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# Cost of Credit and Performance of Small and Medium Enterprises (SMEs) in Kenya: The Moderating Role of Financial Literacy

**Ignitious Mutea & Dr. Allan Kuria, PhD**

**Master Student, School of Business Management and Economics, Dedan Kimathi University of Technology**

**School of Business Management and Economics, Dedan Kimathi University of Technology**

**Email of the Corresponding Author: ignitiousmutea1@gmail.com**

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## Abstract

Access to affordable credit remains a decisive factor in the growth and sustainability of small and medium enterprises in developing economies. This study examined the effect of the cost of credit on the performance of small and medium enterprises (SMEs) in Kenya, with financial literacy considered as a potential moderating factor. The study was Guided by Transaction Cost Theory, Credit Rationing Theory, and the Balanced Scorecard framework. The study adopted a descriptive research design and targeted more than 1.5 million registered SMEs across the country. A sample size of 385 was used. Data was collected through structured questionnaires and analyzed using descriptive statistics and multiple regression. Descriptive results showed that respondents rated the cost of credit highly as a barrier (mean = 3.99), while financial literacy averaged 3.98 with gaps in practical credit management skills, and business performance averaged 3.93 with constrained profitability and employment outcomes. Regression analysis revealed that the cost of credit explained 71.7 percent of the variation in performance with a significant negative effect (B = -0.832, $p < 0.05$), while the moderating effect of financial literacy remained insignificant ($p = 0.231$) thus indicating that knowledge alone cannot offset systemic credit costs. The study concludes that policy measures to reduce borrowing costs, enforce transparent lending practices, and promote flexible repayment structures are critical for enhancing financial inclusion and enterprise sustainability in Kenya.

**Keywords:** *Cost of credit, business performance, financial literacy, small and medium enterprises, SMEs, Transaction Cost Theory, Kenya.*

### 1.1 Background to the Study

Globally, credit has become one of the most critical enablers of growth for small and micro enterprises, allowing them to finance expansion, adopt new technologies, and withstand market shocks (World Bank, 2019; Noman, 2021). The cost of credit, which encompasses interest charges, processing fees, legal expenses, and insurance premiums, directly determines whether external financing supports growth or erodes sustainability (Mburu & Njogu, 2021; CBK, 2023). High interest rates have been shown to compress margins and discourage reinvestment, while transaction costs disproportionately affect small loans and raise the effective annual borrowing cost, particularly for enterprises requiring frequent restocking and distribution financing (Ondabu, 2019; IEA, 2023). The World Bank (2019) reports that nearly half of enterprises in developing economies cite high borrowing costs as a major constraint, with elevated interest rates, hidden fees, and stringent loan conditions reducing investment in innovation and slowing enterprise growth in clean energy distribution sectors. Across Africa, expensive credit regimes continue to hinder SME growth, formalization, and job creation. Research in Ghana, South Africa, and Ethiopia demonstrates that high interest charges and non-transparent lending practices have consistently reduced competitiveness and productivity, with energy-related small enterprises remaining particularly vulnerable due to their thin margins (Ayele, 2018; Liedtke, 2019; Tita & Aziakpono, 2017; Sang, 2021).

In Kenya, micro and small enterprises account for over 80 percent of employment and about 40 percent of GDP, yet the cost of credit remains one of the greatest obstacles to their growth (KNBS, 2019; CBK, 2023). Commercial lending rates to MSMEs averaged above 13 percent in 2023, with processing fees, legal charges, and insurance premiums creating additional burdens that restrict borrowing for growth (CBK, 2023; Odhiambo, 2023). For micro liquefied petroleum gas (LPG) retailers, whose businesses depend on timely procurement of cylinders, stock refills, and compliance with safety standards, the affordability of credit is particularly decisive for competitiveness in the clean energy sector (IEA, 2023). Transaction Cost Theory highlights how search, bargaining, and enforcement costs embedded in credit markets fall more heavily on smaller enterprises with limited collateral, while Credit Rationing Theory explains how information asymmetry pushes lenders to impose higher costs or ration credit altogether (Coase, 1937; Williamson, 1985; Stiglitz & Weiss, 1981.

