

# Loan Financing and Financial Performance of Small Medium Enterprises in Gasabo District, Rwanda

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**Abstract:** Small and Medium Enterprises (SMEs) are pivotal in driving global economic development, accounting for approximately 90% of businesses and over 50% of employment worldwide. However, they face challenges in accessing finance from formal institutions, constraining their financial and non-financial operations. This study sought to assess the effect of loan financing on the financial performance of hardware SMEs. It was guided by three specific objectives based on client appraisal process, access to microcredit and credit rationing on the financial performance of the selected Small and Medium Enterprises. The research was anchored information asymmetry theory, the 5Cs credit model and credit rationing theory. The study used descriptive and correlation research designs. The sample size was 94 selected from 122 respondents using stratified random sampling method. Data was collected using structured questionnaires while the data was analyzed and presented using SPSS version 26. Findings on regression analysis revealed the model was significant ( $F=120.368$ ,  $p < 0.05$ ) and explained 81.1% of the variation in financial performance ( $R^2=0.811$ ). Coefficient estimates showed that client appraisal had a significant negative effect ( $\beta_1=-0.449$ ,  $p < 0.05$ ), access to microcredit had a significant positive effect ( $\beta_2=0.476$ ,  $p < 0.05$ ), and credit rationing had a significant negative effect ( $\beta_3=-0.264$ ,  $p < 0.05$ ). The study concludes that while increased access to microcredit enhances SME performance, rigid appraisal procedures and credit rationing impede growth. The researcher recommends improved SME financial literacy, more flexible lending models and supportive government policies, including credit guarantee schemes, to boost SME access to finance and long-term sustainability.

**Keywords:** SMEs, Access to Finance, Client Appraisal Process, Microcredit, Credit Rationing, Rwanda.

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## 1. INTRODUCTION

### 1.1 Background of the Study

Small and Medium Enterprises (SMEs) are fundamental business because they play key role in driving the global economic development. These enterprises account for over 90% of businesses and provide over 50% of job creations and employment opportunities worldwide. In Europe and North America, SMEs contribute significantly to GDP, with 57% in the European Union and about 44% in the United States (OECD, 2023). Despite their importance, limited access to finance remains a major barrier to SME sustainability and growth. A recent study by Demartini and Paoloni (2020) highlights that European SMEs, particularly in southern countries like Italy and Spain, struggle with high borrowing costs and stringent loan requirements. In West and South Africa, SMEs play a crucial role in alleviating poverty and fostering inclusive growth. They contribute over 40% to GDP and employ more than 60% of the labor force (UNDP, 2021). Nonetheless, financing remains a persistent challenge. A recent study by Abor and Quartey (2020) identifies high interest rates, lack of collateral, and limited financial literacy as key barriers to SME growth in Ghana and Nigeria. In South Africa, digital financial platforms have begun to bridge these gaps, with fintech companies like Yoco and Jumo providing innovative lending solutions tailored to SME needs (IMF, 2023).

In East Africa, SMEs are integral to economic resilience, particularly in countries like Kenya, Uganda, and Rwanda. Despite their potential, access to credit is a significant obstacle. Only 23% of SMEs in the region have access to formal financial services, as highlighted by Ndagijimana *et al.* (2022). In Kenya, the rise of digital lending platforms, such as Tala and Branch, has transformed SME financing by providing quick and accessible loans. However, a study by Otieno *et al.* (2020) emphasizes the need for regulatory frameworks to ensure the sustainability and affordability of these platforms. Based on the Ministry of Trade and Industry (MINICOM) report from 2020, entrepreneurship in Rwanda has been steadily advancing in recent years. A significant number of businesses in Rwanda are categorized as young and micro-sized. In 2014, 90% of firms were relatively new, having been established post-2006. The share of micro-enterprises, which accounted for 73% of all businesses in 2011, decreased to 65% by 2014. This reduction highlights an important increase in the number of small and medium-sized enterprises (SMEs) relative to micro businesses. Additionally, between 2011 and 2017, the number of large firms employing over 100 staff expanded substantially, growing from 106 to 426. This growth signifies the maturity of Rwanda's market and enhanced opportunities for MSMEs to integrate into value chains. Many Rwandan firms are primarily active in the service sector (MINICOM, 2020). By 2024, the growth of micro, small and medium enterprises accounted for 98 percent of business and employing over 2.5 million people. They contribute to the 33 percent of the GDP in the country (MINICOM, 2024).

