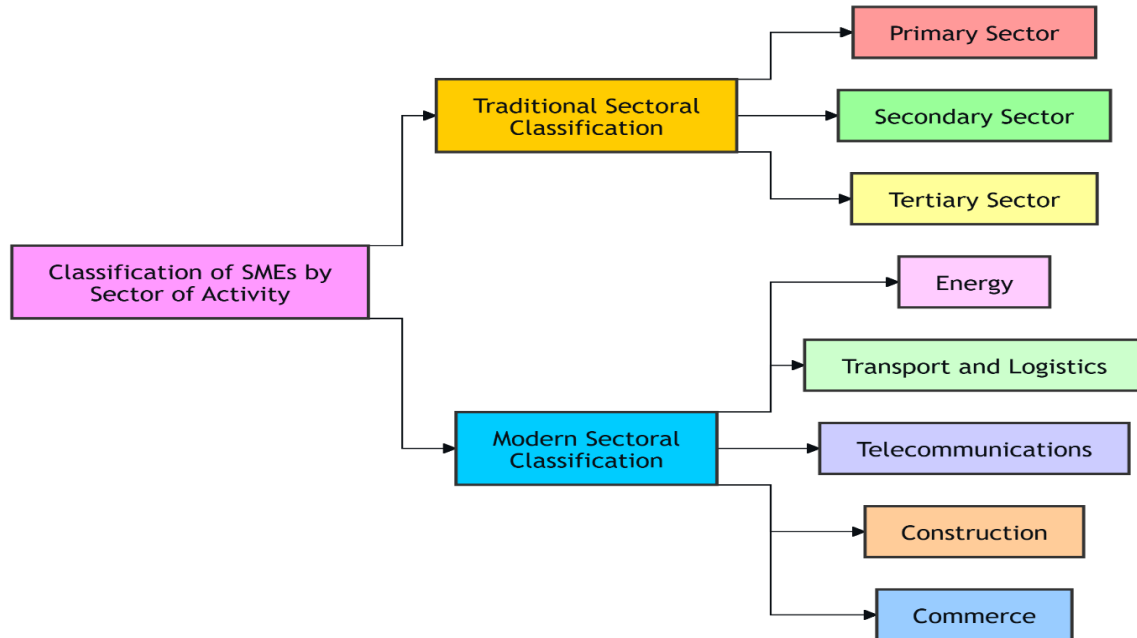
However, this classification is becoming less relevant due to global industrial evolution and economic diversification. (Abitekaniza, 2017)

I.2.4.2 Modern Sectoral Classification:

Modern classification identifies sectors overlooked by the traditional model, such as:

- Energy
- Transport and logistics
- Telecommunications
- Construction
- Commerce

Figure 2: Classification by Sector of Activity



Source: Business Environment, SMEs 2012

I.2.5 Classification by Sector Quality

This method distinguishes between:

- □ **Traditional Sectors:** Labor-intensive operations, outdated equipment, and minimal innovation.
- □ **Modern Sectors:** Technologically advanced, often featuring SMEs that engage in subcontracting and are more independent in operation. (Abdulsaleh, 2013)

I.3 Distinction Between SMEs and Start-Ups:

Differentiating SMEs from start-ups can be complex but is crucial for policy-making and academic research. While there's no standardized global definition, both entities are instrumental in driving innovation and economic diversification.

Definitions are typically based on either qualitative features or quantitative metrics like revenue, staff count, or R&D investment. These distinctions help determine eligibility for various support mechanisms and funding programs. (Lassala, 2022)

I.3.1 Understanding Start-ups:

The concept of a start-up lacks a universally agreed definition, and interpretations vary widely. Research tends to categorize start-ups using either:

- □ *Institutional (quantitative) definitions*, based on metrics like age, funding level, and innovation activity.
- □ *Managerial (qualitative) definitions*, focusing on company vision, scalability, and innovation capacity. (Lassala, 2022)

I.3.1.1 Quantitative Traits of Start-ups:

Organizations such as national and international innovation bodies classify start-ups based on measurable data points—typically emphasizing their novelty, innovation-driven focus, and growth potential (Dalex, 2020).

Table 1: Quantitative Definitions of Start-ups

Organisation/Institution	Definition attributed to startups
OECD	A firm engaged in technological innovation of product and process for a period of one year.
European Commission EC	Young Innovation Companies (YIC) under 6 years of existence having less than 250 employees, and allocating at least 15% of their budget to R&D.
Main European Countries	To qualify as a startup, the company must simultaneously meet five conditions in accordance with Article 44 sexies-0 A of the General Tax Code.

Source: Table created based on the work of (Dalex, 2020)

I.3.1.2 The Qualitative Dimension of Start-ups

Recent perspectives on start-ups have moved beyond quantitative metrics to focus on innovation and adaptability. Steve Blank defines a start-up as a temporary organization seeking a scalable business model, highlighting its transitional nature. Eric Ries emphasizes the human element and innovation under uncertainty. Dave McClure reinforces the idea of uncertainty, noting start-ups initially lack clarity on product, customers, or revenue. These definitions converge on the view that start-ups are experimental and exploratory by nature. Once they achieve clarity and stability, they evolve into established businesses. (Resources, 2020)

I.4 Distinctions Between Small and Large Enterprises

SMEs differ from large corporations primarily through their flexibility and adaptability. According to (Franz (F.) Traxler, 2007) their simpler structures support quick decision-making and innovation. Despite facing pressures from globalization, technology shifts, and competition, SMEs remain agile. However, limited resources and scale pose significant challenges. Still, they often display unique strengths that help them compete effectively.

Despite limited resources and scale, SMEs often exhibit unique strengths that help them navigate competitive challenges. Nonetheless, SMEs often demonstrate distinct traits:

- **Personalized management** and simplified decision-making processes
- **Low specialization**, with employees performing multiple roles
- **Streamlined internal information systems**, which allow for efficient communication
- **Simplified external communication systems**, often due to close geographic proximity to their markets (Franz (F.) Traxler, 2007)

SMEs are legally categorized by their organizational structure, but the legal environment's impact on them varies widely. (Oecd (O.), 2019) highlights that legal norms interact with national, regional, and sector-specific factors. As a result, the influence of law on SMEs is highly contextual and cannot be generalized.

Section 2: Overview of SMEs in Kenya

Small and Medium Enterprises (SMEs) play a critical role in Kenya's economy, contributing significantly to employment and GDP growth. These businesses span various sectors, including agriculture, manufacturing, retail, and services, often driving innovation and regional development. Despite their importance, SMEs in Kenya face challenges such as limited access to financing, regulatory barriers, and market instability.

2.1 Classifications SMEs in Kenya

One of the main challenges in SME research is selecting an appropriate definition, as multiple definitions exist based on qualitative or quantitative criteria. The choice often depends on the researcher's focus—financial analysts may emphasize ownership or capital, while marketers consider market scope. This study, rooted in monetary and banking economics, adopts a broad definition for academic relevance. Moritz raised the question of what definition best captures the SME concept in such contexts. (Moritz, 2019)

In Kenya, SMEs are classified mainly by employee count and annual turnover. This reflects how definitions can vary based on national and institutional frameworks. The criteria are outlined as follows:

➤ **Micro Enterprises**

Number of Employees: Up to 5.

Annual Turnover: Up to Ksh 10 million.

➤ **Small Enterprises**

Number of Employees: Between 6 and 50.

Annual Turnover: Between Ksh 10 million and Kshs. 100 million.

➤ **Medium Enterprises**

Number of Employees: Between 51 and 100.

Annual Turnover: Between Ksh 100 million and Kshs. 360 million.

These classifications help shape Kenya's policy framework for SME development and guide access to financial and institutional support. (E.T. Hickey, 2022)

Table 2: Ranking of SMEs according to size

Size	Number Of Staff	Turnover
Micro Enterprise	Up to 5	10 million
Small Enterprise	6 to 50	10 to 100 million
Medium Enterprise	51 to 100	100 to 360 million

Source: Doing Business Report, 2015

2.2 Start-ups in Kenya

Kenya's start-up ecosystem has experienced notable growth over the past decade, fueled by a youthful population, expanded access to digital technologies, and favorable government policies. This section delves into the primary sectors driving innovation, prominent start-ups, the existing support infrastructure, as well as the challenges and opportunities shaping the landscape of entrepreneurship in Kenya. (Verlag, 2023)

2.2.1 Key Sectors

- **Agriculture:** Start-ups like Akorion and Ensibuuko are improving farming practices and supply chain efficiency by connecting farmers to markets, offering financial services, and providing data-driven solutions.
- **Education:** Edtech companies, such as KAINO Africa, are revolutionizing learning by making educational resources more accessible, improving outcomes, and supporting skills development through digital platforms.