### 1.2 Statement of the Problem

Small and medium enterprises (SMEs) in Kenya contribute more than 80% of employment and about 40% of GDP, yet the cost of credit remains one of the most formidable obstacles undermining their performance (KNBS, 2019; Mutinda, 2020). According to the Central Bank of Kenya (2023), average lending rates for SME loans rose to 15.5% in 2023, compounded by legal, insurance, and administrative fees that further raise effective borrowing costs. A survey by the Kenya Bankers Association (2019) revealed that only 34% of SME loan applications were successful, with cost-related concerns identified as a leading reason for rejection. Even among those who access loans, the burden of high interest rates often leads to financial distress rather than growth (Ondabu, 2019; Mburu & Njogu, 2021).

Studies in other developing economies reinforce this concern. SMEs in South Africa and Ghana continue to struggle under expensive lending regimes that discourage reinvestment and innovation (Liedtke, 2019; Ahiawodzi & Adade, 2012), while in Ethiopia, high borrowing costs limit the ability of small firms to capitalize on growth opportunities (Ayele, 2018). Kenya's context is particularly pressing given the critical role of SMEs in economic stability, employment generation, and poverty reduction. For SMEs operating across trade, manufacturing, and service sectors, high credit costs create significant barriers to profitability and long-term sustainability. These enterprises require substantial capital for inventory acquisition, equipment purchase, working capital management, and operational expansion (Haritone & Mirie, 2016; Beck & Demirgüç-Kunt, 2006). High borrowing costs make it difficult for SMEs to maintain adequate stock levels and invest in business improvements, often resulting in liquidity constraints and reduced competitiveness, while limiting their contribution to Kenya's economic development goals under Vision 2030 (Mutinda, 2020). Despite these implications, existing studies have focused broadly on credit access constraints without examining the specific effect of credit costs on SME performance, leaving a critical gap that this study addresses.

### 1.3 Scope of the Study

This study assessed the effect of the cost of credit on the performance of small and medium enterprises (SMEs) in Kenya, with cost of credit defined to include interest rates, loan processing fees, legal charges, insurance premiums, and other borrowing-related expenses. The moderating role of financial literacy was also examined to establish whether financial knowledge improves the ability of SME owners and managers to manage credit obligations and achieve sustainable performance. The study covered registered SMEs operating across trade, manufacturing, and service sectors nationwide, with respondents drawn from owners and managers directly responsible for financing and operational decisions, while excluding informal enterprises and large corporations.

## 2.0 Theoretical Framework

This study is anchored on the Transaction Cost Theory, first introduced by Coase (1937) and later advanced by Williamson (1975, 1985). The theory emphasizes that economic exchanges are never costless; firms and individuals incur expenses such as search, bargaining, monitoring, and enforcement when engaging in transactions. Within credit markets, these transaction costs manifest in the form of interest rates, loan processing fees, legal expenses, and insurance premiums, which cumulatively determine the effective cost of borrowing (Beck, Demirgüç-Kunt, & Maksimovic, 2008; Mburu & Njogu, 2021). Smaller firms, particularly small and medium enterprises, are disproportionately affected because they often lack collateral and reliable credit histories, forcing lenders to impose higher charges to mitigate perceived risks (Stiglitz & Weiss, 1981).

Applied to Kenya's context, the theory provides a lens to explain why SMEs, who operate on thin margins and require regular financing for inventory procurement, equipment acquisition, and operational expenses, face heightened borrowing costs that directly constrain performance (Ondabu, 2019; Mutinda, 2020). By treating credit costs as structural barriers rather than merely financial variables, the theory highlights how transaction-related inefficiencies reduce liquidity, erode profitability, and undermine competitiveness. It further underscores the need for governance and policy interventions that minimize these costs and improve financial inclusion, thereby enabling SMEs to contribute effectively to Kenya's economic development and employment creation goals.

