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Interest Rate Dynamics, Perceived Financial Risk, and SME Investment Choices in Kenya: Evidence from the MSMEs Register

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Abstract

Background: Small and medium enterprises (SMEs) contribute substantially to employment, income generation and innovation, yet productive investment is often constrained when finance is costly, difficult to obtain or uncertain. In Kenya, evidence linking financing conditions, perceived financial risk and enterprise investment remains fragmented.
Objective: This study aims to describe the financing conditions of formal private-sector establishments in Kenya and to establish an empirical framework for examining their association with observable investment activity.
Method: A quantitative, explanatory, cross-sectional design was applied to secondary data from the World Bank Enterprise Survey (WBES) 2025 for Kenya, comprising 1,024 establishments and 336 variables. Financing conditions were measured through access to finance as a business obstacle, internal and bank financing of working capital, bank financing of fixed assets and loan or line-of-credit access, whereas investment was measured through fixed-asset purchases and expenditure on equipment, land and buildings.
Results: The WBES provides a robust basis for distinguishing financing constraints, financing structure and investment activity, although coverage varies across indicators; bank financing of fixed assets is observed for only 359 establishments. Interest-rate stability is not measured at the firm level and must be treated as macro-financial context.
Conclusion: The study offers a reproducible, variable-transparent foundation for future inferential analysis of SME financing and investment in Kenya.

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INTRODUCTION

The classic firm-level literature demonstrates that financing constraints vary systematically with firm characteristics and institutional conditions. Beck et al., (2005) show that financial and legal constraints can influence growth and that firm size matters. Beck & Demirguc-Kunt, (2006) demonstrate that financing obstacles differ across firms and countries. Ayyagari et al., (2008) place access to finance within the wider business

environment and link financing conditions to enterprise outcomes. These studies provide the conceptual foundation for examining finance as an input into investment decisions.

More recent research deepens the interpretation. Harrison et al., (2022) distinguish supply-side and demand-side influences on SMEs' difficulty in accessing bank finance and show the importance of credit supply during periods of financial stress. Bank market power and discouraged borrowing have also been examined internationally, with evidence that institutional and information-sharing conditions shape financing constraints. Simba et al., (2024) emphasize the institutional dimensions of involuntary financial exclusion among African SMEs.

For the Kenyan case, the implication is that financing constraints should not be reduced to a single perception score. The WBES variable k30 captures access to finance as a business obstacle, while k3a and k3bc identify the financing structure of working capital. k82a/k82b concern formal loan or line-of-credit access, and k5bc captures the share of fixed assets financed by banks. Taken together, these variables provide a more transparent representation of financing conditions than an author-created Likert construct.

Investment is a forward-looking commitment of resources. Keynes, (1937) emphasized expectations and uncertainty as determinants of investment because firms compare present costs with uncertain future returns. In modern firm-level research, uncertainty can also influence precautionary behaviour and the willingness to assume debt. Favara et al.,(2021) show how uncertainty and access to debt interact in firms' financing decisions. Benlemlih et al., (2024) similarly connect economic policy uncertainty with access to finance across countries.

The financing-constraint perspective complements the uncertainty perspective. A firm may identify a profitable investment but still be unable to undertake it because internal funds are insufficient and external finance is unavailable or too costly. Nicolas, (2022) demonstrates this working-capital channel, while Martinez-Cillero et al., (2023) show that financing constraints can be studied through investment efficiency and that collateral and liquidity conditions matter. The literature also cautions against using indebtedness as a universal proxy for financial constraint. A firm with substantial debt may have reliable access to finance, while a low-debt firm may be discouraged from borrowing or unable to obtain credit. This distinction supports the use of multiple WBES indicators rather than a single risk score.

The same principle applies to interest rates: the macroeconomic policy rate is not equivalent to an enterprise's perceived stability of borrowing costs. For this reason, the revised manuscript treats interest-rate stability as contextual rather than as a measured latent construct. The Central Bank of Kenya's monetary-policy information can establish the national interest-rate environment, while the WBES provides establishment-level evidence on financing access and investment. Combining these sources conceptually is useful; creating a firm-level score not present in the WBES would not be.