- **Renewable Energy:** Companies like Solar Now and Fenix International are providing solar-powered solutions to off-grid communities, enhancing energy access and promoting environmental sustainability. (Velgar, 2007)

2.2.2 Notable Start-ups

- **Safe Boda** – Motorcycle taxi platform focused on safety and professionalism, expanding beyond Kenya.
- **Kuda** – Digital banking start-up promoting financial inclusion through user-friendly tools.
- **Solar Now** – Provider of solar solutions in rural and peri-urban areas, improving livelihoods.
- **Ezy Agric** – Agritech platform offering farmers access to inputs, market data, and financial services. (Abitekaniza, 2017)

2.2.3 Emerging Challenges

- **Limited Access to Capital** – Difficulty securing early-stage and growth funding due to strict lending requirements and lack of financial history.
- **Regulatory Hurdles** – Complex and bureaucratic regulatory framework that complicates business operations.
- **Infrastructural Constraints** – Weak infrastructure, especially in rural areas, limiting scalability.
- **Restricted Market Reach** – Challenges in expanding beyond local markets due to competition, marketing limitations, and logistical barriers. (Verlag, 2023)

2.2.4 Emerging Opportunities

- **Digital Transformation** – Opportunities created by increased smartphone and internet access for innovation.
- **Youth-driven Demand** – A young, tech-savvy demographic offering a large market for new products and services.
- **Regional Integration** – Access to wider markets through EAC membership, supporting regional expansion and trade. (Verlag, 2023)

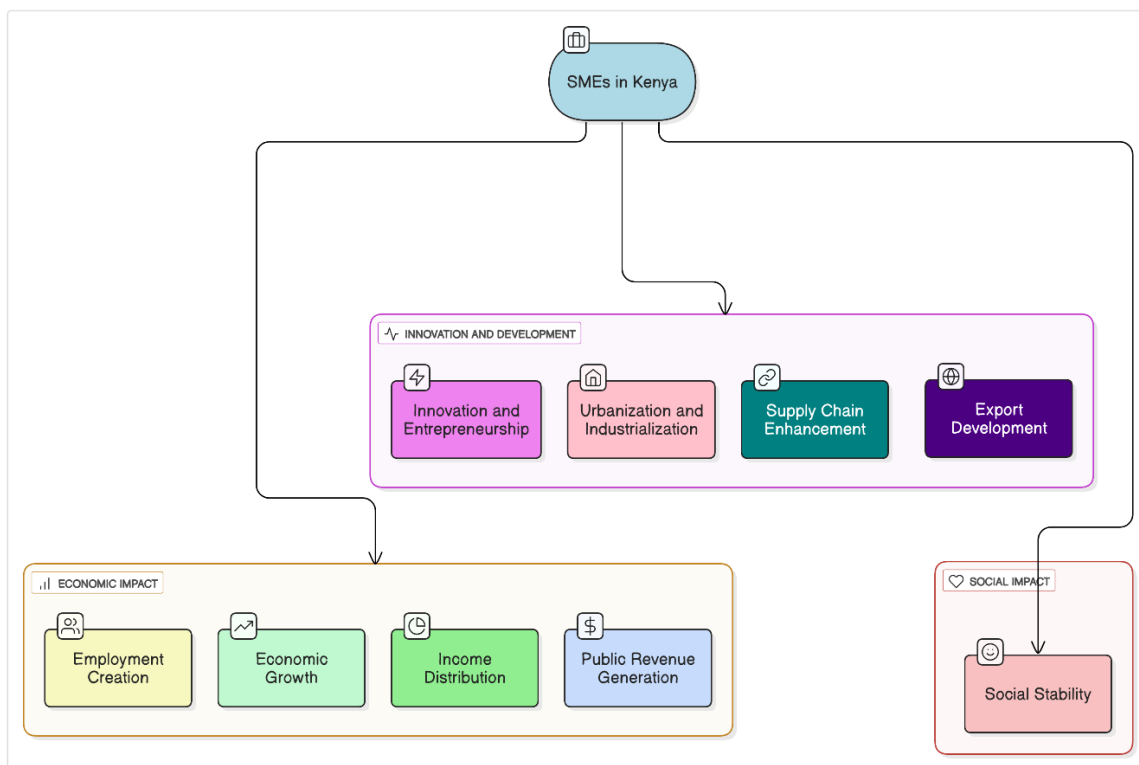
2.3 The Role of SMEs in the Kenyan Economy

- a) **Employment Creation** – Major source of jobs across various sectors.
- b) **Economic Growth** – Significant contributors to GDP and local economic activity.
- c) **Innovation and Entrepreneurship** – Promote technological advancement and entrepreneurial culture.

- d) **Income Distribution** – Improve equity by involving broader population segments.
- e) **Export Development** – Boost foreign exchange through international trade.
- f) **Urbanization and Industrialization** – Support peri-urban growth and infrastructure development.
- g) **Supply Chain Enhancement** – Link with larger firms, especially in agriculture and manufacturing.
- h) **Social Stability** – Reduce social unrest by enhancing economic participation.
- i) **Public Revenue Generation** – Contribute to national income through taxes and fees.

In sum, SMEs are indispensable to Kenya's economic fabric, functioning as engines of growth, inclusion, and innovation. (E.T. Hickey, 2022)

Figure 3: Roles of SMEs in Kenya's economy



Source: Deduction from our research work

2.4 Challenges and Opportunities for SMEs in Kenya

2.4.1 Key Challenges

- ❖ **Access to Finance** – Difficulty securing funding due to high collateral requirements, interest rates, and lack of credit histories.
- ❖ **Regulatory Complexity** – Challenges with business registration, taxation, licensing, and corruption.

- ❖ **Market Limitations** – Barriers in accessing wider markets due to limited marketing skills, high transport costs, and poor market information. (Verlag, 2023)

2.4.2 Opportunities for Growth

- ❖ **Financial Innovation** – Access to finance through fintech and mobile money services.
- ❖ **Government Support** – Public initiatives offering subsidies, grants, and business advisory services.
- ❖ **Regional Market Access** – Opportunities for cross-border trade through EAC integration. (Verlag, 2023)

Conclusion

In conclusion, SMEs are a cornerstone of Kenya's socio-economic landscape, contributing to employment, innovation, and national growth. Despite their importance, access to financing remains a critical barrier, often due to restrictive lending criteria imposed by private banks. Theoretical frameworks such as the Resource-Based View and the Life Cycle Theory of Consumption highlight the need for financial and developmental support throughout the SME lifecycle.

Empirical studies confirm that firm age, quality of financial records, and collateral availability significantly impact credit access. Addressing these constraints is vital for unlocking the full potential of SMEs in driving Kenya's economic transformation.

However, the future holds promise. Fintech innovations offer alternative financing avenues, government initiatives provide foundational support, and regional integration expands market possibilities. Through coordinated efforts by banks, government bodies, and the private sector, SMEs can overcome these hurdles, catalyze job creation, promote innovation, and bolster Kenya's economic resilience.

CHAPTER 2: BANKING SYSTEM IN KENYA.

Introduction

Banks play a crucial role in driving economic development by mobilizing resources and facilitating investment. They act as intermediaries, directing savings towards productive uses and thus fostering innovation and long-term growth. Scholars such as Schumpeter and Smith have underscored the importance of financial intermediation in promoting economic activity. A robust banking system improves liquidity, lowers transaction costs, and mitigates information gaps. This, in turn, makes it easier for businesses and households to access the financial tools they need. Ultimately, banks serve as critical instruments in the effective implementation of monetary policy.

In Kenya, the banking sector is central to the country's financial and economic progress. By providing credit and supporting everyday financial transactions, banks ensure efficient resource allocation across the economy. Technological innovations, such as credit scoring and 24/7 fund access, have enhanced the safety and convenience of banking services. Although Kenya boasts one of Africa's most developed financial systems, much of its progress has been fueled by traditional banking institutions. Despite their importance, Kenyan banks remain under-researched, with many studies focusing broadly on the financial sector. This chapter aims to fill that gap by exploring Kenya's banking system, including its regulations, reforms, and historical challenges since independence.

Section 1: Kenya's banking system: development, classification, and regulatory framework

Kenya's banking system has transformed from a state-controlled sector into a liberalized and competitive financial market. It includes commercial banks, microfinance banks, and non-bank institutions that serve diverse economic needs. The Central Bank of Kenya regulates the sector to maintain stability, protect consumers, and uphold global standards.

Chapter 2: Banking System in Kenya.

1.1 Overview of Kenya's Banking sector

The Central Bank of Kenya (CBK) was formed in 1966 after the East African Currency Board dissolved, marking a shift from regional to national monetary control. Each newly independent country, including Kenya, established its own central bank, with CBK operating under the Ministry of Finance and the Central Bank of Kenya Act.

