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PB/09/26

March 2026

THE CENTRE FOR RESEARCH ON FINANCIAL MARKETS AND POLICY®

Bridging The Financial Gap in MSME Financing in Kenya

Executive Summary

MSMEs are key drivers of Kenya's economy, contributing about 40% of GDP and employing approximately 14.9 million people. Despite their significance, they continue to face significant barriers in accessing credit from financial institutions. Of the estimated 7.4million MSMEs in Kenya, only 16% have access to formal credit. Using FinAccess 2024 firm-level data, we find that constraints such as lack of collateral, inadequate documentation, and negative credit history often exclude MSMEs from access to credit. As such, policy interventions should focus on derisking of the supply side lending risks to improve access to MSME financing.

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1. Context and Importance

The critical role played by MSMEs in Kenya cannot be overstated. In Kenya, MSMEs account for 98% of all businesses and contribute to about 40% of GDP. However, their growth and sustainability are constrained by numerous obstacles, key among them being limited access to affordable formal financing. Kenya continues to face a significant MSME financing gap estimated at Kes 2.49 trillion.

Figure 1: Constraints of MSME financing in Kenya

On the supply side, financial institutions often perceive MSMEs as high-risk borrowers because of their informality and limited financial records. Consequently, strict credit appraisal policies including collateral requirements, documentation and other disclosures, act as a hindrance to MSME financing. While these measures protect the banks against potential risk of loss, they restrict credit access for many businesses.

On the demand side, MSMEs' individual characteristics strengthen or weaken their credit worthiness by the financial institutions. Lack of the required disclosure standards further limit their access to credit. This misalignment between the bank's risk management requirements and MSME capacity to meet them results in exclusion form credit despite the notable demand.

Addressing these barriers through targeted policy interventions such as derisking mechanism and alternative collateral frameworks will unlock sustainable formal credit for MSMEs. Strengthening the supply side while enhancing the readiness of MSMEs for finance is critical to promoting responsible, bank-led financing and supporting the long-term growth and sustainability of the sector.

2. Methods and Results

The paper utilized cross-sectional firm level data drawn from Fin-Access Household survey, 2024. A logistic model is adopted to assess the credit constraints faced by MSMEs in accessing bank credit. The results showed lenders put up stringent credit requirements especially for MSME borrowers as they perceive them as risky to lend to. The study established that:

1. Over collateralization and guarantor requirements exclude MSMEs from bank lending.
2. Negative credit listing of the borrower increased the probability of exclusion from bank credit. The need for information sharing necessitated for listing of borrowers' credit history in the credit reference bureaus.
3. The need for businesses to have proper and reliable business records as it affects the probability of acquiring bank credit. This result could imply that lenders need to ascertain the sustainability of the business before extending credit to the borrower.
4. Availability of alternative sources of income was found to boost the probability of acquiring a bank loan
5. The location of the business was found to influence the probability of accessing bank credit where it was easier for businesses located in rural areas to access bank credit compared to those in urban areas.
6. The gender of the owner of the business was found affected the probability of getting a bank loan where female business owners had a higher probability of accessing formal credit compared to male entrepreneurs.

3. Policy Recommendations

1. Expand the partial credit guarantee scheme to all regulated banking institutions that is commercial banks and microfinance banks. This will lower the risk for lending institutions who are willing to lend to MSMEs but are constrained due to the perceived risky nature of the MSMEs.
2. Expand options available to MSMEs to pledge as collateral: There is need to for policies aimed at alleviating structural constraints. This could include strengthening of the movable property rights to broaden the scope of assets that can be used as collateral. This will accommodate the nature of MSMEs in Kenya and expand their collateral choices.
3. Institutional-centered capacity building and financial literacy program. The focus being to build capacity around formalizing MSMEs in Kenya. The impact-based programs will guide business owners towards sustainable businesses like proper record keeping, project planning.

4. References

1. Wairimu and Kiragu (2026). Bridging The Financial Gap in MSME Financing in Kenya, KBA Working Paper Series Volume 6.

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