# FACTORS INFLUENCING INTEREST RATES ON CREDIT TO MSMEs IN LIBERIA

SURVEY REPORT

# CONTENTS



## ACKNOWLEDGMENTS

This survey report is a product of the SME Finance Working Group (SMEFWG) and its members.

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We would like to thank AFI member institutions, partners and donors for generously contributing to the development of this publication.

# 1. ABSTRACT

**Multiple demand and supply-side factors affect the high interest rates on credit to micro, small, and medium enterprises (MSMEs) in Liberia.**

This report analyzes credit provided by commercial banks, microfinance institutions (MFIs), and other lenders, drawing on empirical data from Liberia and wider Sub-Saharan Africa (SSA).

It finds that interest rates in Liberia are influenced by a combination of high operational costs, credit risk premiums, and market structure on the supply side, as well as borrower characteristics and collateral constraints on the demand side. Liberia's lending rates are broadly in line with other high-risk, low-income SSA economies, though higher than rates in more financially developed SSA countries. The paper concludes with a discussion of policy implications, highlighting the importance of improving credit information systems, reducing transaction costs, and enhancing the overall lending environment to lower the cost of credit for Liberian MSMEs.

# 2. INTRODUCTION

**Access to affordable credit is crucial for the growth of micro, small, and medium enterprises (MSMEs).**

In Liberia, MSMEs account for a significant share of employment and economic activity, yet often face **high borrowing costs** and limited access to financing. Interest rates on loans to MSMEs are often cited as a major barrier to business expansion and entrepreneurship. Anecdotal evidence and reports suggest that **lending rates in Liberia** are higher than in neighboring countries, which raises critical questions: What drives these high interest rates?

*Are they primarily a result of lender-related factors such as the cost of funds and risk management (supply-side), or due to borrower-related factors like creditworthiness and collateral (demand-side)?*

Understanding these factors is key for policymakers and financial sector stakeholders who aim to improve MSME access to credit.

This paper provides a detailed analysis of the determinants of interest rates on MSME credit in Liberia, considering loans from commercial banks, microfinance institutions, and other lenders (such as credit unions and informal moneylenders). It presents both demand-side and supply-side factors that influence the cost of credit. It also incorporates comparative data from Sub-Saharan Africa to contextualize Liberia's situation. By examining both empirical data and theoretical perspectives, the study offers insights into why MSME lending rates are at their current levels, and what might be done to reduce them.

The structure of the paper is as follows: the **Literature Review** discusses existing research and theories on interest rate determination for MSMEs; the **Methodology** outlines the approach and data sources; **Analysis** delves into the demand-side and supply-side factors in detail and compares Liberia with regional peers; and the Conclusion summarizes findings and implications for policy and practice.

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# 3. LITERATURE REVIEW

**A substantial body of literature has examined the determinants of lending interest rates and interest rate spreads, especially in developing countries and for MSME financing.**

**Theoretical frameworks** often start from the classical loan pricing model, where the interest rate is set to cover the lender's cost of funds, operational costs, a premium for credit risk, and a profit margin. In microfinance, for instance, the interest rate on a small loan must cover **operational expenses** (which tend to be high per dollar lent, due to small loan sizes and labor-intensive processes), the cost of the funds that the institution itself borrows or uses, expected loan losses (credit risk), and a margin for sustainability or profit. This can be expressed in the formula:

*"Loan Interest Rate"="Cost of Funds"+"Operating Costs"+"Loan Loss Provisions"+"Profit Margin".*

For mainstream banking, a similar concept applies through the idea of **interest rate spreads** – the difference between the lending rate and the deposit rate – which must cover banks' operating costs, risk, and profits. Studies in Sub-Saharan Africa (e.g., IMF working papers on African banking) have found that interest rate spreads are generally higher in Africa than in other regions, due to factors like higher operating costs and higher risk premiums (IMF Working Paper: "Interest-Rate Spreads in English-Speaking African Countries" (2007, WP/07/101).. Research on banking sectors in low-income countries indicates that overhead costs (as a percentage of assets) and non-performing loan ratios are significantly associated with wider interest margins. These findings suggest that in countries like Liberia, where the banking sector is relatively small and faces many

many structural challenges, lending rates would incorporate hefty premiums for cost and risk.

Another relevant theoretical perspective is the credit rationing theory of Stiglitz and Weiss (1981), which argues that beyond a certain point, raising interest rates to cover higher risk can be counterproductive for lenders. Higher rates may discourage safer borrowers and attract riskier ones (adverse selection) or encourage borrowers to take riskier projects (moral hazard). As a result, lenders may ration credit (i.e., restrict loan supply) rather than price it solely based on supply-demand equilibrium. In the Liberian context, this theory could explain why banks might be reluctant to lend to smaller, riskier MSMEs at any interest rate, preferring instead to lend to larger, safer borrowers or invest in government securities including the Central Bank of Liberia (CBL) bills, even if MSMEs indicate willingness to pay very high rates.

**Empirical studies on MSME finance in Africa** have highlighted both demand-side and supply-side issues. On the demand side, many MSMEs lack collateral and credit history, which leads to higher perceived risk. On the supply side, factors such as lack of competition in the banking sector, absence of robust credit information systems, and macroeconomic instability (inflation and exchange rate risk) tend to drive interest rates up. A 2018 World Bank study on African small business lending found that banks often include a significant **risk premium** for SME loans due to uncertainty in borrower information. Likewise, microfinance research (CGAP reports) notes that the **administrative cost per loan** in low-income countries is very high, a cost which is passed onto borrowers as higher interest.

