

Abstract

It is widely believed that micro and small enterprises (MSEs) tend to be discriminated against by formal financial institutions because of highly skewed information asymmetry, moral hazard problems, and high transaction costs. Without credit, small firms tend to remain small. This, in turn, keeps transaction costs high, thereby perpetuating poor access to credit. How to break this vicious cycle is the focus of this paper. Based on primary data, this paper assesses the extent to which Kariobangi MSEs are credit constrained, their major sources of finances, and suggests strategies of breaking the vicious cycle of credit inaccessibility. It was found that over three-quarters of firms are credit constrained. These firms tend to have entrepreneurs with no professional training, less education, less general and sector-specific experiences and those operating micro firms. While a quarter of firms borrow from formal sources, the rest rely on own savings. Various strategies are proposed to break the vicious cycle of credit inaccessibility among MSEs.