Initially lacking autonomy, CBK gained more independence through the 1997 amendment of the Act, aligning it with Kenya's broader economic reform agenda. Its headquarters is in Nairobi, with regional branches in Mombasa, Kisumu, and Eldoret. This autonomy has allowed CBK to play a more effective role in shaping monetary policy and financial regulation. (Beck, 2004)

Kenya's banking sector is governed by the Banking Act, the CBK Act, and a range of prudential guidelines issued by the CBK. Originally dominated by local entities post-independence, the sector has evolved with increased domestic competition. Today, there are 44 licensed financial institutions, comprising 43 commercial banks and one mortgage finance firm. Of these, 31 are locally owned and 13 are foreign-owned, with the Kenya Bankers Association (KBA) serving as their collective voice. Recent growth in banking assets, deposits, and services is attributed to technological advancement, branch expansion, and a customer-centric focus, solidifying banking as the most dominant financial service in Kenya. (Beck, 2004)

1.2 Classification of Banks in Kenya

Banks in Kenya are classified into various types based on factors such as ownership, operational nature, and other distinguishing characteristics. (Velasco, 2024)

Kenya's banking sector comprises the following classifications in Kenya:

- a. Commercial banks;* These are the most common type of banks in Kenya. They offer a vast range of financial services such as, savings and checking accounts, loans, and mortgages. These banks are regulated by the Central Bank of Kenya (CBK) and serves both individuals or corporates. (Velasco, 2024)

Examples: Kenya Commercial Bank (KCB), Equity Bank, Co-operative Bank of Kenya, Standard Chartered Bank Kenya

Chapter 2: Banking System in Kenya.

b. Microfinance banks: These are banks that focuses on issuing out small loans to individuals, small enterprises, and the groups that may not be having access to commercial Banks's services. They also play a crucial role in promoting financial inclusion in rural and underserved areas. (Velasco, 2024)

Examples: Faulu Microfinance Bank, Kenya Women Microfinance Bank (KWFT), SMEP Microfinance Bank.

c. Foreign Banks: These are banks incorporated outside Kenya but operating through a branch and attachment. They operate in Kenya but they are owned by international entities. Foreign banks cater mainly to multinational companies and high-net-worth individuals. (Velasco, 2024)

Examples: Standard Chartered Bank, Barclays Bank (now Absa Bank), Citibank.

d. Investment Banks; They are banks that provides Investment related services such as advising businesses on acquisitions and mergers, underwriting new securities, and offering services for wealth management. They majorly focus more on investments and corporate financings. (Velasco, 2024)

Examples: Dyer & Blair Investment Bank, Standard Investment Bank

e. Savings and Credit Cooperative Societies (SACCOs): These aren't technically classified as banks in the legal sense but they play an essential role in the Kenya's financial sector. They are known to provide credits and savings services to their members often at favourable rates compared to commercial banks. Several SACCOs have widen their services including, mobile banking and other digital offerings. (Velasco, 2024)

Examples: Mwalimu National SACCO, Stima SACCO

f. Development Banks: These are banks that majorly focuses on economic development activities by providing long-term capital for development projects. They are typically involved in large-scale financing of infrastructural, industrial and agricultural developments. (Velasco, 2024)

Examples: Industrial Development Bank (IDB), Development Bank of Kenya (DBK)

g. Islamic Banks: These banks operate in accordance to Islamic laws (Sharia) in Kenya. They offer banking services and products that prohibits interest, in line with the Islamic prohibition on charging or paying interest (Riba). (Velasco, 2024)

Examples: Gulf African Bank, First Community Bank

Chapter 2: Banking System in Kenya.

h. Specialized Banks: These banks focus on specific sectors or activities, such as housing or agricultural finance. They provide specialised services to deal with the needs of their sectors. (Velasco, 2024)

Examples: Kenya Industrial Estates (KIE), Housing Finance Corporation of Kenya (HFCK)

i. Online Banks: These are digital banks that don't have physical branches. They operate exclusively through digital platforms, including mobile applications and online banking interfaces., offering wide range of services such as savings, loans, and online payments.

Examples: M-Shwari (offered by Commercial Bank of Africa and Safaricom), KCB M-Pesa (a mobile banking service by KCB)

These are the types of banks in Kenya, which can all be distributed according to the law and regulation under which they were certified and the type of power. Therefore, the banking sector in Kenya is wide, with several classifications dealing with different customer needs. Each type bank plays an important role in promoting financial inclusion that fosters the economic growth in Kenya. (Velasco, 2024)

1.3 The Central Bank of Kenya (CBK) and its roles

The Central Bank of Kenya (CBK), established on 24 March 1966 and operational from 14 September 1966, serves as the country's primary monetary authority. Headquartered in Nairobi, the CBK was founded after the dissolution of the East African Currency Board (EACB), which previously handled central banking functions in the region. (Njoroge, 2024)

The CBK plays a central role in Kenya's financial system, with key responsibilities including maintaining monetary stability, regulating financial institutions, and supporting sustainable economic growth. It influences crucial economic indicators such as inflation, interest rates, and exchange rates, and uses monetary policy tools to ensure price stability and financial integrity. (Njoroge, 2024)

By fostering macroeconomic stability, the CBK builds domestic and investor confidence, which promotes investment, employment, and poverty reduction. Its policies aim to create an environment conducive to private sector growth, increased productivity, and efficient resource allocation—key components of a competitive and resilient economy.

Overall, the CBK acts as both a guardian of financial stability and a driver of long-term economic development in Kenya. (Njoroge, 2024)

Figure 4: The Central Bank of Kenya (CBK)



Source: CBK's head office in Nairobi

1.4 The Kenyan Banking regulatory framework

Kenya's banking regulation is anchored in two key laws: the Central Bank of Kenya Act (Cap. 491) and the Banking Act (Cap. 488). According to Section 4(2) of the CBK Act, a core mandate of the Central Bank is to ensure liquidity, solvency, and the proper functioning of a stable, market-based financial system. Section 4A further outlines responsibilities such as licensing and supervising authorized dealers. (Beck, 2004)

To fulfill its regulatory role, the CBK enforces provisions of the Banking Act, which governs the conduct of banking business. Effective regulation helps prevent bank failures, protect depositors, and safeguard the broader economy from systemic risks. The Banking Act covers various regulatory areas, including: (Beck, 2004)

- a. Licensing requirements for new entrants.
- b. Prohibited banking activities.
- c. Reserve and dividend policies.
- d. Accounting and auditing standards.
- e. Reporting and information disclosure.
- f. Inspection and oversight procedures.

In addition to statutory laws, the CBK issues prudential guidelines and banking circulars, legally binding directives that guide policy implementation and operational standards within the banking sector. (Beck, 2004)

Section 2: Historical evolution of the banking system in Kenya

Kenya's banking system began in the early 20th century with colonial banks serving settlers and foreign businesses. After gaining independence in 1963, the government promoted financial inclusion through local banks and regulations. Since then, the sector has evolved into a diverse and modern system through reforms and innovation.

2.1. Reforms implemented to revitalize the banking sector in Kenya (1970s – 2009):

2.1.1 Early Banking Regulation and Challenges

Kenya's banking sector faced fragility due to complex balance sheets and diverse creditors. In the 1970s, the country adopted liberalization policies, supported by the World Bank, to enhance stability and efficiency. Initially, regulations focused on monetary control and asset allocation, followed by prudential supervision. At independence, foreign banks dominated, leading to the establishment of state-owned banks aimed at serving underserved populations. However, many of these institutions performed poorly, and government mandates, like agricultural lending, faced low compliance. During the 1970s, Kenya also faced economic crises due to poor trade terms, which resulted in stricter financial controls and market distortions. (Ochieng, 1992)

2.1.2 Reforms in the 1980s and 1990s

The 1980s marked the beginning of significant financial reforms, including exchange rate adjustments and inflation control, with increased foreign aid supporting the economy. The first major banking crisis in 1983 highlighted weaknesses in indigenous banks, leading to reforms in the Banking Act and the creation of the Deposit Protection Fund Board (DPFB). Throughout the 1990s, economic instability arose from ineffective monetary policies and uncontrolled money supply growth. In response, Kenya liberalized exchange and interest rates, while also strengthening regulatory oversight and implementing prudential guidelines. The Central Bank of Kenya (CBK) gained more autonomy in 1997, further bolstering its supervisory role and ensuring financial stability. (Ochieng, 1992)

2.1.3 Modernization and Financial Inclusion (2000s and beyond)

From 2000 onward, Kenya adopted global banking standards like Basel I to improve capital adequacy, strengthening its financial sector. Following the 2003 Financial Sector Assessment Program, key reforms in licensing, governance, and risk management were introduced. Vision 2030, launched in 2007, focused on promoting financial stability, efficiency, and inclusion.

Chapter 2: Banking System in Kenya.

The Finance Act of 2009 enabled agent banking, significantly expanding access to financial services. These efforts led to growth in financial depth and institutional diversity. Recent reforms have fostered greater competition, reduced government interference, and enhanced banking stability, making the sector more resilient and competitive. (Sahay, 2015)

2.2 The Growth of Kenya's Banking Sector, In response to the Reforms (1963–2010):

2.2.1 Post-Independence Financial Foundations

Following Kenya's independence in 1963, the financial sector was largely dominated by foreign banks and a few NBFIs. To assert local control, the government created the Central Bank of Kenya and established several state-owned banks. The 1970s and 1980s saw a surge in NBFIs, drawn by lighter regulation, with many converting to commercial banks.

However, weak oversight led to a mid-1980s financial crisis, prompting key regulatory reforms. Despite this, both commercial banks and NBFIs expanded, reaching 24 banks by 1988. (Kablan, 2010)

2.2.2 Reforms and Volatility in the 1990s

The 1990s brought a banking boom, with the number of commercial banks peaking at 53 by 1997. Many NBFIs transitioned into banks, encouraged by liberalization efforts and regulatory changes. However, the decade also witnessed instability due to poor governance and insufficient capital, leading to multiple bank failures. Reforms gradually strengthened the sector, and by 2010, non-performing loans had significantly dropped. These changes helped restore confidence and stability in the banking system. (Bawumia, 2010)

2.2.3 Modern Stability and Structural Shifts

In the 2000s and beyond, improved credit infrastructure enhanced sector resilience. The Credit Information Index rose between 2004 and 2007, reflecting better credit data and risk assessment. While the lending-to-GDP ratio stayed steady, credit quality improved notably. Local banks gained prominence as foreign dominance waned, and state involvement in banking decreased. The result is a more diversified, locally driven financial system with stronger institutional foundations. (Bawumia, 2010)

Chapter 2: Banking System in Kenya.