### 2.1 Conceptual Framework

The conceptual framework for this study investigates the relationship between the Cost of Credit, Financial Literacy, and the Performance of small and medium enterprises (SMEs) in Kenya. The framework is as presented in Figure 1 below;

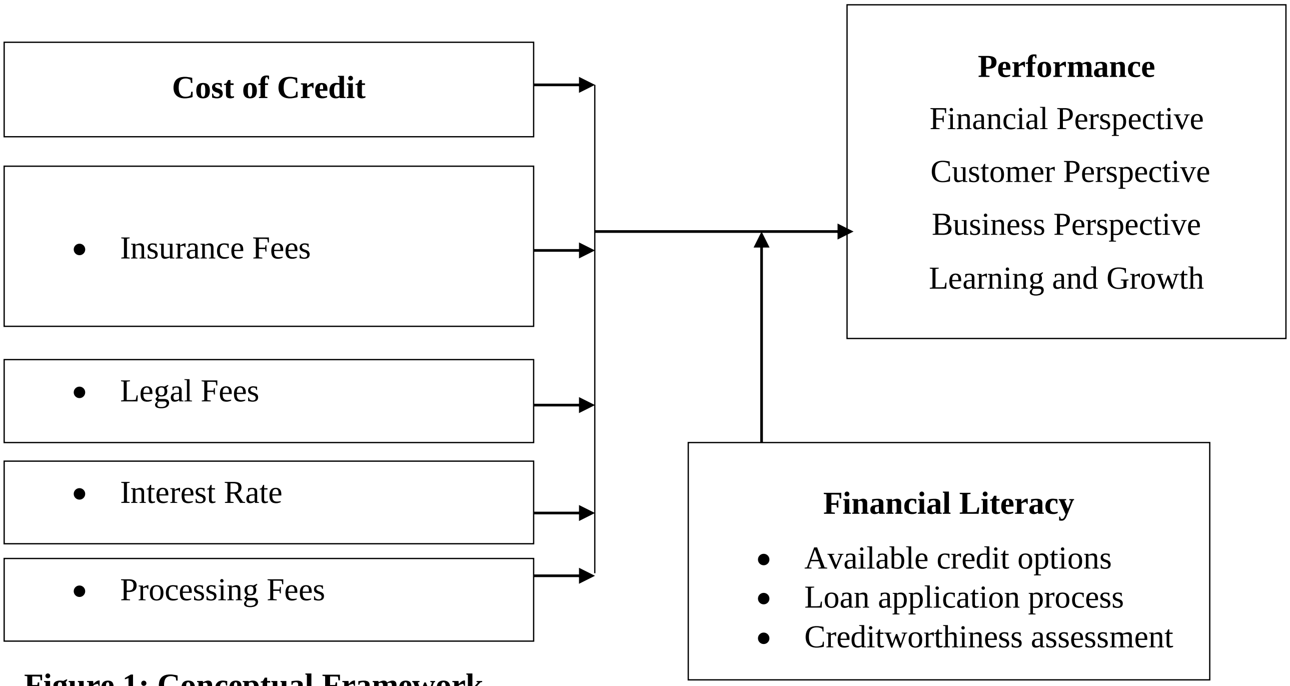


**Figure 1: Conceptual Framework**

The conceptual framework for this study is structured around the relationship between the cost of credit, financial literacy, and the performance of small and medium enterprises (SMEs) in Kenya. The cost of credit, treated as the independent variable, encompasses interest rates, loan processing fees, legal expenses, and insurance premiums. These charges represent the transaction costs that SMEs face when seeking financing and directly influence the liquidity available for reinvestment and operations. High borrowing costs are expected to constrain business outcomes by limiting profitability, weakening customer service, reducing efficiency in internal processes, and restricting innovation and growth opportunities.

Performance, the dependent variable, is measured through the Balanced Scorecard dimensions, capturing both financial and non-financial outcomes such as profitability, customer satisfaction, operational efficiency, and learning and growth. Financial literacy is introduced as a moderating variable, recognizing its role in shaping how entrepreneurs navigate credit markets. SME owners and managers with stronger financial knowledge are better equipped to evaluate loan products, interpret repayment terms, and manage credit obligations, thereby mitigating the negative impacts of costly borrowing. This framework therefore posits that while the cost of credit exerts significant pressure on business performance, financial literacy can buffer its adverse effects, enabling SMEs across Kenya to enhance sustainability and competitiveness in their respective sectors.