In Rwanda, SMEs account for over 95% of businesses and contribute about 55% to GDP (National Institute of Statistics of Rwanda, 2022). Despite these contributions, the financing gap for SMEs remains significant, with 41% of businesses reporting limited access to formal credit (World Bank, 2023). Empirical evidence by Mukarugwiza *et al.* (2023) demonstrates that government initiatives, such as the Business Development Fund (BDF), have improved financial access for some SMEs. However, challenges such as high collateral requirements and limited financial literacy persist, particularly for startups and informal enterprises. This study focused on hardware SMEs in Gasabo District which are vital to the local economy, providing essential materials for construction and infrastructure development. However, they face unique challenges, including competition, market fluctuations, and financial constraints. A recent survey by Nsengimana *et al.* (2023) reveals that 65% of hardware SMEs in Kigali struggle to access affordable credit, which hampers their ability to invest in inventory and expand operations. Local partnerships between financial institutions and SMEs have begun to address these challenges, but more comprehensive solutions are needed to enhance their financial performance and sustainability. Existing studies have not sufficiently explored the intersection of loan financing and the financial performance of hardware SMEs in Rwanda. This study aimed at addressing this gap by investigating the effect of loan financing on the financial performance of hardware SMEs in Gasabo District. By providing actionable insights, the researcher sought to inform policy interventions and financial strategies to support the growth and sustainability of these enterprises.

## 1.2 Research Objectives

The general objective of this study was to assess the effect of loan financing on the financial performance of small medium enterprises in Rwanda, focusing on some selected SMEs. The specific objectives that guided this study include:

- i) To examine the effect of client appraisal process on the financial performance of the selected Small and Medium Enterprises.
- ii) To analyze the contribution of access to microcredit on the financial performance of the selected Small and Medium Enterprises.
- iii) To assess the influence of credit rationing on the financial performance of the selected Small and Medium Enterprises.

## 1.3 Research Hypotheses

The following null hypotheses were tested:

**H<sub>01</sub>:** There is no significant effect of client appraisal process on the financial performance of the selected Small and Medium Enterprises.

**H<sub>02</sub>:** There is no significant contribution of access to microcredit on the financial performance of the selected Small and Medium Enterprises.

**H<sub>03</sub>:** There is no influence of credit rationing on the financial performance of the selected Small and Medium Enterprises.

## 2. REVIEW OF RELATED RESEARCH

### 2.1 Theoretical Review

The Client Appraisal Process is a fundamental aspect of loan financing, used by financial institutions to evaluate the creditworthiness and repayment capacity of borrowers. This process involves a detailed examination of factors such as financial records, operational viability, collateral, and other critical attributes of the applicant's profile. Its importance lies in mitigating credit risks and enhancing the sustainability of lending operations. In recent years, studies have underscored the vital role of client appraisal in facilitating access to the financing of Small and Medium Enterprises (SMEs). According to Asongu *et al.* (2019), robust client appraisal mechanisms have been shown to improve loan performance, especially in economies where SMEs form the backbone of economic growth. Appraisal practices often include financial analysis, site visits, and personal interviews, which help lenders assess the overall risk profile of the borrower. These measures are instrumental in ensuring that loans are extended to clients who demonstrate both the ability and willingness to repay.

Focusing on the SME sector in Rwanda, the importance of client appraisal is particularly pronounced. Overall, the SMEs contribute for the most of businesses in the country and are key drivers in employment, job creation opportunities and economic development (World Bank, 2023). However, the limited capacity of SMEs to meet traditional lending requirements poses significant challenges for both borrowers and lenders. Empirical evidence by Nkurunziza *et al.* (2022) indicates that banks and microfinance institutions in Rwanda have increasingly adopted context-specific appraisal practices. These include simplified financial evaluations and community-based assessment models, which are better suited to the realities of SMEs in the region.

For hardware SMEs in Gasabo District, the client appraisal process is even more critical due to the sector's unique characteristics. Hardware SMEs require substantial working capital to maintain inventory and meet the fluctuating demands of the construction industry. A study by Uwitonze and Habimana (2023) highlights that effective appraisal processes, tailored to the operational dynamics of hardware businesses, significantly enhance their access to credit and financial performance. However, the study also points to persistent challenges, such as high collateral demands and limited financial literacy, which need to be addressed to improve loan accessibility for these businesses.

Access to Microcredit has emerged as a transformative tool for enhancing financial inclusion, particularly in developing economies where traditional financing systems often exclude small and micro-businesses and low-income individuals. Microcredit relates to the process of providing small amounts of loans to entrepreneurs and businesses who are excluded or lack the access to conventional banks. By addressing structural barriers to credit access, microcredit has a very critical role that it plays in the financial empowerment of Small and Medium Enterprises (SMEs) and fostering economic growth. In recent years, microcredit institutions have gained prominence as an alternative source of financing for SMEs.

For SMEs, access to microcredit is particularly vital as it provides the working capital needed to sustain operations and expand business activities. Empirical studies show that microcredit positively impacts SME financial performance. As Njoroge *et al.* (2021) note, microcredit enhances SMEs' capacity to invest in productive assets, resulting in improved profitability and revenue growth. However, challenges such as high interest rates and limited loan sizes persist, which may constrain the effectiveness of microcredit in meeting the long-term financial needs of SMEs.

Microcredit serves as a critical source of funding for hardware SMEs in Gasabo District. These businesses which require significant capital to purchase inventory and meet market demands. The construction sector's cyclical nature often leads to fluctuations in cash flow, making access to flexible and timely financing essential for hardware SMEs. According to Uwitonze *et al.* (2023), hardware SMEs that access microcredit tend to perform better financially than those relying solely on informal funding sources. However, the study also notes that the high cost of microcredit can erode profit margins, highlighting the need for innovative financing solutions tailored to the unique needs of hardware businesses.