Table 3: Growth of Banking Sector in Kenya (2000-2010)

Indicators	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Domestic credit provided to private sector by banking sector as a percentage of GDP	39.2	37.5	40.3	39.8	40.2	38.4	38.0	37.3	40.5	44.8	51.0
Loans net of provisions	20.9	20.2	20.9	20.5	22.8	23.5	23.6	24.8	—	—	—
Bank non-performing loans to total gross loans	33.3	13.1	18.1	34.9	29.3	25.6	21.3	10.9	9.0	7.9	6.3
Credit depth of information index	—	—	—	—	0	2	2	4	4	4	4
Foreign (%)	44.3	46.3	48.3	48.7	45.3	43.4	43.8	43.5	—	—	—
Private Domestic (%)	21.9	22.7	22.6	24.1	25.7	28.7	29.9	31.0	—	—	—
Government (%)	7.1	7.1	6.6	6.0	6.2	5.6	5.3	4.8	—	—	—

Source: World Bank Developments Indicators (2012)

The growth of ATMs in Kenya, especially after 2002, reflects the banking sector's technological advancement and improved access to affordable financial services. By 2008, the country had 1,510 ATMs, serving more low-income users. Microfinance has expanded in rural areas, increasing competition and financial inclusion. Seeing its potential, mainstream banks have re-entered rural markets and introduced simplified products. Some have launched their own microfinance services or formed partnerships to reach underserved populations.

2.3 Growth of Kenya's Banking Sector in 2023 and Strategic Diversification

Kenya's banking sector showed a strong recovery in 2023, with total assets growing by 17.6% to Kshs. 7.7 trillion, marking a return to pre-2015 growth levels. Large banks led this expansion, while smaller ones posted modest gains. The asset mixes diversified, with loans making up nearly half, and placements and non-traditional assets increasing. Lending rose 15.3%, driven by demand in agriculture, trade, and manufacturing, mainly supported by large banks. Deposits grew 15.1% due to digital banking and customer trust, pushing liabilities to Kshs. 6.7 trillion. Despite high market concentration, competition improved slightly. The loan-to-deposit ratio declined, reflecting stronger deposit growth. Strategic diversification and digital advances underscored the sector's resilience and stability. (Beck T. C., 2010)

Section 3: Overview of the SMEs financing landscape in Kenya.

SMEs form the backbone of Kenya's economy, accounting for 98% of businesses and 24% of GDP. Despite their importance, only 16% access formal loans, forcing most to depend on informal financing. Challenges like high interest rates, lack of collateral, and low financial literacy limit their growth and scalability.

3.1 The Strategic Role of Micro, Small, and Medium Enterprises (MSMEs) in Kenya's Economic Growth

The SME sector in Kenya is a major driver of innovation, job creation, and economic development, aligning closely with the country's Vision 2030 goals. Recognizing this, the banking industry has significantly focused on supporting Micro, Small, and Medium Enterprises (MSMEs).

Kenya leads in Africa in SME lending, with 20.5% of bank income derived from this segment—double that of Nigeria. To track progress, the Kenya Bankers Association (KBA) initiated an annual SME survey starting in 2014. This data-driven approach has helped banks tailor strategies and deepen engagement with the MSME sector. (Njoroge, 2024)

3.2 Financial Innovation and Supportive Services for MSMEs

Banks in Kenya have developed a diverse portfolio of financial products for MSMEs, ranging from loans to value-added services. The 2014 and 2015 KBA surveys revealed that banks were offering between 3 to 40 SME-specific products, averaging nine per institution. These offerings include financial tools, training, mentorship, and networking opportunities. Lending to MSMEs rose from Sh190 billion in 2013 to over Sh203 billion in 2014. Banks now recognize that today's small business can become tomorrow's multinational, and supporting this growth is both a strategic and profitable investment. (Njoroge, 2024)

3.3 Non-Financial Support and Strategic Expansion: Capacity Building and Regional Expansion

Kenyan banks have expanded their role beyond traditional financing to include capacity building, advisory services, and even organizing international business trips for MSMEs. These efforts aim to address non-financial challenges such as marketing, accounting, and access to new markets. Banks also seek collaboration with KBA to influence policy, improve regulations, and ensure equitable resource distribution. Furthermore, the intense domestic competition has driven Kenyan banks to expand regionally, with 11 operating outside Kenya, including in high-potential markets like South Sudan and the DRC, where Kenyan MSMEs are also active. (Njoroge, 2024)

Recommendations to Address Challenges in the Banking Sector

Since independence in 1963, Kenya's banking sector has evolved from being dominated by foreign-owned banks to a more diversified system with significant local ownership. The government played a key role early on by establishing the Central Bank and state-owned financial institutions. Non-bank financial institutions expanded in the 1970s and many converted to banks in the 1990s, contributing to sector growth.

However, crises in the 1980s and 1990s revealed weaknesses like undercapitalization and poor governance, prompting major reforms. Regulatory improvements, stronger supervision, and better credit infrastructure helped reduce non-performing loans and enhance financial stability. Credit access improved with rising credit information scores, and the private sector's role grew. Overall, the sector has become more stable, competitive, and locally driven. While historical reforms have shaped the structure of Kenya's banking system, recent years have seen a strategic pivot towards inclusivity, particularly in financing small and medium enterprises (SMEs).

Conclusion

This chapter has provided a comprehensive overview of Kenya's banking sector, examining its evolution since independence in 1963, the reforms implemented over the past several decades, and the persistent challenges it faces. The Kenyan government has continuously implemented reforms aimed at strengthening the banking sector, focusing on enhanced risk management, corporate governance, regulatory frameworks, and fostering healthy competition.

These efforts have been designed to improve the sector's ability to contribute to the real economy by efficiently intermediating between savers and borrowers. While these reforms have brought positive changes, the banking sector still grapples with issues such as high-interest rate spreads, high overhead costs, and limited financial inclusion, particularly in rural areas.

CHAPTER 3: METHODOLOGY AND RESEARCH ANALYSIS.

Introduction

This final chapter consolidates the key findings from my research into the challenges faced by Small and Medium Enterprises (SMEs) in Kenya when seeking financing from financial institutions like banks. Despite their critical role in driving economic growth and job creation, SMEs encounter significant barriers that hinder their access to essential financial resources. The study delves into these obstacles, aiming to identify the underlying causes and their broader impact on the financial landscape.

The research focuses on understanding the principal challenges SMEs face in securing financing, with particular attention to bank lending practices. By analyzing data and integrating financial theories, this chapter provides a deeper understanding of how various factors influence lending decisions. The conclusions and recommendations offer practical strategies to overcome these challenges, advocating for targeted financial reforms and improvements within the banking sector to create a more supportive environment for SME growth and sustainability.

Section 1: Methodology

This section outlines the approach to data collection for achieving the research objectives. It covers the research design, study population, sampling techniques, data collection methods, and analysis. Additionally, it addresses validity, reliability, ethical considerations, and study limitations.

1.1 Research Design

To answer the question on challenges SMEs in Kenya face in accessing bank financing, a cross-sectional survey design was used. This combined quantitative and qualitative methods to gather data at one point in time. The approach allowed for analysis of population traits and variable correlations. It was well-suited for comparing multiple factors in the Kenyan context.

1.2 Target Population

A target population refers to a group with a shared characteristic relevant to the researcher's study. Before selecting this population, the researcher ensures the study problem directly or indirectly impacts them.

In Kenya, the study focused on at least five SMEs from each of the country's five regions—East, West, South, Central, and Northern Kenya. However, the primary focus was on SMEs in Nairobi with county business permits from local governments.

1.3 Sampling Technique

The study used a purposive sampling technique to select SMEs relevant to the research objectives. At least five SMEs were chosen from each of Kenya's five regions: East, West, South, Central, and Northern. However, the main focus was on SMEs based in Nairobi with valid county business permits. This approach ensured participants were directly affected by the study topic. It helped capture diverse insights while emphasizing the capital's business environment

1.4 Instrumentation

According to (Beck T. D.-K., 2002), questionnaires are an efficient data collection tool but must be carefully designed to ensure accurate and meaningful results. This study used both open and close-ended questions, with the latter featuring a five-point Likert scale ranging from Strongly Agree to Strongly Disagree. The design followed a conceptual framework outlining the key variables and sub-variables. The combination of open-ended and close-ended questions aimed to provide both detailed insights and targeted responses, enhancing data reliability and depth.

1.5 Data Collection Procedures

The study utilized both primary and secondary data, with primary data collected directly from the field. A questionnaire was the main tool used due to its simplicity and cost-effectiveness. It was distributed with an introductory letter explaining the study's objectives. Respondents were given two weeks to complete and submit the questionnaire.

1.6 Data Analysis

This study employed descriptive analysis to interpret survey data, identifying trends and categorizing responses to uncover the challenges SMEs face in accessing bank financing in Kenya. Comparative analysis was also used to highlight similarities and differences across various SME types. Together, these methods offered a nuanced understanding of the factors influencing SME financing. Ultimately, this approach helped identify key themes and insights crucial to the research.

