

Beyond Access: How the Cost of Credit Shapes SME Financing Adequacy in Murang'a County, Kenya

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ABSTRACT

Despite the fundamental role in spurring economic growth, SMEs continue to experience significant barriers accessing formal credit, with affordability and loan terms proving key constraints that limit their meaningful participation in formal financial markets, particularly in emerging economies. This study, anchored in credit rationing theory, investigates the influence of cost of credit on credit access and adequacy in Murang'a County, Kenya. Drawing on empirical data from 150 SME owners, while employing a cross-sectional explanatory research design, the study evaluates how cost of borrowing affects SMEs willingness and ability to access formal credit. The results indicate that despite loan facilities being available, cost of borrowing is a key constraint where higher cost of credit reduces attractiveness and affordability of formal credit. The study further highlights the compounding effect of other lending requirements and conditions that increase cost burden thus creating a distinction between interest rates and effective borrowing cost. It conceptualizes cost of credit as a multi-dimensional constraint encompassing interest rates, collateral-related costs and fees examining how they shape willingness and ability to access formal credit. The findings reveal that financial exclusion is not exclusively a consequence of credit unavailability but may result from pricing beyond the capability of viable SMEs for economically productive use. The study extends existing literature by shifting attention from credit access as a binary outcome to focus on affordability, adequacy and usability.

Keywords: Small and Medium Enterprises, Cost of Credit, Credit Adequacy, Credit Access

BACKGROUND OF THE STUDY

Access to credit constitutes a key impediment for Small and Medium Enterprises (SMEs), especially in emerging economies (Khan, 2022; Tariq, 2025). The concept of credit access, however, extends beyond the ability to secure loans since mere access may not necessary be an indicator of meaning financial access. Credit access encompasses more than just approval of a loan. An enterprise may receive credit yet remain constrained if amount obtained is inadequate compared to financing needs or if conditions and cost of borrowing render the credit facility economically unsustainable (Nyangaresi, 2023). The distinction between availability and adequacy of credit is fundamental in understanding SME credit constraints. Credit rationing theory underpins this perspective by explaining that lenders may restrict not only the number of customers that access credit but also the conditions and amount provided. Other than interest rates, the demand for credit may be controlled using other mechanisms such as quantity, shorter repayment period and contractual conditions (Stiglitz & Weiss, 1981). Thus, an enterprise may face financial exclusion by partial financing, outright rejection or access on conditions that considerably constrain productive usefulness.

While quoted interest rates constitute an important measure of cost of borrowing, it may not entirely reflect the financial burden incurred by enterprises once insurance, processing, collateral-related charges, transaction costs and other lending terms are put into consideration (Mutinda, 2020). In this context, cost of credit demands for a closer examination that extends beyond the conservative focus of quoted interest rates. The resulting effective cost of borrowing, therefore, may significantly differ from the quoted cost of finance (Gassiah & Kikula, 2022), providing far-reaching explanation of whether enterprises can access and utilize credit productively. This study evaluates whether cost of borrowing adequately explains SME credit access and adequacy. By linking cost, quantity and adequacy, the study offers a more nuanced approach of

affordability, adequacy and usable credit thus shifting from the binary conception of credit access as either approval or rejection of loan application.

Statement of the Problem

Small and Medium Enterprises (SMEs) are essential engines of job creation, poverty reduction, economic growth and equitable development. Despite their fundamental role, access to formal credit continues to constrain their growth and sustainability. Evidence from the Central Bank of Kenya's 2024 survey report on MSME access to bank credit points to a decline in the number of active loan accounts by 24.7% between 2022 and 2024. Interestingly, loan portfolio value increased from Ksh. 783.3 billion to Ksh. 784.4 billion over the same period, accounting for only 0.1% change. The average interest rate increased from 15.5% in 2022 to 16.4% in 2024. The respective average rates for the micro-enterprises, small enterprises and medium-sized enterprises were 16.0%, 16.6% and 16.7% (Central Bank of Kenya, 2025), demonstrating that quoted price of credit may itself constitute a barrier. The combined statistics of 24.7% decline in active loan accounts, only 0.1% increase in loan portfolio value, and 16.4% average interest rate raises a critical question regarding the nature of credit access for SMEs. While SMEs loan accounts fell substantially, the value of lending remained almost unchanged. The concern is whether the apparent availability translates into adequate and affordable credit for SMEs in need of financing. It remains insufficiently understood whether the apparent stability in loan value masks a contraction in the number of SMEs accessing credit while the remaining borrowers potentially obtain credit under more demanding conditions or at higher prices. The challenge therefore extends beyond access to sufficiency and economic usability of credit acquired, creating a significant conceptual and empirical gap. This study therefore investigates effective cost of borrowing and examines the implication for both access and adequacy.