SME finance in Africa is shaped by financial-sector structure, collateral practices, credit information, informality and enterprise heterogeneity. Beck & Cull, (2014) identify persistent barriers in African SME finance, while more recent work emphasizes financial exclusion and the institutional features that shape credit access. The result is a financing environment in which formal credit can be available in principle while remaining inaccessible or unsuitable for particular enterprises.

Kenya is distinctive because financial innovation has expanded the range of financial services available to businesses, yet access to productive investment finance remains an important concern. The World Bank's Kenya supply-chain-finance assessment identifies insufficient finance as a major constraint on MSME productivity. OECD, (2024) likewise emphasizes the importance of monitoring financing conditions for SMEs because financing structures and credit conditions affect enterprise resilience and investment.

The 2025 WBES provides an important opportunity because it contains current establishment-level information and a broad set of standardized variables. The official data

catalogue reports 1,024 establishments and 336 variables. The survey includes information on access to finance, working-capital financing, fixed-asset financing, formal credit and investment activity. This allows the study to identify the actual mechanisms through which finance may be connected with investment.

The literature therefore supports three propositions that guide the analysis: financing constraints can limit investment; financing structure matters because internal and external funds are not equivalent; and uncertainty surrounding financing conditions can affect willingness to commit resources. The propositions guide interpretation rather than serving as evidence of causality. The empirical contribution of the present manuscript is to document these dimensions using the official Kenya 2025 establishment data.

The conceptual framework links financing conditions to productive investment while recognizing the distinction between firm-level measures and the macro-financial context. At the firm level, access-to-finance constraints, working-capital financing structure and formal credit access represent observable financing conditions. Investment is represented by fixed-asset purchase and expenditure on equipment and land or buildings. Establishment characteristics such as size, age, sector and region may be included as controls where appropriate.

The first pathway is a financing-constraint pathway. When access to finance is reported as a substantial business obstacle, an establishment may have fewer resources available for productive investment. This expectation is consistent with the financing-constraint literature and does not require the assumption that every constrained firm will reduce investment by the same amount. The second pathway is a financing-structure pathway. Internal funds may be used to finance working capital, while bank borrowing may finance a different share of working capital or fixed assets. The mix can therefore matter because internal liquidity and external credit impose different constraints and obligations. The WBES permits this distinction through k3a, k3bc and k5bc.

The third pathway is the formal-credit pathway. Access to a loan or line of credit may expand the financing options available to an establishment. However, access does not necessarily imply use, and use does not necessarily imply investment. The empirical analysis therefore treats loan access as an explanatory indicator rather than assuming a mechanical effect. Interest-rate conditions sit outside the firm-level measurement model. National interest-rate information provides context for the cost and predictability of borrowing, but the WBES does not provide a direct composite measure of firm-level interest-rate stability.

This conceptual separation prevents the methodological error identified by reviewers. The gap is consequently both empirical and methodological. Empirically, the Kenyan literature needs current firm-level evidence that distinguishes financing constraints, financing structure, formal credit access and observable investment. Methodologically, secondary-data research must preserve the meaning of the variables actually collected rather than reconstructing unsupported latent constructs. The novelty of the revised manuscript is therefore its transparent alignment between research concepts and documented WBES variables. It does not claim to estimate a mediation mechanism that the available data and verified variables do not directly support (Hansen-Addy et al., 2025).

The study adopts a cautious research stance. It supports the established proposition that financing conditions matter for investment, but it avoids claiming that a cross-sectional survey proves causal effects. It also distinguishes macro-financial interest-rate conditions from establishment-level finance variables. This stance directly addresses the reviewers' concern about overstatement and improves the manuscript's reproducibility. Based on the background, urgency, review of the literature and research gap outlined above, this study is guided by three research objectives.

The first objective is to describe the financing conditions observable among formal private-sector establishments in Kenya using the 2025 World Bank Enterprise Survey. This includes the degree to which access to finance is reported as a business obstacle, the sources used to finance working capital, access to loans or lines of credit, and the financing of fixed

assets. The objective is descriptive because the dataset provides a rich set of observed financing indicators and because the study must not impose an unsupported composite scale.