Section 2: Results and Analysis

The analysis of the study's conclusions based on the information obtained from the respondents is presented in this section. Descriptive as well as inferential analysis were performed. Different charts such as tables and graphs were all employed in the study to present the results.

Table 4: Response Rate of the research and the results

	Frequency	Percentage%
Successful	32	78%
Unsuccessful	9	22%
Total	41	100

Source: Elaborated by us from the data obtained

The study, which concentrated on small and medium sized businesses, was carried out in the different regions of Kenya. The respondents received a total of 41 questionnaires, and 32 of them were fully completed when they were returned. This translates to a satisfactory response rate for the research of 78%. (Njoroge, 2024) indicate that a response rate of sixty percent is deemed adequate, while a rate of seventy percent is deemed exceptional and suitable for analysis.

2.1 Demographic Characteristics of Respondents.

The study analyzed respondents' gender, age, education, workforce size, business duration, and ownership type to understand their demographic profile. This data helped clarify the background of participants. To ensure fair representation, deliberate efforts were made to select respondents equitably. This approach aimed to give everyone an equal chance to participate and have their views fairly represented.

2.1.1 Gender.

The gender distribution of the respondents is shown in Table III.3 below

Table 5: Gender Distribution

Gender	Frequency	Percentage
Male	22	68.8
Female	10	31.2
Total	32	100

Source: Constructed by us using results from the Survey

According to the findings, there were 68.8% male participants and 31.2% female participants. This shows that the respondents' genders were properly distributed, showing that there was no obvious gender imbalance in the study. You can refer to Table 2.2 for a visual representation of this information.

2.1.2 Education Level.

The education background of respondents is presented in table below.

Table 6: Education Level

Years	Frequency	Percentage (%)
Post Graduate	2	6.25
Degree	18	56.25
Diploma	7	21.88
Certificate	5	15.62
Total	32	100

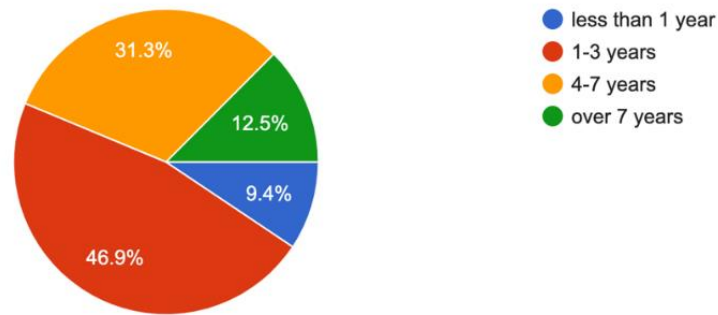
Source: Constructed by the authors using results obtained from the survey

2.1.3 Years of Operation.

The purpose of the study was to determine the number of years that the respondents to the study had been in business. The results are presented in Figure below

Figure 5: Years of Operation

Years of operation for this business?
32 responses



Source: Prepared by us using the data obtained from the survey

The findings showed that 9.4% of respondents had been in business for less than a year, 46.9% for one to three years, and 31.3% for four to seven years. Additionally, 12.5% had operated for over seven years. These figures reflect a wide range of business experience among participants. This variation suggests that respondents had sufficient knowledge to provide meaningful insights for the study.

2.1.4 Number of Employees.

The study sought to investigate the number of employees employed by each business. The findings of the study were presented in the table below.

Table 7: Number of Employees

Number of Employees	Frequency	Percentage (%)
Less than 5 Employees	17	53.1
6 – 50 Employees	12	37.5
51 – 100 Employees	0	0
101 and Above Employees	3	9.4
Total	32	100

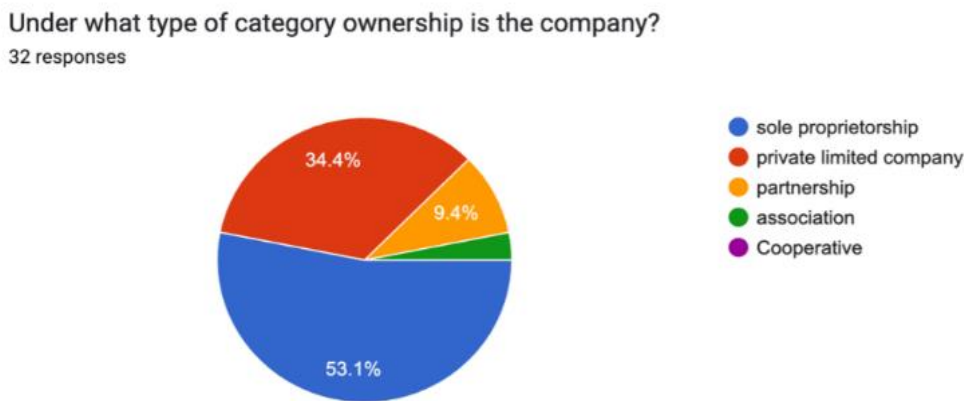
Source: Constructed by the authors using data obtained from the survey

The findings revealed that 53.1% of respondents employed fewer than five staff, 37.5% employed between 6-50 workers, and none employed 51-100 staff. Only 9.4% had over 101 employees. This suggests that most businesses were small in size, with the majority employing fewer than five workers.

2.1.5 Business Ownership.

The researcher sought to find out the business ownership categories that the respondents of the study were involved in. Findings are presented in figure below.

Figure 6: Business Ownership category



Source: Prepared by the authors using data obtained from the survey

The majority of respondents, 53.1%, reported their businesses as private limited companies, making it the most common ownership type. Sole proprietorships accounted for 34.4%, highlighting a significant number of small, individual-owned businesses. Partnerships and associations were less common, at 9.4% and 3.1%, respectively, while cooperatives had no representation. This distribution shows a clear dominance of private limited and sole proprietorship structures in the sample, with less focus on cooperative and associative models.

2.2 Descriptive Statistics Analysis

For each of the study's four variables, descriptive statistics are provided in this section. Illustrative measurements and rates, were utilized to sum up and depict these factors.

The scale utilized for the factors went from 1 to 5, with 1 specifying "strongly agreed" (SA), 2 indicating "agreed" (A), 3 indicating "neutral" (N), 4 indicating "disagreed" (D), and 5 indicating "strongly disagreed" (SD).

2.2.1 Interest Rates

The responses to the survey, which were asked to share their thoughts on the following statements about interest rates, are shown in table below.

Table 8: Statistics for Interest Rates

Statements	SA%	A%	N%	D%	SD%
The majority of SME enterprises in Kenya pay significantly high interest rates to banking institutions.	62.5	31.25	0	3.125	3.125
Many SMEs are deterred from seeking banking institutions for lending facilities by the high-interest rates.	34.375	50	6.25	6.25	3.125
The prevailing lending rates offered by financial institutions have had a discouraging effect on many SME owners, leading them to hesitate in seeking both short-term and long-term loans for their businesses.	56.25	31.25	9.375	0	3.125
Financial institutions tend to exhibit bias when assessing SMEs for loans or credit, in contrast to large corporates.	21.875	40.625	28.125	6.25	3.125

Source: Constructed by the authors using information obtained from the research.

The study found that high interest rates charged by banking firms in Kenya are a major barrier for SMEs, with 93.75% of respondents agreeing that the rates are excessive, and 84.375% stating that these high rates deter them from seeking loans. Only a small minority disagreed or remained neutral, highlighting the widespread concern about interest rates. Additionally, 87.5% of participants noted that current lending rates influenced their hesitation to take both short-term and long-term loans, further discouraging borrowing.

The study also revealed a perceived bias in loan evaluations, with 62.5% believing that SMEs are seen as riskier than larger corporations, limiting their financing options. These findings align with previous studies by Maalim and Gikandi (2016) and Chilembo (2021), which also linked high interest rates to reduced credit access and financial strain for SMEs. The study stresses the need for fairer lending practices and interest rate reforms to enhance financial support for SMEs.

2.2.2 Credit Profile.

Respondents were asked to provide their feedback on various statements regarding their credit profile, and the results are presented in table below.

Table 9: Statistics for Credit Profile

Statements	SA%	A%	N%	D%	SD%
Poor credit rating has led to challenges in accessing finance from financial institutions.	40.625	50	9.375	0	0
Previous credit facilities limit access to current credit.	37.5	25	25	12.5	0
Borrowers not having a credit history are deemed to be risky.	56.25	15.625	12.5	15.625	0
Listing by mobile apps prevents SME's from accessing credit from financial institutions	41.25	38.125	15	5.625	0
There is not enough credit available to invest in expanding new businesses.	25	37.5	31.25	6.25	0

Source: Constructed by author using data obtained from the survey

The study revealed that poor credit ratings are a major barrier to SME funding, with 90.625% of respondents identifying them as a key obstacle to securing bank loans. Only 9.375% remained neutral, and none disagreed, underscoring the significant role of creditworthiness in accessing finance.