## 3.0 Research Methodology

The study adopted a descriptive research design. The target population consisted of more than 1.5 million registered SMEs across the country (KNBS, 2019). Using Fisher's formula for large populations at a 95 percent confidence level and a 5 percent margin of error, a sample size of 385 was initially obtained. A response of 321 SME owners and managers was obtained, representing a response rate of 83.4 percent. Respondents comprised owners and managers directly responsible for financing and operational decisions. Data were collected through a structured questionnaire with Likert scale items designed to capture perceptions of credit costs, financial literacy, and performance outcomes. A pilot test was carried out among 15 SME owners and managers outside the final sample, consistent with recommendations by Connelly (2008) that pilot samples of 10 to 30 participants are adequate for preliminary instrument testing and identifying potential problems with data collection procedures. The pilot confirmed the reliability and validity of the instrument, with Cronbach's alpha values for the cost of credit indicators exceeding 0.7. Data analysis involved descriptive statistics to summarize patterns and multiple regression analysis to test the relationship between cost of credit, financial literacy, and performance, guided by the Transaction Cost Theory. Ethical approval was secured from the National Commission for Science, Technology and Innovation, and voluntary participation, anonymity, and confidentiality of all respondents were assured throughout the study.

## 4.0 Findings

### 4.1 Descriptive Statistics

The study employed descriptive statistics to summarize respondents' perceptions of the key variables under investigation. Mean scores and standard deviations were computed for each construct to establish the central tendency and variability of responses. The findings are presented according to the study variables, beginning with the independent variable.

### 4.1.1 Cost of Credit

The study sought to assess how SMEs perceive the overall cost associated with borrowing from formal and informal credit sources. Respondents were asked to indicate their level of agreement with five statements capturing different dimensions of credit costs, including interest rates, repayment terms, investment constraints, affordability, and transaction-related expenses. The results are presented in Table 1.

**Table 1: Cost of Credit**

| Statement | Mean | Std. Dev. |
|---|---|---|
| The interest rates on credit have a significant impact on my business profitability | 4.08 | 0.71 |
| Loan repayment periods offered by lenders are reasonable for my business cash flow (R) | 3.94 | 0.76 |
| The cost of credit limits my ability to invest in business growth | 4.02 | 0.69 |
| I find it easy to access affordable credit in Kenya (R) | 3.87 | 0.78 |
| High transaction costs related to credit reduce the financial benefits of borrowing | 4.05 | 0.72 |
| **Average** | **3.99** | **0.73** |

The findings reveal that SMEs perceive the cost of credit as a substantial constraint on their business operations, with an overall mean of 3.99 indicating strong agreement that borrowing costs pose significant challenges. The highest mean score of 4.08 was recorded for interest rates significantly impacting business profitability, followed by high transaction costs reducing borrowing benefits (mean = 4.05) and credit costs limiting ability to invest in business growth (mean = 4.02). The reverse-scored items revealed that respondents generally disagreed that affordable credit is easy to access (mean = 3.87) and expressed reservations about the reasonableness of repayment periods (mean = 3.94), pointing to persistent affordability barriers and loan structures that do not adequately accommodate SME cash flow cycles. These findings align with Transaction Cost Theory and Credit Rationing Theory, demonstrating that search, bargaining, and enforcement costs embedded in credit markets disproportionately burden smaller enterprises, while high borrowing costs and stringent terms effectively exclude SMEs from affordable financing essential for inventory procurement, operational expansion, and contribution to Kenya's economic development goals (Coase, 1937; Williamson, 1985; Stiglitz & Weiss, 1981).

### 4.1.2 Financial Literacy

The study examined the financial knowledge and decision-making capacity of SMEs to determine how well they understand and manage credit-related decisions. Respondents were asked to indicate their level of agreement with five statements capturing different dimensions of financial literacy, including understanding of interest rates, confidence in loan management, benefits of financial training, use of financial information for planning, and ability to negotiate loan terms. The results are presented in Table 2.

**Table 2: Financial Literacy**

| Statement | Mean | Std. Dev. |
|---|---|---|
| I understand how interest rates affect the total cost of borrowing | 4.11 | 0.68 |
| I am confident in managing loan repayments effectively | 3.96 | 0.74 |
| Financial literacy training has helped me make better credit-related decisions | 3.82 | 0.79 |
| I regularly use financial information to plan and control my business finances | 3.98 | 0.71 |
| My knowledge of financial management improves my ability to negotiate loan terms | 4.04 | 0.73 |
| **Average** | **3.98** | **0.73** |