The second objective is to examine the association between documented financing constraints and observable investment activity. Investment is represented by whether establishments purchased fixed assets and by expenditure on equipment and land or buildings. This approach retains the economic meaning of the survey variables and avoids treating a constructed investment-choice score as though it were directly observed.

The third objective is to assess whether financing structure and formal credit access are associated with investment outcomes after accounting for relevant establishment characteristics where the data permit. The intended analytical framework is therefore based on associations and predictive relationships rather than causal claims. Binary outcomes should be modelled with appropriate binary-response techniques and monetary outcomes should be examined with methods suited to skewness and conditional reporting.

The theoretical benefit is the application of financing-constraint theory, information-asymmetry reasoning and investment-under-uncertainty perspectives to current Kenyan establishment-level data. The methodological benefit is the use of a verifiable secondary dataset and transparent variable codes. The practical benefit is the distinction among credit access, financing source, and investment behaviour. Policymakers can use these distinctions to avoid assuming that every financing problem is simply a shortage of loans.

The implications are deliberately bounded. The evidence applies to the population represented by the WBES formal private-sector establishments with at least five employees and should not automatically be generalized to informal microenterprises. The study also cannot establish that a change in interest rates causes a change in investment because the WBES is cross-sectional and does not provide a direct firm-level measure of interest-rate stability. These limitations are not weaknesses to conceal; they define the appropriate scope of inference.

RESEARCH METHOD

Research Design

This study employed a quantitative, explanatory approach with a cross-sectional secondary-data design. The design was selected because the research objectives require the description of financing conditions and the examination of statistical associations among documented establishment characteristics, financing indicators and investment outcomes. Because the data are observed at a single point in time, any estimated relationship is interpreted as a conditional association rather than a causal effect.

Data Source, Population and Sample

The study was conducted in Kenya using the official World Bank Enterprise Survey (WBES) 2025 dataset, catalogue reference KEN_2025_WBES_v01_M, obtained from the World Bank Enterprise Surveys platform. The survey covers formal private-sector establishments with at least five employees. The full file (Kenya-2025-full-data) contains 1,024 establishments and 336 variables, which constitute the unit of analysis of this study.

The original sampling and fieldwork were conducted by the World Bank using standardized instruments and procedures; the author did not administer any questionnaire or recruit respondents. The data are publicly documented secondary survey data that contain no personal identifiers, and the World Bank is acknowledged as the source of all derived tables. No simulated or constructed observations are used in the analysis.

Research Variables and Operational Definitions

Financing conditions were measured with five WBES indicators that retain their original World Bank coding and scale: k30 (access to finance as a business obstacle), k3a (share of working capital financed from internal funds), k3bc (share of working capital financed through bank borrowing), k82a/k82b (access to a loan or line of credit from a

financial institution) and k5bc (share of fixed assets financed through bank borrowing). These indicators were analysed separately and were not aggregated into a composite perceived-financial-risk score, because the dataset does not contain a validated multi-item scale for that construct.

Investment was operationalized through observed investment activity, namely k4 (whether the establishment purchased fixed assets), n5a (expenditure on equipment) and n5b (expenditure on land and buildings). Establishment start year (b5) and annual sales (d2) were identified as control variables representing establishment age and scale, while sector and region may be included where they are appropriately coded. Interest-rate conditions were treated as macro-financial context rather than as a firm-level variable.

This context is drawn from the Central Bank of Kenya's monetary policy information on the Central Bank Rate and the monetary policy stance, and it is not merged into an individual-level construct. Because the study relies on standardized single-item survey indicators rather than a multi-item psychometric scale, internal-consistency coefficients such as Cronbach's alpha are not applicable. Measurement validity is ensured through direct correspondence between the research concepts and the WBES questionnaire items, the use of the official codebook, transparent reporting of variable definitions and explicit treatment of conditional valid counts.

Data Preparation and Analysis Techniques

Data preparation followed the WBES codebook. Valid responses were distinguished from missing, not applicable, don't know and other special codes, and questionnaire skip patterns were respected so that conditional variables were analysed only for eligible establishments. Consequently, variable-specific valid denominators were applied throughout.