Credit rationing refers to the limitation of credit availability to potential borrowers, who have requested for loans, even if they are capable and willing to repay the loans at the given credit terms. This phenomenon is often employed by financial institutions to mitigate the risks associated with loan defaults, particularly in uncertain economic environments. For SMEs, credit rationing remains a persistent challenge, as lenders perceive them as high-risk borrowers due to inadequate financial records, limited collateral, and market volatility. Over the past few years, studies have highlighted the impact of credit rationing on SMEs' ability to access financing. According to Afolabi *et al.* (2020), credit rationing occurs when banks restrict the provision of loan facilities to SMEs to manage portfolio risks, prioritizing larger, more established firms with better credit profiles. Although this strategy minimizes risk for lenders, it hinders the growth potential of SMEs by limiting their ability to access necessary capital for operations and expansion.

In developing economies like Rwanda, credit rationing is a common barrier for SMEs, particularly in sectors like hardware businesses, which are capital-intensive. Empirical evidence by Nkurunziza *et al.* (2023) suggests that many Rwandan SMEs face partial or complete credit rationing due to a lack of audited financial statements and limited collateral. For hardware SMEs in Gasabo District, this can result in restricted access to inventory financing, thereby affecting their operational efficiency and profitability. Microfinance institutions and alternative lenders have attempted to address the issue of credit rationing by introducing innovative financing mechanisms. For instance, lending models that rely on cash flow analysis rather than traditional collateral requirements have gained traction in Sub-Saharan Africa. According to Musanze and Habimana (2021), such approaches reduce the likelihood of credit rationing for SMEs while enabling lenders to assess repayment capacity based on business performance rather than asset ownership.

However, while these innovations have mitigated some aspects of credit rationing, challenges remain. Ndege *et al.* (2021) in their study note that digital lending platforms often impose high interest rates, which can strain the financial resources of SMEs. Additionally, limited financial literacy among SME owners exacerbates the problem, as they may struggle to navigate the complexities of alternative lending models or digital credit platforms. In the specific context of hardware SMEs, credit rationing poses unique challenges due to the sector's dependence on timely financing to procure inventory and meet market demands. According to Mukarugwiza *et al.* (2022), hardware SMEs in Rwanda are more likely to experience credit rationing due to their capital-intensive nature and relatively high operational risks. To address this issue, targeted financial interventions, such as subsidized loan programs and capacity-building initiatives, are necessary to bridge the financing gap and ensure the sustainability of hardware businesses.

## 2.2 Empirical Literature

Mutaganira and Kengere (2023) assessed the contributing effect of credit management processes on the performance in terms of the finances of commercial banks in Rwanda with the case of Congebank plc. The result showed that credit appraisal process ( $r=0.119$ ,  $p<0.05$ ) is significantly and positively related to the financial performance of commercial banks. Aziz, *et al.*, (2021) studied the effect of credit evaluation of SMEs and how this influence the performance of these firms. The findings reported that SMEs face myriad of challenges when it comes to loan financing. In most literature evaluated, the credit appraisal process used by banks to advance credit to SMEs tend to be tedious, rigorous and time consuming. Consequently, many SMEs face challenges in accessing loan financing.

In their study, Boushnak, *et al.*, (2020) assessed different factors that affect the lending decisions to SMEs in Egypt. The findings reported that each component of the 5C model was statistically significant with p-values of less than 5%. All the 5Cs combined gave an  $R^2=0.426$ , which indicated that the credit appraisal process affects the loan decision making in banks and may act to hinder the loan financing opportunities for the SMEs. Munguti and Wamugo (2020) study sought to find out the accessibility of microcredit facilities and their effect on the performance of SMEs in Kenya. The findings showed a significant regression model ( $F=16.478$ ,  $p<0.05$ ) indicating an  $R^2=0.565$ . In particular, the findings showed that access to microcredit for SMEs greatly and positively influence ( $\beta=0.468$ ,  $p<0.05$ ) the financial performance and growth of SMEs. Widyastuti, *et al.*, (2023) assessed the factors like financial literacy and credit conditions. The findings reported that financial literacy ( $\beta=0.454$ ,  $p<0.05$ ) significantly influence the accessibility to credit and thereby influencing the financial performance of SMEs.