Objective of the Study

To examine the influence of the cost of credit on SMEs' access to and adequacy of credit in Murang'a County, Kenya

Theoretical Framework

According to Credit Rationing Theory (Stiglitz and Weiss, 1981), under information asymmetry, lenders experience difficulties in distinguishing high and low-risk borrowers, and determining borrower behaviour after credit is granted. This explains why markets may fail to allocate loans solely based on interest rate adjustments. Increasing interest rates therefore may not necessarily control for excess demand, rather lenders may ration credit through approved amounts, tightening lending terms or rejecting applications from willing applicants (Kwashie, Baidoo & Ayesu, 2022). Credit rationing theory implies that the cost, quantity and conditions of advancing funds are jointly crucial in establishing effective access to credit. For SMEs, the cost of borrowing may exceed stated interest rate due to processing fees, transaction charges and insurance costs (Gassiah & Kikula, 2022). An enterprise may therefore remain financially constrained despite technically obtaining credit if the amount received is inadequate relative to needs, or if the overall cost renders the loan economically not viable. Access to credit therefore shifts from a question of loan approval to sufficiency and at a cost that allows for productive use. This theory is applicable in examining how cost of borrowing influence access to and adequacy of credit providing a broader context of affordability, sufficiency and usability.

Empirical Review

Using quantitative data, Msomi (2023) investigated the effect of interest rates on SME credit access in South Africa and established a significant negative relationship between interest rate and credit access. Similarly Akintayo, Odeh, Lawal and Makinde (2024) established that excessive interest rates significantly influenced SMEs ability to secure funding. However, conceptually, these studies focus on credit access as simply obtaining finance without sufficiently differentiating between availability and adequacy. The studies overlook instances where credit obtained is insufficient compared to amount of loan required. Additionally, the studies focused on quoted interest rates thus failing to adequately consider the broader cost resulting from lending

conditions and additional charges. The present study addresses the identified gaps by investigating how perceived effective borrowing influence both access and adequacy of credit.

Yusuf, Lawal, Mahadi, Akande, Ademilua, Kabir and Amos (2024), examined the influence of credit access, delivery and variation on interest rates using SME performance in Nigeria. Data was analyzed through Partial Least Square of Structural Equation Modeling (PLS-SEM). The study established that interest rates variation significantly influenced performance. Additionally, a study by Karanja and Muathe (2025) revealed that cost of credit significantly predicted performance. Despite their contribution, these studies exhibit a conceptual gap by failing to distinguish between credit received and sufficiency of credit obtained. Further, the studies offer limited explanation on mechanisms through which borrowing cost constrains access to credit. Contextually, Yusuf et al., (2024) focuses on micro-bank financing for SMEs and may therefore fail to fully reflect the environment of SME financing in Kenya. The current study bridges these gaps by shifting focus from influence of credit on performance to examination of affordability and sufficiency of credit obtained.

Existing studies (Walubuka, 2023; Otieno, Anyuki and Musa, 2021; Mburu and Njogu, 2021) establish that collateral, interest rates and other lending conditions limit access to finance. However, they inadequately clarify how effective cost of borrowing translates into sufficient credit. Limited attention has been given to the distinction between quoted cost of credit and effective borrowing cost. Besides, studies examining whether enterprises that obtain credit nonetheless remain financially constrained either because borrowing costs or amount of financing obtained is inadequate, remain scanty.

The Conceptual Framework

The conceptual framework is grounded in the proposition that cost of credit is an important determinant of effective access to credit, and recognizes that lending decisions are not dependent on interest rates only. Other than interest rates, lenders may ration credit using amounts advanced, repayment conditions and other terms (Stiglitz & Weiss, 1981). The framework conceptualizes cost of credit as the independent variable represented by perceived overall borrowing cost while the dependent variable is effective credit access represented by availability and adequacy. Lenders may respond to risk by increasing cost of lending or advancing smaller amounts thus resulting into partial or complete rationing (Arinzeh, 2022).