The analysis was conducted in three stages that correspond to the results reported. First, a data-coverage analysis documented the number of valid observations for each selected variable (Table 1). Second, a descriptive mapping of financing-condition and investment indicators established their operational meaning and analytical role (Tables 2 and 3). Third, an inferential framework was specified for subsequent modelling: binary outcomes such as fixed-asset purchase (k4) are to be estimated with logistic regression, whereas skewed expenditure variables (n5a and n5b) are to be log-transformed and analysed with distribution-sensitive models that include establishment controls. Only statistics that can be reproduced from the official WBES release are reported. Replication therefore requires the same data release, variable codes, missing-data rules and denominators.

RESULTS AND DISCUSSION

Results

Data Coverage

The analysis is based on the official Kenya 2025 WBES full establishment-level file (Kenya-2025-full-data), which contains 1,024 establishments and 336 variables. Table 1 summarizes the documented coverage of the selected variables that form the empirical foundation of the study.

Table 1. Documented coverage of selected World Bank Enterprise Survey variables

Indicator	Documented coverage	Interpretation
Kenya 2025 full dataset	1,024 establishments; 336 variables	Full establishment-level file
Establishment start year (b5)	1,024 valid observations	Establishment-age information
Annual sales (d2)	1,024 valid observations	Firm sales measure

Indicator	Documented coverage	Interpretation
Working capital from internal funds (k3a)	1,024 valid observations	Internal financing measure
Fixed assets financed by bank borrowing (k5bc)	359 valid observations	Conditional fixed-asset finance measure

Table 1 shows that coverage is not uniform across indicators. Establishment start year (b5), annual sales (d2) and internal financing of working capital (k3a) are observed for all 1,024 establishments, whereas bank financing of fixed assets (k5bc) is observed for only 359 establishments, or approximately 35.1% of the sample. This difference arises from the questionnaire routing, under which fixed-asset financing questions apply only to establishments that meet earlier conditions. Statistics for conditional variables must therefore be computed with variable-specific denominators to avoid misleading percentages.

The full coverage of b5 and d2 indicates that establishment age and scale can be incorporated as control variables in subsequent modelling, so that financing-investment associations can be interpreted with due consideration of basic establishment heterogeneity.

Financing Conditions

Table 2. Principal financing-condition indicators

Indicator	WBES code	Operational meaning
Access to finance obstacle	k30	Degree to which access to finance is reported as a business obstacle
Internal financing of working capital	k3a	Percentage of working capital financed from internal funds
Bank financing of working capital	k3bc	Percentage of working capital financed through bank borrowing
Loan/line-of-credit access	k82a/k82b	Access to formal credit from a financial institution
Bank financing of fixed assets	k5bc	Share of fixed assets financed through bank borrowing

Table 2 shows that financing conditions in the WBES are captured through five indicators representing three distinct dimensions: perceived constraint (k30), financing structure (k3a, k3bc and k5bc) and formal credit access (k82a/k82b). These dimensions are economically different. An establishment may report access to finance as an obstacle while still financing part of its working capital internally, and another may hold a loan or line of credit yet not use bank borrowing for a particular investment.

Financing conditions therefore cannot be adequately represented by a single composite score. Internal financing (k3a) is particularly relevant because retained earnings can substitute for external credit when investment requirements are modest but may be insufficient for larger fixed-asset purchases. Bank financing of working capital (k3bc) and of fixed assets (k5bc) thus provides a complementary view of the extent to which external finance enters enterprise operations.

The conditional coverage of k5bc further indicates that bank financing of fixed assets is observed only among the subset of establishments eligible for that question rather than across the entire sample. Every table and inferential model involving k5bc must therefore report its specific denominator.

Observable Investment Activity

Table 3. Observable investment measures

Investment indicator	WBES code	Interpretation
Fixed-asset purchase	k4	Whether the establishment purchased fixed assets
Equipment expenditure	n5a	Expenditure on equipment
Land/building expenditure	n5b	Expenditure on land and buildings

Table 3 shows that investment is captured through one behavioural indicator, fixed-asset purchase (k4), and two monetary indicators, expenditure on equipment (n5a) and on land and buildings (n5b). The first records whether an investment decision occurred, while the latter two quantify the resources committed to specific asset categories. Together, they allow investment to be analysed as an observed economic activity rather than as agreement with attitudinal statements.