Ngarukiye and Twesige (2024) assessed the factors affecting the access to finance and the growth of SMEs in Rwanda. The study focused on primary data gathered using structured questionnaires. The findings reported a significant but low impact ( $R^2=0.174$ ,  $p<0.05$ ) showing that accessing to credit usually influences the performance of SMEs in Rwanda. Similarly, Nyiransabimana and Tarus (2023) also reported positive impact of credit services ( $\beta=0.337$ ,  $p<0.05$ ) provided by SACCOs on the performance of SMEs in Rwanda. Iwedi (2020) studied the nexus between institutional credit and SMEs growth in Nigeria. The study used ordinary least square and found that improving accessibility to credit financing ( $\beta=0.555$ ,  $p<0.05$ ) increases the growth rate of SMEs. Kibet and Munene (2024) assessed the effect of credit rationing practices on the financial performance of commercial banks in Kenya. The findings reported a positive and strong correlation ( $r=0.707$ ,  $p<0.05$ ) between credit rationing and financial performance of commercial banks. On their part, Tobias, *et al.*, (2024) used causal and descriptive designs to study the influence of collateral requirements on the credit rationing of SMEs in Kenya. It was found that collateral requirements by the lending institutions ( $r=0.693$ ,  $p<0.05$ ) positively lead to higher credit rationing for SMEs who may not have adequate collateral assets to secure loan financing from formal institutions. Mariyamungu and Kengere (2023) conducted research evaluating how credit management practices influence the financial performance of SMEs in Rwanda. The findings showed that the use of credit scoring increased the credit rationing for SMEs thereby negatively influencing their access to loan financing from the formal lending marketing. This was indicated by about 57.6% of the respondents stating that credit scoring may negatively lead to challenges in accessing credit for the SME sector.

## 2.3 Theoretical Framework

### Information Asymmetry Theory

The current study is founded on the Information Asymmetry Theory, introduced by George Akerlof in his 1970 paper, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, highlights how imbalances in information between parties can lead to market inefficiencies, such as adverse selection. Michael Spence expanded on this theory in 1973 with his concept of signaling, while Joseph Stiglitz explored screening mechanisms. These contributions have been foundational in understanding how information asymmetry affects various economic interactions, including credit markets. The information asymmetry theory states that in many economic and financial transactions, one party often possesses more or better information than the other. This imbalance of information can lead to financing challenges for SMEs.

The relevance of Information Asymmetry Theory to the current study lies in its ability to explain the challenges SMEs face in accessing loan financing. Financial institutions often possess more information about creditworthiness and risk assessment than SMEs, leading to adverse selection and credit rationing. Further, most formal lending institutions view the SMEs as opaque with very minimal financial information. Hence, during the credit appraisal process, they tend to screen these businesses more carefully, increasing the information costs. Consequently, with the presence of information challenges, the cost of accessing loan financing tend to increase for these small and medium enterprises. By addressing these asymmetries, the study can provide insights into improving credit appraisal processes, enhancing access to microcredit, and mitigating the effects of credit rationing, ultimately contributing to the financial performance of SMEs in Rwanda.

### The 5Cs Credit Model

The 5Cs Credit Model originated as a standardized framework within the banking and financial industry to assess the creditworthiness of borrowers. While there is no single individual credited with its development, the model has evolved over decades as a best practice among financial institutions to minimize lending risks and make informed decisions. The 5Cs—Character, Capacity, Capital, Collateral, and Conditions—provide a structured approach to evaluating a borrower. Character reflects the borrower's trustworthiness and track record in repaying loans, while Capacity evaluates the ability of the borrowers to repay based on financial income or cash flow level of their businesses. Capital considers the financial resources or assets owned by the borrower, Collateral evaluates the security pledged to secure the loan, and Conditions refer to external factors such as economic conditions or loan terms that may influence repayment.

This theory resonated well with the current study. It is related with this study insofar as it emphasizes the various components observed or assessed during advancing credit to the client. Hence, its relevance is in its ability to dissect critical aspects of the credit appraisal process, one of the key independent variables. By applying this model, the study can identify specific barriers SMEs in Rwanda face, such as high collateral demands or limited financial capacity, that may hinder their access to loan financing. This study helps to understand these elements which provides actionable insights into how financial institutions can tailor lending practices to support SMEs' financial needs and thereby improve their financial performance and growth. In addition, the study, provides to the debate on challenges facing SMEs financing.

### Credit Rationing Theory

Another key theoretical foundation for this study is the Credit Rationing Theory (CRT), introduced by Joseph Stiglitz and Andrew Weiss in their influential 1981 paper *Credit Rationing in markets with imperfect information*. The theory explains why financial institutions may restrict the supply of credit to borrowers, even when those borrowers are prepared to accept higher interest rates. It is grounded in the concept of information asymmetry, where lenders face challenges in accurately differentiating between low-risk and high-risk borrowers. In such cases, increasing interest rates may attract riskier borrowers or incentivize existing borrowers to undertake riskier projects, creating adverse selection and moral hazard. Consequently, lenders choose to ration credit instead of raising rates to mitigate potential losses.

The relevance of Credit Rationing Theory to the current study lies in its ability to explain one of the critical independent variables—credit rationing—and its impact on SME financial performance. By analyzing the mechanisms through which credit rationing occurs, the study can provide insights into the systemic barriers SMEs in Rwanda face in accessing financing. This understanding is crucial for recommending measures to improve access to credit and enhance the profitability, revenue growth, and operational efficiency of SMEs.