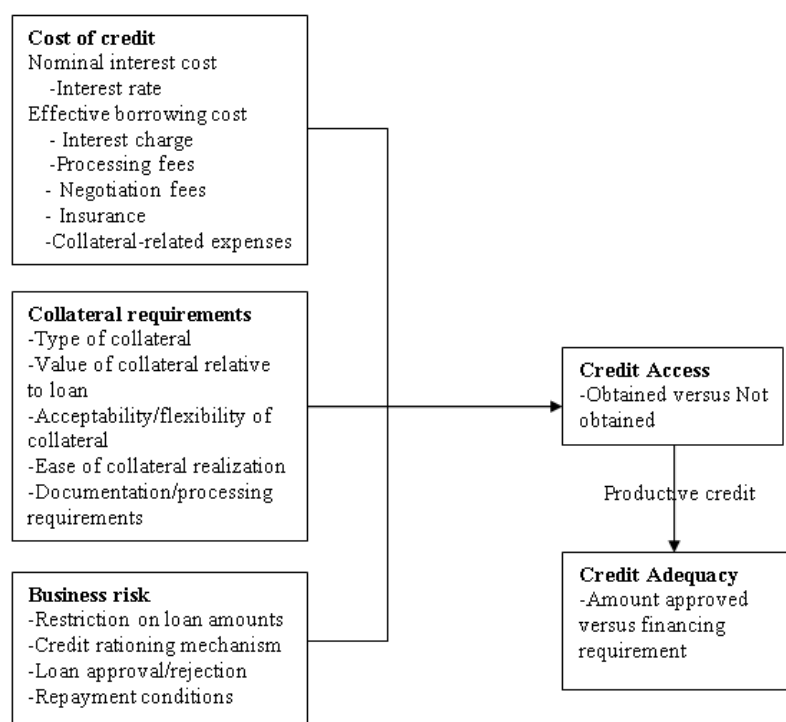


Figure 1: Conceptual Framework

DATA AND METHODOLOGY

Research Design

This study adopted a cross-sectional explanatory research design (Hunziker and Blankenagel, 2021), and targeted 150 Small and Medium Enterprises in Murang'a County, Kenya. The study sought to examine the effect of cost of credit on credit access among SMEs. The research design was considered appropriate since data on borrowing experiences, credit costs, access and adequacy was collected at a single point in time (Cummings, 2018). The aim of the study was not just to describe financing conditions but to determine the extent to which cost of credit explains access and sufficiency of credit. The unit of analysis was the SME while unit of observation was the enterprise owners. A combination of purposive and simple random sampling was used to select SMEs owners with sufficient knowledge of financing and borrowing experiences (Zrineh, 2026). To minimize selection bias, simple random sampling was used to select respondents from accessible population. Target population comprised 150 ($N=150$) respondents from whom a sample of 89 ($n=89$) respondents was selected and successfully included in the study. The sample represented 59.3% of the population. This was considered appropriate for the relatively small and clearly defined population providing sufficient observations for descriptive, correlational and regression analysis considering it met the minimum requirement for multiple regression analysis as recommended by Green's (1991) formula ($N \geq 50 + 8m$) where m stands for number of variables. Since credit needs, loan size and borrowing costs may substantially differ across sectors, sectoral representation was considered by sampling enterprises in agro-processing, trade, services and manufacturing. Data was collected using a structured questionnaire predominantly closed-ended and on five-likert scale.

Data Analysis

The collected data was analyzed using both descriptive and inferential statistical techniques with the aid of STATA software. Descriptive analysis involved computation of measures of central tendency and dispersion (Ali, Bhaskar & Sudheesh, 2019). The mean score established the general tendency of perceptions while standard deviation revealed the extent of variation in responses. Inferential analysis employed correlation and multiple linear regression methods (Kulas, Roji & Smith, 2021). Credit access was conceptualized as related dimensions of broader outcome that incorporated accessibility and adequacy. The dimensions were measured using multiple likert scale items. The first three statements measured cost-related barriers, the fourth captured interest rate effect on ability to obtain sufficient credit while the fifth measured the sufficiency of the amount of credit obtained relative to financing needs. The five items were aggregated to form a composite credit access and adequacy index. Thus the dependent variable represented combined outcomes of access and adequacy. The regression did not model credit access alone.

The regression model was specified in the following functional form:

$$SCAA_i = \beta_0 + \beta_1 IR_{i1} + \beta_2 C_{i2} + \beta_3 BR_{i3} + \mu_i$$

Where;

$SCAA_i$ represents composite credit access and adequacy index encompassing both accessibility and adequacy,

β_0 represents the coefficient of interaction,

IR_{i1} represents cost of credit score,

C_{i2} represents collateral requirements

BR_{i3} represents business risk

μ_i the error term.