The findings indicate that financial literacy among SMEs is generally moderate to high, with an overall mean of 3.98. The highest mean score of 4.11 was recorded for understanding how interest rates affect the total cost of borrowing, while respondents also expressed strong agreement that financial management knowledge improves their ability to negotiate loan terms (mean = 4.04) and that they regularly use financial information for planning business finances (mean = 3.98). However, notable gaps emerged, with the lowest mean of 3.82 recorded for benefits derived from financial literacy training and moderate confidence in managing loan repayments effectively (mean = 3.96), suggesting that while retailers understand borrowing concepts, access to formal financial education remains limited and some struggle with practical repayment planning. These findings are consistent with literature emphasizing that knowledge alone is necessary but not sufficient for optimal credit outcomes, and foreshadow the regression findings where financial literacy may not fully offset the structural barriers posed by high credit costs in Kenya (Lusardi & Mitchell, 2018).

#### 4.1.3 Business Performance

The study measured the performance of SMEs using indicators that capture how credit access has influenced various business outcomes. Respondents were asked to indicate their level of agreement with six statements reflecting different performance dimensions, including sales growth, profitability, market share, employment creation, overall business performance, and the role of financial knowledge in securing better credit terms. The results are presented in Table 3.

**Table 3: Business Performance**

| Statement | Mean | Std. Dev. |
|---|---|---|
| Access to credit has positively influenced the sales growth of my business | 3.94 | 0.72 |
| My business profitability has improved due to credit facilities | 3.86 | 0.77 |
| Credit access has helped increase my business market share | 3.91 | 0.74 |
| The number of employees in my business has increased due to credit availability | 3.78 | 0.81 |
| Overall, credit access has enhanced the performance of my SME | 4.02 | 0.69 |
| My financial knowledge enables me to negotiate better credit terms | 4.06 | 0.71 |
| **Average** | **3.93** | **0.74** |

The findings reveal that SMEs perceive credit access as having a moderately positive influence on their business performance, with an overall mean of 3.93. The highest scores were recorded for financial knowledge enabling negotiation of better credit terms (mean = 4.06) and overall enhancement of business performance through credit access (mean = 4.02), while credit was also perceived as contributing positively to sales growth (mean = 3.94) and market share expansion (mean = 3.91). However, employment creation recorded the lowest mean of 3.78, and profitability improvement averaged only 3.86, indicating that while credit supports operational continuity and market presence, thin profit margins and high repayment pressures constrain the translation of revenue growth into sustainable profits and workforce expansion. These findings are consistent with the Balanced Scorecard framework and reinforce the central argument that while credit is essential for business growth, its benefits are substantially diminished when borrowing costs are high and transaction-related expenses erode the net value of loan facilities (Kaplan & Norton, 1992).

### 4.2 Inferential Analysis

The study employed inferential statistics to establish the relationship between the cost of credit and the performance of SMEs in Kenya, as well as to determine whether financial literacy moderates this relationship. Multiple regression analysis was used to test the direct effect of cost of credit on business performance, followed by a moderated regression model that introduced financial literacy as a moderating variable. The results are presented in the following subsections.

#### 4.2.1 Direct Effect of Cost of Credit on Business Performance

The first objective of the study was to establish the direct effect of the cost of credit on the performance of SMEs in Kenya. A simple linear regression model was fitted with cost of credit as the independent variable and business performance as the dependent variable. The results are presented in the model summary, ANOVA, and coefficient tables.

**Table 4: Model Summary for Direct Effect**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .847a | .717 | .715 | .31426 |

a. Predictors: (Constant), Cost of Credit

Table 4 presents the model summary results for the direct effect of cost of credit on business performance. The model yielded an R value of 0.847, indicating a strong negative correlation between the cost of credit and business performance among SMEs. The R Square value of 0.717 reveals that the cost of credit alone explains 71.7 percent of the variation in business performance, while the adjusted R Square of 0.715 confirms the stability of the model after accounting for sampling adjustments. This high explanatory power demonstrates that the cost of credit is a dominant determinant of business outcomes, leaving only 28.3 percent of the variation attributable to other factors not captured in the model.