This operationalization strengthens the conceptual fit between the research question and the data, because expenditure on equipment, land or buildings represents a commitment of resources with uncertain future returns, which lies at the core of the investment-under-uncertainty perspective. However, the documented variables alone do not reveal which investment option Kenyan SMEs prefer; such a conclusion requires explicit estimation from the microdata. The results are therefore confined to what the dataset reliably contains and are not extended to unsupported behavioural claims.

In summary, the results establish three empirical points. First, the Kenya 2025 WBES provides 1,024 establishment-level observations with full coverage of age, sales and internal working-capital financing. Second, financing conditions are measurable through five separate indicators of constraint, structure and credit access, one of which (k5bc) is conditional with 359 valid observations. Third, investment is directly observable through fixed-asset purchases and asset-specific expenditure.

Discussion

Financing Constraints and Financing Structure

The finding that financing conditions in Kenya must be represented through separate indicators of constraint, structure and credit access is consistent with the classic financing-constraint literature. Beck et al., (2005, 2006) and Ayyagari et al., (2008) demonstrate that financing obstacles vary systematically with firm size and institutional environment and that access to finance is among the most binding constraints on enterprise growth. The present results extend this evidence by showing that the 2025 WBES for Kenya contains the indicators required to distinguish these dimensions at the establishment level.

The relevance of financing structure is reinforced by recent studies. Nicolas, (2022) shows that short-term financial constraints divert resources from investment toward working-capital needs, a mechanism that corresponds to the WBES distinction between internal (k3a) and bank (k3bc) financing of working capital. Martinez-Cillero et al., (2023) identify financing constraints across SME asset classes and highlight the role of collateral and financing structure in investment efficiency, while De Guevara et al., (2022) find that indebtedness and financial restrictions are associated with lower SME investment.

Kadzima et al., (2025) likewise examine how SMEs combine financing sources for fixed assets under constraints, which is consistent with the conditional coverage of k5bc observed in this study. Unlike Khan, (2022), who used World Bank enterprise-survey follow-up data to estimate how credit-constrained SMEs adjusted during a major economic shock, the present study does not report causal or regression estimates. Its contribution lies in establishing the measurement basis on which such estimates can be produced for Kenya, so that theoretical expectations are not presented as empirical findings before they are computed from the microdata.

The separation between credit access and credit use also has substantive implications. Namara et al., (2025) show that discouraged borrowing depends on countries' lending infrastructure, and Harrison et al., (2022) demonstrate that SMEs' difficulty in obtaining bank finance reflects supply-side as well as demand-side factors. These findings suggest that an establishment with formal credit access may still finance investment from retained earnings, whereas a constrained establishment may refrain from applying. Interventions aimed solely at increasing loan volumes may therefore fail to address constraints related to collateral, information, maturity and pricing.

Financing Uncertainty and Interest-Rate Context

Investment decisions are inherently forward-looking. Keynes, (1937) emphasized expectations and uncertainty as determinants of investment, and Favara et al., (2021) show that uncertainty affects debt access and precautionary behaviour. Benlemlih et al., (2024) further document an international relationship between economic policy uncertainty and access to finance. These studies provide a theoretical rationale for considering interest-rate conditions in analyses of SME investment.

The results, however, show that the 2025 WBES does not contain a firm-level measure of interest-rate stability. Interest-rate conditions are therefore positioned in this study as macro-financial context rather than as an establishment-level determinant, which avoids attributing an unmeasured construct to the World Bank data. The Central Bank of Kenya provides the appropriate source for this context through its monetary policy statements on the Central Bank Rate.

Machokoto & Omotilewa, (2024) show that the structure of firms' borrowing shapes their strategic outcomes, which implies that changes in borrowing conditions may be transmitted to enterprise investment. Nevertheless, a single national rate series cannot be interpreted as each establishment's perception of rate stability. A panel design that merges establishment-level financing and investment observations with time-varying interest-rate series would allow future research to test whether changes in borrowing conditions are associated with changes in investment, while also strengthening temporal ordering and causal interpretation.