FINDINGS

Descriptive Results

Table 1: Descriptive results for cost of credit

	Mean	Std. Dev.
Interest rates charged affects my decision to apply for loan	2.74	1.130
Loan processing, insurance, valuation and other mandatory charges substantially increase cost of borrowing	3.82	1.064
Additional borrowing charges make loans more expensive than stated interest rates indicate	3.77	1.047
High rates of interest affects the ability to access adequate credit	3.23	1.031
Amount of credit approved is less than my business requires to finance needs	3.90	1.067

The descriptive statistics presented in Table 1 reveal the extent to which interest rates and associated borrowing costs influence access to and adequacy of credit. The analysis focused on mean and standard deviation. Higher mean scores indicated stronger agreement with respective statements. From the findings, respondents were less inclined to agree ($M = 2.74$, $SD = 1.130$) that interest rates directly influenced their decision to apply for a loan. The results reveal that interest rates alone are not necessarily the primary reason determining whether enterprises initiate loan applications. Respondents, however, agreed that additional costs incurred to secure a loan substantially increased cost of borrowing ($M = 3.82$, $SD = 1.064$). The finding demonstrate that cost of credit extends beyond quoted price to include processing fee, insurance, valuation and other mandatory charges which increases the effective cost of financing making formal credit expensive for SMEs.

Majority of the respondents ($M = 3.77$, $SD = 1.047$) agreed that the actual cost of borrowing may be higher than what is conveyed by the stated interest rate. The finding reinforces the preceding results and suggests that interest rates alone are insufficient to determine whether a credit facility is costly or not. Rather costly credit should be understood in terms of the total cost of borrowing. Further, the statement that high interest rates affect the ability to access adequate credit recorded moderate scores ($M = 3.23$, $SD = 1.031$), suggesting that the cost of borrowing may limit not only access to credit but also the amount of credit that a business can obtain relative to their financing requirements. This is reinforced by the highest mean score ($M = 3.90$, $SD = 1.067$), recorded for the statement that the amount of credit approved is less than the amount required to finance business needs. The finding points to a potential gap between the credit accessed and the credit required by SMEs, highlighting the issue of credit adequacy. The descriptive findings indicate that although interest rates may not solely determine the initial decision to apply for credit, the overall cost of borrowing that includes additional charges may render the credit more of a burden thus leading to inadequate funding. The results offer preliminary evidence in line with the study proposition signifying that the concern is not merely the availability but also affordability and sufficiency of credit acquired.

Table 2: Correlation Analysis

Variable	Cost of Credit	Collateral Requirement	Business Risk
Credit Access	0.106($p < .05$)	0.232($p < .05$)	-0.422($p < .05$)

The cost of credit had a correlation co-efficient of $r = 0.106$, $p < .05$ signifying a weak but statistically significant positive relationship with access to credit. The findings align with Mburu and Njogu (2021) who established a positive correlation between cost of credit and access to credit among small and medium-sized

enterprises. Although cost of credit is statistically associated with credit access, the very weak positive correlation fails to support the expectation that higher cost of credit corresponds to lower access. This positive relationship was attributed to SMEs that continue to seek credit notwithstanding high costs of borrowing since credit remains essential for operations.

Regression Analysis:

The regression analysis results examining the influence of cost of credit on access and adequacy of credit are presented as follows.

Table 3: Regression Results

Predictor	<i>B</i>	<i>SE</i>	β	<i>t</i>	<i>p</i>
Constant	2.428	0.674	-	3.602	.001
Cost of credit	-0.150	0.082	-0.239	-1.929	.057
Collateral requirement	-0.284	0.141	-0.230	-2.017	.047
Business Risk	-0.448	0.103	-0.468	-4.331	< .001

Model statistic	Value
<i>R</i>	0.475
<i>R</i> ²	0.226
Adjusted <i>R</i> ²	0.198
<i>F</i> (3, 85)	8.251
<i>p</i>	< .001

From the findings, cost of credit exhibited a negative coefficient ($B = -0.150$, $\beta = -0.239$, $t = -1.929$, $p = .057$) which is consistent with the study proposition, though its effect was not statistically significant at 5% level of significance. The findings concur with Ndungu (2016), who established a negative relationship between interest rates and access to credit among SMEs. The inverse relationship suggests a tendency for higher cost of credit to be linked with reduced access to credit among SMEs. The findings, viewed within the conceptualization of credit as entailing both affordability and adequacy, reveal that increased borrowing costs may limit the ability to obtain affordable and sufficient credit (Widyastuti, Ferdinand & Hermanto, 2023). Since the p -value = 0.057 exceeds the 5% level of significance, the result indicates a negative tendency rather than conclusive evidence that cost of credit significantly affects SMEs' access to adequate and affordable credit. When considered alongside the descriptive findings, which indicated a relatively high level of agreement that additional charges increase the cost of borrowing and that higher borrowing costs affect access to adequate credit, the results provide a more nuanced perspective on the relationship between the cost of credit and SMEs' effective access to financing.