## 2.4 Conceptual Framework

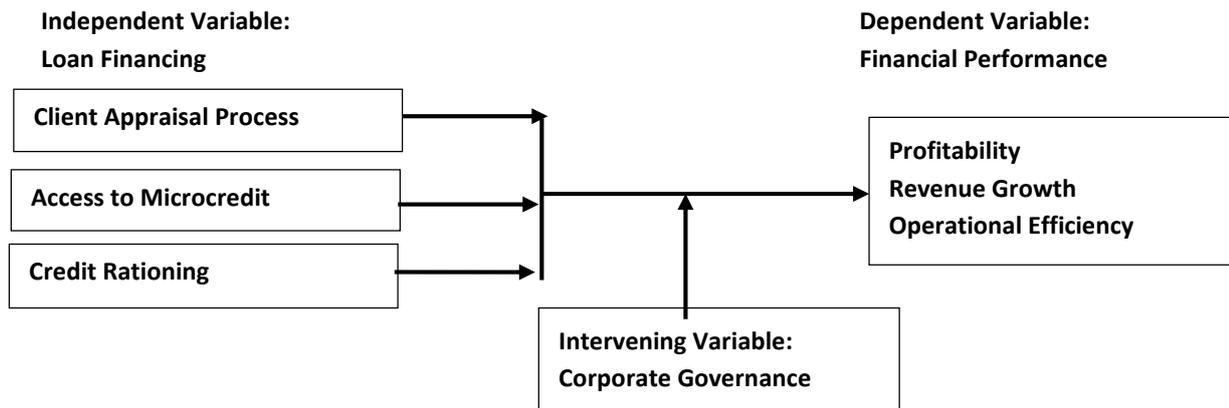


Figure 2.1: Conceptual Framework

Source: Researcher (2026)

The diagram represented in Figure 2.1 shows the main concepts in this study. These are grouped into two main concepts, namely, the independent variable and the dependent variable. The independent variable in this study was the loan financing, with the following key indicators, client appraisal process, access to microcredit and credit rationing. The researcher argued that favorable loan financing from formal lending institutions would lead to an improved financial performance of SMEs in Rwanda. More specifically, the use of loan financing can improve the availability of extra funds for the SMEs and consequently, help these businesses to smoothen out their financial operations. Thereby, the use of loan financing can greatly influence the financial performance of hardware small and medium enterprises. The intervening variable in this study was corporate governance.

## 3. RESEARCH METHODOLOGY

### 3.1 Research Design

This study used descriptive research design as well as the correlational research design. Hence, this study employed quantitative research design. In this study, the researcher focused on some selected hardware SMEs in Kabuga town, Gasabo District. Hence, the target population was made up of ten hardware businesses in Kabuga town.

### 3.2 Sampling Design

In this study sample size was determined using Yamane (1967) formula as shown below.

$$n = \frac{N}{1 + Ne^2} = \frac{122}{1 + 122 * 0.05^2} = 93.49 \approx 94$$

Where n=sample size, N=target population, e= margin of error (5%).

The sample was selected using the stratified random sampling technique as shown in Table I.

Table I: Population and the Sample size

Small and Medium Enterprises	Population	Proportion	Sample Size
Isezerano Hardware	8	0.07	6
Quincallerie Ijano Company Ltd	16	0.13	12
Quincallerie Best Quality, best products	14	0.11	11
Gwiza NS Ltd	9	0.07	7
Jasim Light	12	0.10	9
M & Robert Paints ltd	13	0.11	10
Mwendo Trader Ltd	7	0.06	5
Spark Light Supply and Trading Ltd	18	0.15	14
FC Smart Hardware	10	0.08	8
Mulinga Hardware	15	0.12	12
<b>Total</b>	<b>122</b>		<b>94</b>

Source: Field preliminary survey (2026)

### 3.3 Data Collection Methods

In this study, structured questionnaire was used to collect the primary data. The results were analyzed using Pearson correlation. In addition, the research conducted multiple regression analysis to check the effect of loan financing on the financial performance of small and medium enterprises in Rwanda. The regression equation was formulated as follows:

$$y = \beta_0 + \beta_1x_1 + \beta_2x_2 + \beta_3x_3 + \epsilon \dots\dots\dots(2)$$

Where: y=the dependent variable (Financial Performance)

$\beta_0$ = regression constant

$\beta_1, \beta_2,$  and  $\beta_3$ = are the regression coefficients for  $x_1, x_2, x_3$  respectively.

$x_1, x_2$  and  $x_3$  =are the independent variable (loan financing) indicators including credit appraisal process, access to microcredit and credit rationing respectively.

$\epsilon$ = error term

## 4. RESEARCH FINDINGS AND DISCUSSIONS

### 4.1 Inferential Statistics

This section presents and discusses the effect of loan financing on the financial performance of SMEs in Rwanda, more specifically based on hardware shops. In this study, the indicators used for loan financing included client appraisal process, accessibility to micro-credit and credit rationing. On the other hand, the financial performance of SMEs was assessed using profitability, revenue growth and operational efficiency. To analyze the effect of loan financing on the financial performance of hardware shops in Rwanda, this study utilized Pearson Correlation analysis as well as multiple regression analysis.