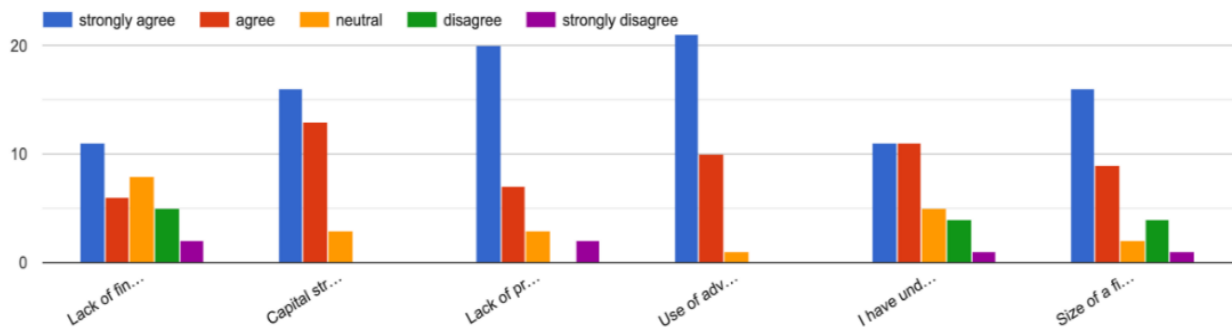
Additionally, 62.5% agreed that prior credit facilities limited their current borrowing potential, while 71.87% believed that borrowers without credit history were seen as high risk. The research also found that 79.375% viewed mobile app listings as hindering credit access, likely due to negative data sharing practices. Furthermore, 62.5% felt that there was insufficient credit available for business expansion, limiting growth opportunities. These findings support earlier research by (Njoroge, 2024), who noted high loan rejection rates and a reliance on informal financing due to poor credit profiles. The results highlight the systemic challenges SMEs face in establishing creditworthiness. Overall, the study calls for improved credit assessment mechanisms and broader access to formal financial services to support SME development.

2.3 SME's Performance.

The respondents were asked to express their opinions on specific statements related to the performance of SMEs, and their views are presented in figure below.

Figure 7: Statistics for Financial Performance

Kindly tick appropriately whether you agree with the statements relating to the effect of performance on credit access from financial institutions, where (SA-strongly agree, A-agree, N-Neutral, D-Disagree, SD-strongly disagree).



Source: Elaborated by us using data and results obtained from the survey.

The study reveals that limited funding from financial institutions significantly hinders SME performance, with 53.125% of respondents citing financing shortages as a major constraint. A vast 90.625% emphasized the critical role of capital structure in determining business success, linking access to funding directly with firm growth. Inadequate operational funds were a persistent challenge for 68.75% of respondents.

The study also found that larger firms had better loan access, with 78.125% acknowledging financing inequalities based on business size. Financial literacy and credit management training were identified as key for improving SME financial performance. Strong capital bases, proper documentation, and sound financial analysis were essential factors for credit access. These findings align with (Oecd (O.), 2019), who linked reduced credit constraints with faster firm growth in Africa. The study calls for inclusive lending systems, improved financial education, and reforms to expand financing access for SMEs, promoting their growth and sustainability.

2.3.1 Collateral Requirements.

Respondents were requested to indicate their views on the following statements in relation to collateral requirements and their views were presented in table below.

Table 10: Statistics for Collateral Requirements

Statements	SA%	A%	N%	D%	SD%
The limited ability of SMEs to provide tangible assets as security hinders their access to credit facilities.	71.875	9.375	18.75	0	0
The absence of fixed assets poses a challenge for many SMEs in accessing credit.	56.25	25	15.625	0	3.125
Borrowing by SMEs is discouraged due to the costs associated with the collateralization process, such as legal fees, stamp duty, valuation, insurance, and others.	31.25	43.75	18.75	6.25	0
SMEs are discouraged from borrowing due to the lengthy process involved in registering and creating a charge on the security they pledge to financial institutions.	21.875	46.875	15.625	12.5	3.125
Potential borrowers are discouraged from borrowing due to the strict and demanding credit terms imposed by financial institutions.	62.5	12.5	18.75	3.125	3.125

Source: Prepared by me, the authors using the data obtained from the survey.

The study highlights that SMEs in Kenya face significant challenges accessing credit, primarily due to the inability to provide tangible collateral, with 81.25% of respondents identifying this as a major barrier. The lack of fixed assets exacerbates this issue, as lenders prefer asset-backed loans, excluding many small businesses. Additionally, 75% of respondents pointed to high collateral-related costs, including stamp duty, insurance, and legal fees, as major deterrents. Long and complex registration procedures were cited by 68.75% as further obstacles. Stringent loan terms were also a discouraging factor for 75% of respondents, reinforcing the financial barriers.

These findings align with previous studies by Mumin (2018) and Ndungu (2016), which identified collateral and loan conditions as consistent issues. The study emphasizes the need for reforms in the financial sector to reduce collateral requirements, simplify procedures, and improve credit access for SMEs.

2.3.2 Access to Finance

Respondents were asked to indicate their views on the following statements relating to access to finance and their views presented in table below.

Table 11: Statistics for Access to Finance

Statements	SA%	A%	N%	D%	SD%
Poor access to credit has been a result of inadequate or non-existent collateral.	46.875	31.25	15.625	6.25	0
Compared to medium and small enterprises, large enterprises have a higher likelihood of accessing credit easily.	62.5	31.25	6.25	0	0
Loans are completely denied to borrowers who are deemed to be not creditworthy.	46.875	34.375	15.625	3.125	0
Poor access to credit by SMEs is attributed to a lack of awareness on funding opportunities.	25	40.625	18.75	9.375	6.25
Insufficient credit is available for investment in new business expansion.	31.25	31.25	18.75	9.375	9.375

Source: Constructed by us using data obtained from the survey.

The study found that a lack of collateral is a major hurdle for SMEs seeking credit, with 78.125% citing it as a key barrier, restricting financing especially for smaller firms with limited assets. Additionally, 93.75% agreed that large enterprises enjoy better credit access, showing a systemic bias toward asset-rich businesses. This highlights a structural imbalance in lending, where firms perceived as low-risk are favored. Such preferences marginalize smaller businesses and call for more inclusive credit assessment models. Moreover, 81.25% noted that uncreditworthy applicants are often denied loans, while 65.625% identified limited awareness of financing options as a constraint. This reflects gaps in financial literacy and access to credit information. Also, 62.5% believed that credit shortages hinder business growth and expansion. Together, these insights echo prior findings like Kung'u (2011), stressing that collateral requirements, perceived creditworthiness, and information asymmetry shape SME financing outcomes.

2.4 Discussion of Research Findings.

The study found that high interest rates significantly hinder access to finance for SMEs in Kenya on the discouragement of costly borrowing. Larger SMEs have better credit access than micro enterprises, aligning with (Vemic, 2018). Systemic issues such as credit rating policies and penalties further constrain access, especially for SACCOs. These barriers underscore deep-rooted financial ecosystem challenges that restrict SME growth. Firm size and institutional frameworks emerged as key factors influencing financial access. Credit profiles were crucial, supporting (Njoroge, 2024) on the role of credit reporting in borrower screening. (Oecd (O.), 2019) highlighted SMEs' lack of financial records and collateral as persistent obstacles. Better-performing SMEs typically receive more favorable loan terms. However, collateral can either help or hinder access, depending on the situation. Overall, financial, operational, and systemic elements jointly shape SME funding access in Kenya.

Section 3: Summary, Conclusion, and Recommendation:

This section provides a concise overview of the key findings, draw conclusions based on those findings, and offer recommendations that align with the topic and objectives of the study.

3.1 Summary of the Findings

This study's research strategy was a descriptive survey method, coupled with the application of multiple regression analysis for data investigation and analysis. Access to finance was

measured by interest rate, credit profile, SME's performance, and collateral requirements. The study's conclusions showed that these characteristics had a favourable and statistically significant influence on the availability of credit.

3.2.1 Effects of Interests Rates on SME's Access to Finance

This study's main goal was to investigate how interest rates affect SMEs' access to financing Kenya. The results showed a notable link between interest rates and the ability of SMEs to access finance in Kenya. Aspects of interest rates such as CBK's interest rate caps and interest changed by banks raises the interest charged on loans making them more expensive for SMEs.

3.2.2 Effect of Credit Profile on SMEs Access to Finance

In addition to examining the impact of interest rates, this study also sought to investigate the influence of credit profile on the access to finance for SMEs in Kenya. The findings revealed a notable and positive correlation between credit profile and the ability of SMEs to access finance in the country.

Various aspects of credit profile such as CRB rating and listing prevents most SME's from accessing loans from most financial institutions where the rating is a determinant to accessing finance.

3.2.3 Effect of SME's Performance on SME's Access to Finance

Examining the effect of SMEs' performance on their ability to acquire financing in Kenya was another goal of this study. Results showed that the effectiveness of an SME had a substantial impact on SME's access to finance in the different regions of Kenya. Various aspects of performance such as return on assets affected SME's performance and was a big determinant to access to finance by SMEs in Kenya.

3.2.4 Effect of Collateral Requirements on SME's Access to Finance

The goal of the study was to determine how collateral restrictions affected SMEs' ability to get financing in Kenya. The results showed a negative and statistically significant correlation between the need for collateral and SMEs' ability to receive financing in the country. Factors such as the value and level of collateral were identified as influential in determining SMEs' ability to access finance.

3.2 Key Insights.

The research highlights that high interest rates significantly limit SMEs' access to financing in Kenya, as the cost of loans becomes unaffordable for many. Additionally, credit profiles,

particularly for SMEs listed on the Credit Reference Bureau (CRB), hinder their ability to obtain loans from financial institutions. The performance of SMEs is another key factor, as financial institutions assess business success before granting credit. Collateral requirements also pose challenges, with many SMEs unable to provide the necessary assets, and the added costs of collateralization further discourage loan applications. These barriers restrict SMEs' growth potential by limiting their access to financial resources.