The descriptive findings imply that respondents perceived credit as costly while the regression results revealed that cost of credit does not predict access to credit at 5% level of significance when considered simultaneously with other lending requirements such as collateral and level of risk. Focus lies in the distinction suggesting that costly credit does not necessarily mean that price alone determines whether businesses obtain credit. Rather, access appears to be shaped by a combination of cost of borrowing and supply-side consideration such as

collateral and risk (Krasniqi, Kotorri & Aliu, 2023). The overall model was statistically significant $F(3, 85) = 8.251$, $p < .001$, indicating that predictors collectively had a significant effect on access to credit. Model summary statistics had a coefficient ($R = .475$) signifying moderate relationship between the independent variables and access to credit. The coefficient of determination ($R^2 = .226$), shows that predictors explained 22.6% of the variation in access to credit. Overall, the findings provide partial support for the proposition that cost of credit influences access and adequacy. The findings therefore suggest that SME credit constraints are multidimensional, where access is influenced not only by the cost of borrowing but also by other lending requirements such as collateral and perceived riskiness.

Results were substituted as follows:

Credit access and adequacy = $2.428 - 0.150 \text{ cost of credit} - 0.284 \text{ collateral requirement} - 0.448 \text{ business risk}$

DISCUSSIONS OF THE FINDINGS

The study established a negative but statistically insignificant effect of cost of credit on credit access among SMEs in Murang'a County ($B = -0.150$, $\beta = -0.239$, $t = -1.929$, $p = .057$). The inverse relationship implies that an increase in cost of borrowing is associated with reduction in SMEs cost of credit. This means that as borrowing costs increase, businesses may become less able or willing to seek credit (Konstantakopoulou, 2023). The direction of the coefficient is theoretically meaningful since high interest rates, insurance charges, processing fees, collateral-related and other transaction costs increase effective cost of borrowing. SMEs often operate on limited cash flows (Widasari, Paniran, Furniawan & Mufidah, 2024), and therefore increased borrowing costs can make credit financially unstable and less attractive. The coefficient supports the proposition that cost of credit may be a financial constraint especially if SMEs have limited capacity to service high-debt obligations. The statistical results, however, suggest that the effect of cost of borrowing may not operate in isolation. Decisions, willingness and ability to obtain credit are likely informed by a combination of factors including lender risk assessment and collateral requirements.

Further, the finding may signify the nature of borrowing behaviour in that businesses do not necessarily assess credit exclusively based on monetary price. Rather, access itself may precede the consideration of affordability (Gyimah, Akande & Muzindutsi, 2022). Where lenders impose strict eligibility conditions, businesses may fail to obtain credit despite prevailing interest rates being relatively attractive. Likewise, enterprises may accept relatively expensive credit facilities if financing is required urgently for liquidity management, working capital, business expansion or inventory acquisition. The findings explain the reason cost of credit can yield a negative coefficient though a statistically insignificant determinant of effective credit access. In such circumstances, non-pricing and institutional lending barriers may surpass the effect of cost of credit. As a result, effective credit accessibility is better understood as multifaceted phenomena where both price and non-price barriers interact (Khanal, 2024).

CONCLUSION AND RECOMMENDATION OF THE STUDY

The findings reveal a qualified rather than a contradictory view of the role of cost credit on access and adequacy among SMEs. The negative coefficient supports the economic view that increase in cost of credit could discourage borrowing and limit access. However, the statistical insignificance points to a broader interpretation that credit accessibility and adequacy are shaped by the interaction of both price-related and institutional barriers. Consequently, interventions meant to improve access and adequacy of credit should not treat cost as a standalone solution but simultaneously tackle informational and structural barriers that influence whether SMEs qualify for, acquire and productively use credit.

Based on the findings, lending institutions should develop SME-sensitive and appropriately priced products that include transparent fee schedules, flexible repayment structures and financing structures that match cash flow characteristics of small businesses. Disclosure of effective cost of borrowing would enable businesses make informed decisions thus reducing uncertainty on the actual financial burden associated with loans. SME-support agencies, policymakers and financial institutions should pursue policies that improve credit affordability while addressing non-price barriers to access. Recommendations should therefore extend beyond

interest rate reduction to include consideration of non-price barriers such as limited access to credit information and excessive collateral requirements. Enhancing credit guarantee mechanisms and strengthening record-keeping and financial literacy could potentially yield greater effect on access and adequacy than focusing solely on price of credit.

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