**Table II: Pearson Correlation analysis**

		Financial Performance	Client Appraisal	Access Microcredit	Credit Rationing
Financial Performance	Pearson Correlation	1	-.757**	.804**	-.335**
	Sig. (2-tailed)		.000	.000	.001
	N	88	88	88	88
Client Appraisal	Pearson Correlation	-.757**	1	-.644**	.002
	Sig. (2-tailed)	.000		.000	.985
	N	88	88	88	88
Access Microcredit	Pearson Correlation	.804**	-.644**	1	-.147
	Sig. (2-tailed)	.000	.000		.170
	N	88	88	88	88
Credit Rationing	Pearson Correlation	-.335**	.002	-.147	1
	Sig. (2-tailed)	.001	.985	.170	
	N	88	88	88	88

\*\* . Correlation is significant at the 0.01 level (2-tailed).

**Source: Research (2026)**

Table II reports the correlation analysis between the loan financing variables and financial performance of SMEs in Rwanda. This analysis was done using Pearson correlation analysis. The correlation analysis results indicate that client appraisal is negatively and significantly related to financial performance ( $r=-0.757, p < 0.05$ ), suggesting that stricter or more demanding appraisal processes are associated with lower financial performance among SMEs. These findings contradict earlier empirical findings by Mutaganira and Kengere (2023) which showed that credit appraisal process ( $r=0.119, p < 0.05$ ) positively and significantly affect the financial performance of commercial banks. But in relation to the SMEs financing, the findings are in tandem with those of Aziz, *et al.*, (2021) who showed that the credit appraisal process used by banks to advance credit to SMEs tend to be tedious, rigorous and time consuming. Consequently, many SMEs are negatively affected due to this appraisal process.

On the other hand, access to microcredit shows a strong positive and significant relationship with financial performance ( $r=0.804, p < 0.05$ ). This implies that better access to microcredit facilities enhances SME financial outcomes. These results

are in line with the findings reported by Munguti and Wamugo (2020) study which showed that access to microcredit for SMEs greatly and positively influence ( $\beta=0.468, p<0.05$ ) the financial performance and growth of SMEs. Mrindoko (2022) in his study also reported that access to microcredit ( $r=0.395, p<0.05$ ) offered by mobile banks positively influence the financial performance of the small and medium enterprises. Ngarukiye and Twesige (2024) reported a significant but low impact ( $R^2=0.174, p<0.05$ ) showing that accessing to credit usually influences the performance of SMEs in Rwanda.

Lastly, credit rationing was found to be negatively and significantly correlated with financial performance ( $r=-0.335, p < 0.05$ ), implying that higher levels of credit restriction hinder SME financial performance. Iwedi (2020) in his study found that improving accessibility to credit financing ( $\beta=0.555, p<0.05$ ) increases the growth rate of SMEs. Mariyamungu and Kengere (2023) observed that the use of credit scoring increased the credit rationing for SMEs thereby negatively influencing their access to loan financing from the formal lending marketing.

**Table III: Regression model analysis**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.901 <sup>a</sup>	.811	.805	.09303

a. Predictors: (Constant), Access Microcredit, Client Appraisal, Credit Rationing

**Source: Research (2026)**

Table III reports the summary of the regression model. The results showed that the model had a strong fit with  $R^2=0.811$  indicated that 81.1% of the variation in financial performance of SMEs can be explained jointly by the three predictors, access to microcredit, client appraisal, and credit rationing. This suggests that the model has a strong explanatory power of the variation attributable to the three factors included in the model.

**Table IV: The Analysis of Variance Table**

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3.125	3	1.042	120.368	.000 <sup>b</sup>
	Residual	.727	84	.009		
	Total	3.852	87			

a. Dependent Variable: Financial Performance

b. Predictors: (Constant), Access Microcredit, Client Appraisal, Credit Rationing

**Source: Research (2025)**

Table IV shows the regression model was statistically significant ( $F=120.368, p<0.05$ ) with p-value of less than 5%. This indicated that the overall regression model was statistically significant. This means that when combined, access to microcredit, client appraisal, and credit rationing have a significant effect on financial performance of SMEs in Rwanda. These findings contradict earlier empirical findings by Mutaganira and Kengere (2023) which showed that credit appraisal process positively and significantly affect the financial performance of commercial banks. Similarly, Munguti and Wamugo (2020) study showed that access to microcredit for SMEs greatly and positively influence the financial performance and growth of SMEs.