3.3 Recommendations

The study suggests reviewing interest rates set by banks and financial organizations to help SMEs access funding for expansion. It recommends legislation to harmonize these rates across institutions, improving accessibility. Furthermore, alternative collateral options should be explored, as most SMEs lack the typical assets like titles and logbooks required by lenders. One solution could be mutual business guarantees among SMEs. The study also advocates for more inclusive credit rating policies that would allow SMEs to obtain the necessary finance for sustainable operations. Lastly, it calls for government action to develop collateral guarantee alternatives through legislation, ensuring that SMEs can access the funds they need for growth.

Conclusion

This research explores the obstacles that individuals and SMEs face in accessing credit from financial institutions, highlighting barriers such as high interest rates, strict collateral requirements, low financial literacy, and insufficient resources. These challenges create a disconnect between borrowers and lenders, limiting opportunities for both personal and business growth, with SMEs being particularly impacted. The study calls for reforms in the financial sector, including improving financial literacy, reducing collateral demands, and regulating interest rates. It also suggests using advanced analytics for better credit assessments to bridge the credit gap. More inclusive lending practices could foster innovation, business expansion, and long-term economic growth.

An integrated approach involving policymakers, financial institutions, and educational bodies is essential to implement these recommendations effectively. Collaboration can ensure that reforms are tailored to the unique needs of SMEs and underserved populations. Additionally, digital financial tools and platforms can play a crucial role in broadening access and streamlining loan processes. By embracing innovation and inclusivity, the financial sector can become a catalyst for equitable economic development.

GENERAL CONCLUSION

The financing of Small and Medium Enterprises (SMEs) in Kenya remains a critical issue in the country's economic development agenda. This study was anchored on the persistent challenge that despite the recognized contribution of SMEs to employment creation, innovation, and GDP growth, their access to finance—particularly from formal financial institutions such as banks—remains significantly constrained. The problem statement highlighted the financing gap that limits SME growth and sustainability, largely due to factors including lack of collateral, high interest rates, limited credit history, and stringent bank lending policies.

Using a mixed-methods approach, the research employed both qualitative and quantitative methodologies. Data were gathered through structured questionnaires administered to SME owners and interviews with bank credit officers. This was supplemented by a review of secondary data from financial institutions, government reports, and academic literature. The methodology was designed to offer a comprehensive understanding of both the SME and financial institution perspectives on credit accessibility.

The findings of the study revealed several key challenges that hinder SMEs from accessing finance from banks. Among the most prevalent issues were lack of sufficient and acceptable collateral, inadequate financial documentation, and limited business credit histories. Many SMEs operate informally and do not maintain proper financial records, which hampers their ability to meet the due diligence requirements of banks. Furthermore, banks perceive SMEs as high-risk borrowers, which contributes to high interest rates and unfavorable loan terms. The bureaucratic and time-consuming loan application processes were also identified as significant deterrents. Additionally, a lack of awareness and financial literacy among SME owners further compounds the problem, as many are not familiar with available financial products or how to structure their businesses to qualify for loans.

Despite its contributions, this research faced a few limitations. Firstly, the study was largely focused on urban areas, particularly Nairobi and its environs, where access to formal banking institutions is relatively better. Consequently, the experiences of SMEs in more remote or rural areas may not be fully captured.

General Conclusion

Additionally, the sample size, though statistically significant, may not wholly represent the full spectrum of Kenya's SME sector, which is diverse in terms of size, industry, and maturity. Furthermore, some SME owners were reluctant to share financial information, which may have limited the depth of some data insights.

In light of the findings and limitations, the study opens up several avenues for future research. There is a need for in-depth regional studies that explore the unique financing challenges faced by rural-based SMEs. Future studies could also delve into the role of alternative financing options such as microfinance institutions, SACCOs, fintech platforms, and venture capital in addressing the SME credit gap. Additionally, further research could explore the effectiveness of government-backed credit guarantee schemes and financial literacy programs in enhancing SME access to finance. A comparative analysis between sectors could also offer insights into how specific industries fare in accessing finance and what targeted interventions might be effective.

In conclusion, addressing the challenges faced by SMEs in accessing bank finance requires a multi-faceted approach. Financial institutions need to adapt their lending models, policymakers must foster a conducive regulatory environment, and SMEs themselves must be empowered through education and capacity building. Only through such concerted efforts can the financing landscape for Kenyan SMEs be transformed to support sustainable business growth and economic development.

BIBLIOGRAPHY

- Abdulsaleh, A. M. (2013). *Small and Medium Sized Enterprises Financing: A Review of Literature*. International Journal of Business and Management.
- Abitekaniza, J. (2017). Enhancing Youth Employment and Small Firms Growth. *Conference Hall at Silver Springs*.
- Allen N. (A. N.) Berger, .. G. (1998). The economics of small business finance: The roles of private equity and debt markets in the financial growth cycle.
- Al-Qirim, N. A. (2004). *Electronic Commerce in Small to Medium-Sized Enterprises: Frameworks, Issues and Implications*. Australia: Idea Group Pub., Hershey, PA,.
- Ayyagari, M. B.-K. (2003). *Small and medium enterprises across the globe*:. Washington DC: World Bank Publications.
- Bank, W. (2006). *World Development Indicators*. World Bank.
- Bawumia, M. (. (2010). *Monetary Policy and Financial Sector Reform in Africa; Kenya's Experience*. CreateSpace.
- Beck. (2004). *Structural Issues in the Kenyan Financial System: Improving Competition and Access*. World Bank Publications.
- Beck, T. C. (2010). *Banking sector stability, efficiency and outreach in Kenya*. The world bank policy research working paper.
- Beck, T. D.-K. (2002). *Small and Medium Entreprises, Economic Growth and Development*. Mimeo: World Bank.
- CBS, I. a.-R. (1999). *National micro and small enterprise baseline survey*. Kenya: Central Bureau of Statistics (CBS), International Center for Economic Growth (ICEG).
- Dalex, K. (2020). *DIncubators, start-ups, and partnerships*. Strasbourg.: Doctoral thesis,.
- E.T. Hickey, A. K. (2022). *The role of small and medium agrifood enterprises in rural transformation – The case of rice processors in Kenya*. Nairobi: Food & Agriculture Org.
- Franz (F.) Traxler, .. G. (2007). *Handbook of Business Interest Associations, Firm Size and Governance*.. *A comparative analytical approach*. Routledge.
- Kablan, S. (2010). *Banking efficiency and financial development in Sub-Saharan Africa*. International Monetary Fund.

Bibliography

- Kenya, G. o. (2007). *Economic Survey by Ministry of Planning and National Development*. Nairobi: Government of Kenya.
- Lassala, C. &.N. (2022). *Financing startups: Understanding Strategic Risks, Funding Sources, and the Impact of Emerging Technologies*. Springer Nature.
- Liedholm, C. (2001). *Small firm dynamics: Evidence from Africa and Latin America*. World Bank Institute. Retrieved from <http://siteresources.worldbank.org/WBI/Resources/wbi37189.pdf>
- Moritz, A. (. (2019). *Contemporary Developments in Entrepreneurial Finance*. Springer Nature.
- Njoroge, P. (. (2024). *50 Years of Central Banking in Kenya*. Oxford University Press.
- Ochieng, W. R. (1992). *An Economic History of Kenya*. East African Publishers.
- Oecd (O.). (2019). *OECD SME and Entrepreneurship Outlook*. OECD Publishing.
- Omolo, J. a. (2005). *Difficulties of employment creation in micro and small enterprises in Kenya*. (IPAR DP No. 071/2005, Ed.) Nairobi: Institute for Policy Analysis and Research.
- Patricof, A. J. (2005). *Venture capital for Development*. Retrieved from <http://www.brokings.edu/>
- Report, D. B. (2015). *Doing Business Report*. The World Bank.
- Resources, M. A. (2020). *Start-Ups and SMEs: Concepts, methodologies, tools, and applications*. IGI Global.
- Sahay, M. C. (2015). *Financial inclusion*. International Monetary Fund.
- Srivastava, B. T. (1996). *Structural aspects of manufacturing in sub-Saharan Africa: : Findings from a seven country enterprise survey*. World Bank Discussion Paper No. 346.
- Velasco, C. (. (2024). *Commercial Banking in Kenya*. Taylor & Francis.
- Velgar, L. (2007). *Strategies for Securing Energy Supply in Kenya*. Nairobi: Lit Velgar.
- Vemic, M. 1. (2018). *Strategic Optimization of Medium-Sized Enterprises in the global market*. USA: Hershey, PA., IGI Global,.
- Verlag, L. (. (2023). *Business Opportunities, Start-ups, and Digital Transformation in Africa*. LIT Verlag.