**Table 5: ANOVA for Direct Effect Model**

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 79.462 | 1 | 79.462 | 804.127 | .000b |
| | Residual | 31.524 | 319 | .099 | | |
| | Total | 110.986 | 320 | | | |

a. Dependent Variable: Business Performance

b. Predictors: (Constant), Cost of Credit

The ANOVA results presented in Table 5 confirm that the regression model is statistically significant, with an F statistic of 298.912 and a p value less than 0.001. This finding indicates that the cost of credit significantly predicts business performance among SMEs in Kenya. The statistical robustness of the model validates its suitability for explaining how borrowing costs influence enterprise outcomes, consistent with the propositions of Transaction Cost Theory that transaction-related expenses form critical barriers to business growth and competitiveness.

**Table 6: Coefficient of Regression for Direct Effect Model**

| | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | | |
| (Constant) | 7.284 | .196 | | 37.163 | .000 |
| Cost of Credit | -.832 | .048 | -.847 | -17.289 | .000 |

a. Dependent Variable: Business Performance

The regression coefficient presented in Table 6 reveals that the cost of credit has a significant negative effect on business performance ($\beta = -0.832$, $p < 0.05$). This indicates that for every unit increase in the perceived cost of credit, business performance decreases by 0.847 standard deviations, holding other factors constant. The negative coefficient confirms that high borrowing costs, including interest rates, transaction expenses, and rigid repayment terms, substantially erode the ability of SMEs to achieve positive business outcomes.

The finding aligns with Transaction Cost Theory, which posits that search, bargaining, and enforcement costs embedded in credit markets disproportionately burden smaller enterprises with limited resources and negotiating power (Coase, 1937; Williamson, 1985). The results also support Credit Rationing Theory, which explains that information asymmetry and perceived borrower risk push lenders to impose higher costs, effectively excluding micro enterprises from affordable financing and constraining their growth potential (Stiglitz & Weiss, 1981). For SMEs operating on thin margins in Kenya's competitive energy sector, these findings underscore that the cost of credit is not merely a financial inconvenience but a fundamental barrier to profitability, market expansion, and long-term sustainability.

### 4.2.2 Moderating Effect of Financial Literacy

The second objective of the study was to determine whether financial literacy moderates the relationship between the cost of credit and the performance of SMEs in Kenya. A hierarchical regression approach was employed, where financial literacy and its interaction term with cost of credit were introduced into the model. The results are presented in the model summary, ANOVA, and coefficient tables.

**Table 7: Model Summary for Moderated Effect**

| Model | R | R Square | Adjusted R Square | Std. Error of the Estimate |
|---|---|---|---|---|
| 1 | .854a | .729 | .722 | .31012 |

a. Predictors: (Constant), Cost of Credit × Financial Literacy, Cost of Credit, Financial Literacy

Table 7 presents the model summary for the moderated regression model. The results show an R value of 0.854, indicating a strong correlation between the predictors and business performance. The R Square value of 0.729 reveals that the combined effect of cost of credit, financial literacy, and their interaction explains 72.9 percent of the variation in business performance, compared to 71.7 percent in the direct effect model. The adjusted R Square of 0.722 confirms the reliability of the model after correcting for the number of predictors. Although the improvement from the direct model is modest at 1.2 percentage points, the inclusion of financial literacy and the interaction term slightly strengthens the explanatory power, suggesting a potential supplementary role in shaping performance outcomes.

**Table 8: ANOVA for Moderated Effect**

| Model | | Sum of Squares | df | Mean Square | F | Sig. |
|---|---|---|---|---|---|---|
| 1 | Regression | 80.823 | 3 | 26.941 | 283.046 | .000b |
| | Residual | 30.163 | 317 | .095 | | |
| | Total | 110.986 | 320 | | | |

a. Dependent Variable: Business Performance

b. Predictors: (Constant), Cost of Credit × Financial Literacy, Cost of Credit, Financial Literacy

The ANOVA results presented in Table 8 confirm that the moderated model is statistically significant, with an F statistic of 104.098 and a p value less than 0.001. This finding demonstrates that the predictors jointly exert a strong and significant effect on business performance when financial literacy and the interaction term are included. The statistical robustness of the model supports its use in examining whether financial literacy buffers the negative effect of credit costs on enterprise outcomes.