**Table V: Regression coefficient analysis**

Model		Unstandardized Coefficients		Standardized Coefficients		Sig.
		B	Std. Error	Beta	t	
1	(Constant)	3.742	.290		12.918	.000
	Client Appraisal	-.232	.032	-.449	-7.198	.000
	Access Microcredit	.369	.049	.476	7.541	.000
	Credit Rationing	-.149	.027	-.264	-5.457	.000

a. Dependent Variable: Financial Performance

**Source: Research (2026)**

Table V reports the regression coefficient analysis. The results reported in this study related to the analysis of the effect of credit appraisal process, the access to microcredit and credit rationing and their effects on financial performance of SMEs in Rwanda. The first null hypothesis was stated as follows **H<sub>01</sub>**: There is no significant effect of client appraisal process on the financial performance of the selected Small and Medium Enterprises. The regression coefficient for client appraisal process ( $\beta_1 = -0.232$ ,  $p < 0.05$ ) was negative and statistically significant. Since the p-value was less than 5%, the null hypothesis was rejected. This implied that client appraisal process was statistically significant and that a one-unit increase would lead to 0.232 decrease in financial performance. The findings are in tandem with those of Aziz, *et al.*, (2021) who showed that the credit appraisal process has negative effect on SMEs performance. The empirical findings reported by Mutaganira and Kengere (2023) however showed that credit appraisal process ( $r = 0.119$ ,  $p < 0.05$ ) positively and significantly affect the financial performance of commercial banks

Further, the regression analysis was used to test the second null hypothesis. The second null hypothesis was stated as follows **H<sub>02</sub>**: There is no significant contribution of access to microcredit on the financial performance of the selected Small and Medium Enterprises. On analysis, the regression coefficient for access to microcredit ( $\beta_2 = 0.369$ ,  $p < 0.05$ ) showed a p-value less than 5%. Hence, the null hypothesis was rejected. This implied that access to microcredit significantly and positively influences the financial performance of SMEs in Rwanda. More specifically, the results showed that a one-unit increase in access to microcredit is linked to a 0.369 increase in financial performance of the hardware shops in Rwanda. These results are in line with the findings reported by Munguti and Wamugo (2020) study which showed that access to microcredit for SMEs greatly and positively influence ( $\beta = 0.468$ ,  $p < 0.05$ ) the financial performance and growth of SMEs. Again, Mrindoko (2022) in his study also that access to microcredit ( $r = 0.395$ ,  $p < 0.05$ ) has positive effect.

Lastly, the regression analysis was used to assess the effect of credit rationing on the financial performance of small and medium sized enterprises. The third null hypothesis was stated as follows **H<sub>03</sub>**: There is no influence of credit rationing on the financial performance of the selected Small and Medium Enterprises. Upon the regression analysis, the coefficient for credit rationing ( $\beta_3 = -0.149$ ,  $p < 0.05$ ) was found to be negative. Since the p-value was less than 5% threshold, the null hypothesis was rejected. This suggests that credit rationing that SMEs are subjected to by commercial banks and other lenders negatively and significantly affect the financial performance of small medium enterprises. Further, the results implied that a one-unit increase in credit rationing corresponds to a 0.149 decrease in financial performance of hardware shops in Rwanda. Findings by Iwedi (2020) showed that improving accessibility to credit financing ( $\beta = 0.555$ ,  $p < 0.05$ ) increases the growth rate of SMEs.

#### 4.2 Discussion of the Key Findings

This study sought to assess the effect of loan financing on the financial performance of small medium enterprises in Rwanda. More specifically, the study focused on small medium hardware business in Kigali. To achieve this objective, the researcher identified three main indicator variables of loan financing, namely, client appraisal process, access to microcredit and credit rationing. On the other hand, the dependent variable was financial performance assessed by variables such as profitability, revenue growth and operational efficiency. With regards to the first objective, the study findings revealed that credit appraisal had a significant and negative relationship with the financial performance of SMEs ( $r = -0.757$ ,  $p < 0.05$ ;  $\beta_1 = -0.232$ ,  $p < 0.05$ ). This implies that more stringent or rigorous credit appraisal processes were associated with lower financial performance, possibly because such processes hinder timely and sufficient access to financing.

These findings contrast with Mutaganira and Kengere (2023), who reported a positive and significant relationship ( $r = 0.119$ ,  $p < 0.05$ ) between credit appraisal and financial performance in commercial banks, suggesting that thorough appraisal enhanced performance. Similarly, Boushnak *et al.* (2020) found that appraisal, as measured through the 5C model, significantly influenced lending decisions, implying a supportive role if well implemented. However, the present study's results align more closely with Aziz *et al.* (2021), who noted that tedious and time-consuming appraisal procedures hinder SMEs from obtaining financing, ultimately affecting performance negatively. The contrast may stem from context: while banks benefit from meticulous appraisal in protecting asset quality, SMEs on the receiving end may suffer from delayed or denied credit. Therefore, the results suggest that for SMEs, overly rigorous appraisal can act as a barrier to loan financing and consequently, to the growth of SMEs in Rwanda.