APPENDICES

SME Financial Access Survey Questionnaire

Target Respondents: Owners or financial managers of Small and Medium Enterprises

❖ **Background Information;**

1. Name of the enterprise (Optional):
2. Type of business activity:
3. Year of establishment:
4. Number of employees:
☐ 1–5 ☐ 6–20
☐ 21–50 ☐ 51–100
5. Approximate annual turnover (Kshs):
☐ Less than 500,000 ☐ 500,000 – 2 million
☐ 2 million – 10 million ☐ Over 10 million

❖ **Loan Application Experience;**

6. Have you ever applied for a loan from a formal financial institution?
☐ Yes ☐ No
7. If no, what is the main reason? (Select one)
☐ Perceived complexity of process ☐ Fear of rejection ☐ No need for credit
☐ Other (please specify):
8. If yes, how many times in the past 5 years?
☐ 1 ☐ 2–3 ☐ More than 3
9. What was the outcome of your most recent loan application?
☐ Approved in full ☐ Partially approved ☐ Rejected
10. If rejected, what reason was provided? (Select all that apply)
☐ Inadequate collateral ☐ Insufficient business records
☐ High perceived risk ☐ Other (please specify):

❖ **Loan Terms and Conditions;**

11. What type of collateral was required (if any)? (Select all that apply)
☐ Land title deed ☐ Vehicle logbook ☐ Business assets
☐ Guarantors ☐ None
12. What interest rate were you offered (approximate % per annum)?
☐ Below 10% ☐ 10% – 15%
☐ 16% – 20% ☐ Over 20%
13. Were the loan terms clear and easy to understand?
☐ Yes ☐ No ☐ Somewhat

❖ **Open-Ended Questions**

21. In your opinion, what are the main challenges SMEs face when seeking credit from formal financial institutions?
22. What improvements would you suggest to make credit more accessible to SMEs?.....

Thank you for your participation!

Your input is valuable in understanding and addressing the financial access challenges faced by SMEs.

LIST OF ILLUSTRATIONS

Table 1: Quantitative Definitions of Start-ups	10
Table 2: Ranking of SMEs according to size.....	12
Table 3: Growth of Banking Sector in Kenya (2000-2010)	23
Table 4: Response Rate of the research and the results	29
Table 5: Gender Distribution	30
Table 6: Education Level	30
Table 7: Number of Employees	31
Table 8: Statistics for Interest Rates	33
Table 9: Statistics for Credit Profile	34
Table 10: Statistics for Collateral Requirements.....	36
Table 11: Statistics for Access to Finance.....	37
Figure 1: Legal Classification of Entreprises	8
Figure 2: Classification by Sector of Activity	9
Figure 3: Roles of SMEs in Kenya's economy	14
Figure 4: The Central Bank of Kenya (CBK)	20
Figure 5: Years of Operation	31
Figure 6: Business Ownership category	32
Figure 7: Statistics for Financial Performance	35

TABLE OF CONTENTS

DEDICATIONS	ii
ACKNOWLEDGEMENTS	iii
LIST OF ABBREVIATIONS	iv
GENERAL INTRODUCTION	1
Background.....	1
Objectives of the study.....	2
Problem Statement.....	2
Research hypotheses.....	3
• Primary Hypothesis	3
• Alternative Hypotheses.....	3
Methodology Announcement.....	4
Structure of the Study.....	4
CHAPTER 1: THEORETICAL FRAMEWORK OF SMALL AND MEDIUM SIZED ENTREPRISES.....	5
Introduction	5
Section 1: Theoretical Framework on SMEs.....	5
1.1 Literature Review Summary.....	5
1.2 Generalities on SMEs	6
1.3 Distinction Between SMEs and Start-Ups:	9
1.4 Distinctions Between Small and Large Enterprises	11
Section 2: Overview of SMEs in Kenya	11
2.1 Classifications SMEs in Kenya.....	11
2.2 Start-ups in Kenya.....	12
2.2.1 Key	12
2.2.2 Notable Start-ups.....	13
2.2.3 Emerging Challenges	13
2.2.4 Emerging Opportunities	13
2.3 The Role of SMEs in the Kenyan Economy	13
2.4 Challenges and Opportunities for SMEs in Kenya.....	14
2.4.1 Key Challenges.....	14

Table of Contents

2.4.2 Opportunities for Growth	15
Conclusion	15
CHAPTER 2: BANKING SYSTEM IN KENYA.	16
Introduction	16
Section 1: Kenya's banking system: development, classification, and regulatory framework	16
1.1 Overview of Kenya's Banking sector	17
1.2 Classification of Banks in Kenya	17
1.3 The Central Bank of Kenya (CBK) and its roles	19
1.4 The Kenyan Banking regulatory framework	20
Section 2: Historical evolution of the banking system in Kenya	21
2.1. Reforms implemented to revitalize the banking sector in Kenya (1970s – 2009):	21
2.2 The Growth of Kenya's Banking Sector, In response to the Reforms (1963–2010):	22
2.3 Growth of Kenya's Banking Sector in 2023 and Strategic Diversification	23
3.1 The Strategic Role of Micro, Small, and Medium Enterprises (MSMEs) in Kenya's Economic Growth	24
3.2 Financial Innovation and Supportive Services for MSMEs	24
3.3 Non-Financial Support and Strategic Expansion: Capacity Building and Regional Expansion	25
Conclusion and recommendations	26
Recommendations to Address Challenges in the Banking Sector	25
CHAPTER 3: METHODOLOGY AND RESEARCH ANALYSIS.	27
Introduction	27
Section 1: Methodology	27
1.1 Research Design	27
1.2 Target Population	27
1.3 Sampling Technique	28
1.4 Instrumentation	28
1.5 Data Collection Procedures	28
1.6 Data Analysis	28
Section 2: Results and Analysis	29
2.1 Demographic Characteristics of Respondents	29

Table of Contents

2.2 Descriptive Statistics Analysis	32
2.3 SME's Performance.....	35
Section 3: Summary, Conclusion, and Recommendation:.....	38
3.1 Summary of the Findings	38
3.2 Key Insights.....	39
3.3 Recommendations.....	40
Conclusion	41
GENERAL CONCLUSION.....	42
BIBLIOGRAPHY	44
APPENDICES	46
LIST OF ILLUSTRATIONS	47
ABSTRACT.....	51
Keywords	51
الملخص	51
الكلمات المفتاحية	51

ABSTRACT

This thesis explores the critical role of Small and Medium Enterprises (SMEs) in Kenya's economic development and the major financing challenges they face. Despite their contributions to job creation and income generation, SMEs struggle to access funding from formal financial institutions due to strict collateral demands, high interest rates, information asymmetry, and weak credit histories. Using a mixed-methods approach—combining surveys and interviews with SME owners and bank officials—the study identifies regulatory, institutional, and borrower-related barriers to financial access.

The findings highlight a persistent financing gap that mainly affects startups and youth-led businesses, threatening SME sustainability and growth. The research also analyzes banks' credit risk frameworks, revealing a misalignment between formal lending criteria and the practical realities of SMEs, especially those operating informally. Additionally, the thesis evaluates existing policy measures and financial innovations—such as credit guarantees, digital lending, and financial literacy programs—but finds their impact limited. It concludes with recommendations for policy reform, stronger bank-SME collaboration, and the development of alternative financing solutions to close the credit gap and promote inclusive economic development.

Keywords

Bank credit, Financing, Kenya, SMEs (Small and Medium Enterprises)

RESUME

Ce mémoire analyse le rôle clé des PME dans le développement économique du Kenya et les obstacles majeurs qu'elles rencontrent pour accéder au financement. Malgré leur importance en matière d'emploi et de revenus, les PME sont limitées par des garanties strictes, des taux d'intérêt élevés et un manque d'historique de crédit. L'étude, fondée sur des enquêtes et entretiens, identifie des freins institutionnels, réglementaires et liés aux emprunteurs.

Les résultats révèlent un important déficit de financement, touchant particulièrement les startups et les entreprises dirigées par des jeunes. Un décalage est observé entre les critères bancaires et la réalité des PME, notamment dans l'informel. Malgré les efforts politiques et les innovations financières (garanties, prêts numériques, éducation financière), l'impact reste limité. Le mémoire propose des réformes politiques, une meilleure collaboration banques-PME et des solutions alternatives pour renforcer l'inclusion financière.

Mots clés : Crédit bancaire, Financement, Kenya, PME.

الملخص

يتناول هذا البحث دور المؤسسات الصغيرة والمتوسطة في التنمية الاقتصادية في كينيا، والعقبات الرئيسية التي تواجهها في الحصول على التمويل. وعلى الرغم من أهميتها في خلق فرص العمل وتوليد الدخل، تواجه هذه المؤسسات قيوداً بسبب متطلبات الضمان الصارمة، وارتفاع معدلات الفائدة، ونقص السجل الائتماني. تعتمد الدراسة على استبيانات ومقابلات لتحديد العوائق المؤسسية والتنظيمية وتلك المتعلقة بالمقترضين.

تكشف النتائج عن وجود فجوة تمويلية كبيرة تؤثر بشكل خاص على الشركات الناشئة والمؤسسات التي يقودها الشباب. كما تُظهر الدراسة وجود فجوة بين معايير الإقراض البنكية والواقع العملي للمؤسسات، خاصة في القطاع غير الرسمي. ورغم الجهود السياسية والابتكارات المالية (مثل الضمانات، الإقراض الرقمي، وبرامج التثقيف المالي)، يبقى التأثير محدوداً. ويوصي البحث بإصلاحات سياسية، وتعزيز التعاون بين البنوك والمؤسسات الصغيرة والمتوسطة، وتطوير حلول تمويل بديلة لتعزيز الشمول المالي.

الكلمات المفتاحية

الائتمان البنكي، التمويل، كينيا، المؤسسات الصغيرة والمتوسطة