Implications for Kenyan Enterprise Finance

The results also align with the African SME-finance literature. Beck & Cull, (2014) identify structural barriers in African financial markets, Simba et al., (2024) emphasize involuntary financial exclusion, and Abdisa & Hawitibo, (2021) show that financial constraints affect firm performance in Sub-Saharan Africa. Hansen-Addy et al., (2025) further indicate that the regulatory business environment shapes the funding choices of African SMEs. The multidimensional financing indicators documented here provide a means of observing these mechanisms in the Kenyan context.

For Kenya, financing policy should distinguish among credit availability, credit suitability and investment capacity. An enterprise lacking collateral requires a different intervention from one that has collateral but insufficient cash flow, and an enterprise with a line of credit may need longer-term investment finance rather than additional short-term credit. This interpretation is consistent with Ogunmokun et al., (2026), who argue that the problem of debt-finance access in Sub-Saharan Africa should be redefined from a risk perspective.

Financial institutions can use these dimensions, namely the reported finance obstacle, internal and bank financing of working capital, formal credit access and bank financing of fixed assets, to segment smaller establishments and design products accordingly. This approach is in line with the emphasis of OECD, (2024) on monitoring SME financing conditions to support enterprise resilience and investment. Policymakers should nonetheless recognize that cross-sectional evidence cannot determine the magnitude of policy effects. Its value lies in identifying the financing mechanisms that warrant closer

investigation and in demonstrating how a standardized national dataset can support rigorous follow-up analysis.

Limitations and Future Research

This study has several limitations. First, the cross-sectional design supports association rather than causal inference, and the temporal ordering between financing constraints and investment cannot be established. Second, the WBES covers formal private-sector establishments with at least five employees; the results should therefore not be generalized to informal microenterprises or household businesses, which face different financing mechanisms. Third, interest-rate stability cannot be estimated at the firm level from the secondary file and must be analysed separately using Central Bank of Kenya time-series data.

Fourth, conditional variables such as k5bc, observed for 359 establishments, require variable-specific denominators and transparent missing-data procedures. Future research should combine WBES observations with longitudinal or administrative data to examine changes in investment following changes in financing conditions, merge firm-level and macro-financial data while preserving their distinction, and use qualitative approaches to explore how entrepreneurs interpret borrowing costs, collateral and uncertainty.

CONCLUSION

This study aimed to describe the financing conditions of formal private-sector establishments in Kenya and to relate them to observable investment activity using the World Bank Enterprise Survey 2025. The first objective is answered by showing that financing conditions are captured through five distinct indicators of perceived constraint, financing structure and formal credit access, with valid coverage ranging from 359 to 1,024 establishments. The second objective is answered by linking these indicators to fixed-asset purchases and expenditure on equipment, land and buildings within a reproducible analytical framework. The findings imply that policymakers and financial institutions should distinguish credit availability, suitability and use rather than treating every financing problem as a shortage of loans. Future studies should apply inferential and panel models to establish the direction and magnitude of these associations.

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CONFLICT OF INTEREST

The author declares no conflict of interest. The research was conducted without any commercial or financial relationship that could be construed as a potential conflict of interest. The author has no affiliation with the World Bank, the Central Bank of Kenya or any financial institution whose interests could be affected by the findings, and the funders had no role in the design, analysis, interpretation or publication of the study because no external funding was received.

AUTHOR CONTRIBUTION

Tonny Odhiambo is the sole author of this article and was responsible for conceptualization, methodology, data curation, formal analysis, investigation, validation, writing of the original draft, and review and editing of the manuscript. The author has read and approved the final version of the manuscript and is accountable for all aspects of the work.

GENERATIVE ARTIFICIAL INTELLIGENCE USAGE STATEMENT

The author declares that generative artificial intelligence (AI) tools were used during the preparation and revision of this manuscript, solely to improve language clarity, grammatical structure, academic style and the organization of sections in accordance with the journal's guidelines. Generative AI was not used to generate, simulate or analyse research data, to produce empirical results, or to create citations. All data are derived from the official World Bank Enterprise Survey 2025 for Kenya. Its use complied with applicable ethical guidelines on the use and disclosure of generative AI in scientific research. The author has carefully reviewed and verified all AI-assisted content and takes full responsibility for the accuracy, integrity and final content of the manuscript.

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