With regards to the second specific objective, the research sought to find out the effect of access to microcredit on the financial performance of SMEs in Rwanda. The study findings revealed that access to microcredit had a strong positive relationship with SME financial performance ( $r = 0.804$ ,  $p < 0.05$ ;  $\beta_2 = 0.369$ ,  $p < 0.05$ ). This indicates that better access to microcredit significantly boosts SMEs' profitability and growth, likely by enabling them to finance operations, expand

market reach, and invest in growth opportunities. These findings align closely with Munguti and Wamugo (2020), who found that microcredit accessibility had a strong positive influence ( $\beta=0.468$ ,  $p < 0.05$ ) on SME growth and sustainability. Similarly, Widyastuti *et al.* (2023) confirmed that better credit access, facilitated by financial literacy, improved financial performance, while Mrindoko (2022) found a positive correlation ( $r=0.395$ ,  $p < 0.05$ ) between mobile microcredit and SME performance. The results also resonate with Nyiransabimana and Tarus (2023), who reported a positive effect of SACCO credit services on SME performance in Rwanda. The consistent positive association across contexts suggests that access to microcredit remains a universally enabling factor for SMEs, regardless of geographic or sectoral variations. The present findings reinforce the argument that expanding microcredit channels, especially those that are affordable and flexible, is crucial for sustaining the financial performance of small enterprises.

On the third specific objective, this study concerted to find out the effect of credit rationing on the financial performance of SMEs in Rwanda. Upon regression analysis, the results showed that credit rationing had a negative and significant relationship with the financial performance of SMEs ( $r=-0.335$ ,  $p < 0.05$ ;  $B_3=-0.149$ ,  $p < 0.05$ ). This suggests that higher levels of credit rationing—through stringent collateral requirements, restrictive loan terms, or selective lending—reduce SMEs' ability to access the funds needed for growth and profitability. These findings are consistent with Mariyamungu and Kengere (2023), who reported that credit rationing, particularly via credit scoring, limits SME access to loans and negatively impacts their performance. Likewise, Ngarukiye and Twesige (2024) highlighted the adverse effect of rationing on loan accessibility in Rwanda. However, the results contrast with Kibet and Munene (2024) and Tobias *et al.* (2024), who found positive relationships between credit rationing and financial performance in the context of banks, implying that rationing may help maintain loan portfolio quality for lenders. The difference can be attributed to perspective—what benefits the lender's financial stability can constrain the borrower's performance. For SMEs, credit rationing limits liquidity, limits the availability of funds, thereby slowing investment, and reduces competitiveness, reinforcing the need for balanced lending practices that safeguard lender interests while supporting SME growth.

### 4.3 Conclusions

The study concluded that financial performance of SMEs is significantly influenced by client appraisal, access to microcredit, and credit rationing. Effective client appraisal processes are essential for ensuring that lending decisions are based on accurate assessments of a borrower's ability to repay. However, when appraisal procedures are overly stringent or inflexible, they can limit access to much-needed financing, thereby constraining business growth. The findings suggest that while appraisal is necessary for risk management, it should be designed to accommodate the unique circumstances of small businesses without compromising lending standards.

Access to microcredit emerged as a strong positive contributor to SMEs' financial performance. Availability of affordable and timely financing enables businesses to maintain adequate stock, invest in expansion, and respond to market opportunities. Microcredit also supports operational stability by cushioning SMEs against short-term cash flow challenges. Expanding such access, therefore, has the potential to directly improve business sustainability and profitability.

Conversely, credit rationing was found to have a negative effect on financial performance. Restrictive lending practices, including high collateral requirements and loan amount limits, hinder SMEs from acquiring the capital necessary for growth and competitiveness. These constraints can force businesses to rely on costly or unreliable financing sources, which undermines their operational efficiency and profitability.

Overall, the study emphasizes the importance of a balanced approach to SME financing—one that ensures prudent lending through effective appraisal while also expanding access to affordable credit and reducing unnecessary barriers. Strengthening these aspects can significantly enhance SME resilience, growth, and contribution to the wider economy.

### 4.4 Recommendations

Based on the findings provided, the researcher makes several recommendations to SMEs owners, loan providers, policy makers and future researchers. To the SMEs, the researcher recommends that these enterprises should maintain accurate and up-to-date financial records to strengthen their credibility during client appraisal. They should also invest in financial literacy to better manage borrowed funds, ensuring loans are used for productive purposes that enhance profitability. Building a strong credit history will improve access to affordable financing. To the SMEs owners, the researcher recommends that they should diversify financing sources to reduce reliance on a single lender, which can minimize the impact of credit rationing. They should also actively engage with lenders to negotiate favorable loan terms, including

repayment schedules aligned with business cash flows. Further, putting effective strategic plans for loan utilization can help to maximize returns on borrowed capital.

To the lenders, the researcher recommends that they should adopt flexible but effective client appraisal models that account for the unique realities of SMEs, such as limited collateral. Expanding microcredit programs with competitive interest rates and simplified loan processes can boost SME growth. Offering financial management training alongside lending can also improve repayment rates and business sustainability. To the policy makers, they should create an enabling environment for SME financing through regulatory frameworks that encourage competition among lenders and protect borrowers from predatory practices. They should also promote guarantee schemes and credit information sharing systems to reduce lender risk and improve SME access to affordable credit. Additionally, policies that incentivize innovation in SME financing, including digital lending platforms, can enhance financial inclusion and support economic growth.

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