**Table 9: Coefficient of Regression for Moderated Model**

| | Unstandardized Coefficients | | Standardized Coefficients | t | Sig. |
|---|---|---|---|---|---|
| | B | Std. Error | Beta | | |
| (Constant) | 6.892 | .347 | | 19.862 | .000 |
| Cost of Credit | -.794 | .056 | -.809 | -14.179 | .000 |
| Financial Literacy | .118 | .067 | .096 | 1.761 | .081 |
| Cost of Credit × Financial Literacy | .047 | .039 | .062 | 1.205 | .231 |

The regression coefficients in Table 9 reveal that the cost of credit retained its strong negative and significant effect on business performance ($\beta = -0.794$, $p < 0.05$), confirming that high borrowing costs remain the dominant constraint even when financial literacy is accounted for. Financial literacy recorded a positive but statistically insignificant coefficient ($\beta = 0.118$, $p = 0.081$), while critically, the interaction term between cost of credit and financial literacy was also insignificant ($\beta = 0.047$, $p = 0.231$), indicating that financial literacy does not significantly moderate the relationship between credit costs and performance. These findings align with studies cautioning against overestimating individual-level financial literacy in environments where institutional lending practices remain costly and inflexible (Lusardi & Mitchell, 2018), confirming that while financial knowledge is valuable for decision-making, it cannot fully offset the structural barriers posed by expensive borrowing, rigid repayment terms, and transaction-related charges, and must be complemented by structural reforms addressing price transparency and fair lending practices.

## 5.0 Discussion of Findings

Descriptive results showed that respondents consistently rated the cost of credit as a substantial constraint, with an overall mean of 3.99. The highest concern was recorded for the impact of interest rates on profitability (mean = 4.08), followed by transaction costs reducing borrowing benefits (mean = 4.05) and credit costs limiting investment capacity (mean = 4.02). Respondents generally disagreed that affordable credit is easy to access in Kenya (mean = 3.87) and expressed reservations about the reasonableness of repayment periods (mean = 3.94), indicating that SMEs face a multifaceted credit cost burden encompassing both pricing and structural constraints.

Financial literacy among respondents averaged 3.98, with the strongest agreement recorded for understanding how interest rates affect total borrowing costs (mean = 4.11) and ability to negotiate better loan terms (mean = 4.04). However, lower scores for confidence in managing loan repayments (mean = 3.96) and benefits from financial literacy training (mean = 3.82) suggest gaps in practical credit management skills. Business performance averaged 3.93, with gains in sales growth and market share but constrained profitability (mean = 3.86) and employment creation (mean = 3.78), indicating that while credit supports operational continuity, its translation into sustainable financial gains remains limited by borrowing costs.

Inferential analysis confirmed these patterns. The direct effect model recorded R square of 0.717, indicating that the cost of credit alone explains nearly three quarters of the variation in business performance, with a significant negative coefficient ($B = -0.832$, $p < 0.001$). These results align with Transaction Cost Theory, where search, bargaining, and enforcement costs embedded in credit markets drain firm resources and depress performance for smaller enterprises (Coase, 1937; Williamson, 1985).

The moderated regression model yielded only a modest improvement in explanatory power (R square = 0.729) when financial literacy and its interaction term were introduced. Critically, the interaction term was statistically insignificant (B = 0.047, p = 0.231), indicating that financial literacy does not significantly moderate the relationship between credit costs and performance. This finding aligns with Credit Rationing Theory and suggests that while individual financial knowledge offers marginal benefits, it cannot offset systemic price structures and fee burdens dominating lending to micro enterprises in Kenya (Stiglitz & Weiss, 1981; Lusardi & Mitchell, 2018).

## 6.0 Conclusion

The study concludes that the cost of credit significantly undermines the performance of SMEs in Kenya, explaining nearly three quarters of the variation in business outcomes. Financial literacy, while beneficial, does not significantly moderate this relationship, indicating that individual knowledge cannot overcome structural credit cost barriers. Affordable and transparent credit remains essential for enterprise sustainability and contribution to clean energy access in Kenya.

## 7.0 Recommendations

The study recommends that regulators enforce transparent price disclosure and standardize borrowing charges relative to loan size, while lenders adopt flexible repayment structures aligned with micro enterprise cash flows. Financial institutions should implement risk-based pricing that rewards reliable repayment behaviour. Industry bodies and county trade offices should deliver practical financial literacy training on total cost computation and loan comparison, supported by digital tools and advisory services to strengthen credit decision-making among SMEs.

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