Liberia-specific studies are relatively scarce, but reports by the CBL, the IMF and IFC offer some insights. CBL's annual reports often discuss the banking sector's performance and challenges: they note issues like high non-performing loan (NPL) ratios and high overhead costs for banks operating in a difficult economic environment. These conditions contribute to maintaining high lending rates. A 2018 IFC enterprise finance survey in Liberia noted that many MSMEs consider the cost of credit as a major constraint, alongside collateral requirements. Although exact interest rate data for MSME-specific loans is not always published, it is acknowledged that micro-loans and small enterprise loans carry higher rates than large corporate loans in Liberia, consistent with risk-based pricing.

Overall, the literature suggests a confluence of factors influencing MSME lending rates: macroeconomic risk, institutional weaknesses (e.g. weak contract enforcement, limited credit information), lender operational costs, and borrower-specific risks. The theoretical frameworks and prior studies provide a lens through which we can analyze Liberia's situation in detail. The next sections outline how this study approached this analysis, before delving into the specific factors at play in Liberia, corroborated by data where available.

# 4. METHODOLOGY

**This study employs a mixed-methods approach, combining quantitative analysis of available data with qualitative insights from prior studies and economic theory.**

**Secondary data** on interest rates and financial indicators was gathered from sources such as the World Bank's World Development Indicators (for average lending interest rates and interest rate spreads in Liberia and other countries), the Central Bank of Liberia (for local banking sector statistics), and reports by organizations like the IMF and IFC that discuss Liberia's financial sector and MSME finance. Comparative data for Sub-Saharan Africa (SSA) were collected to benchmark Liberia's interest rates against regional peers. In cases where Liberia-specific data for MSME lending rates were limited, proxy indicators were used (e.g., overall average lending rates in the economy, microfinance institution reports, and anecdotal evidence from surveys).

On the qualitative side, the study reviewed literature on interest rate determinants, especially those relevant to developing countries and MSME credit. This informed the identification of key **demand-side** and **supply-side** factors to examine. The study then analyzed how each factor is manifested in Liberia's context, using a narrative synthesis of findings from reports and theoretical expectations.

**Demand-side factors** are defined as those relating to the characteristics and behavior of MSME borrowers that affect the interest rate (or the willingness of lenders to supply credit at a given rate). Supply-side factors relate to lenders (banks, MFIs, etc.), financial markets, and the broader economic environment that influence the cost of providing loans. This study also differentiates between types of lenders – notably commercial banks vs. microfinance institutions vs. informal lenders – since their cost structures and target clientele differ markedly, which in turn affects their interest rate levels.

This study includes tables and charts to illustrate key data points, such as how Liberia's lending rates compare with other countries and what typical interest rates are charged by different lender types in Liberia. All monetary values are in Liberian dollars or annual percentage rates, unless otherwise noted.

The analysis does not involve primary data collection, relying on the most recently available data. It aims to provide a comprehensive picture of the factors affecting interest rates on MSME credit in Liberia.

ANALYSIS AND FINDINGS

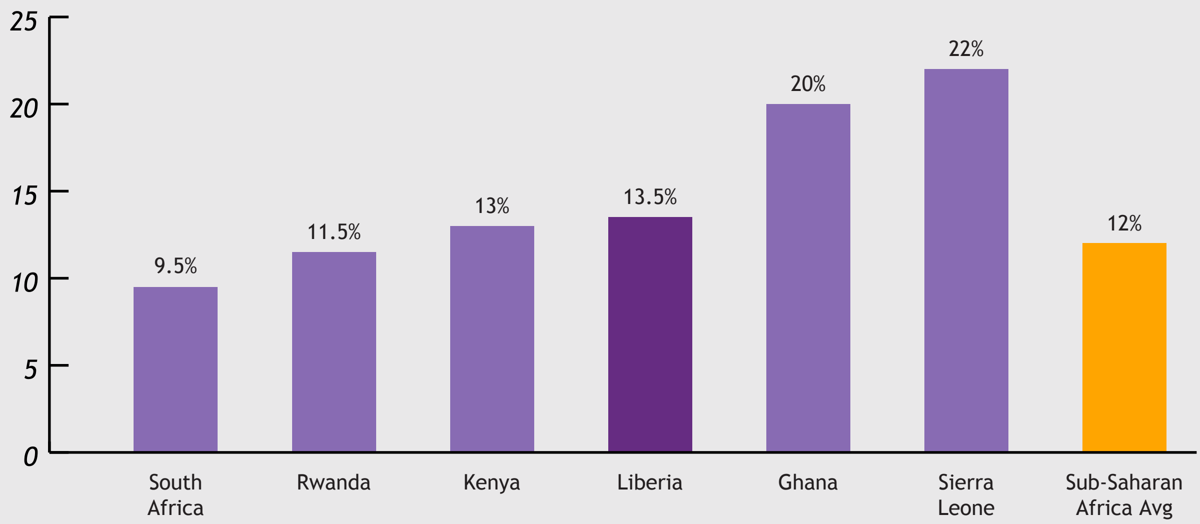
## 5. OVERVIEW OF MSME LENDING RATES: LIBERIA IN CONTEXT

**Liberia's interest rates on loans have historically been relatively high, reflecting the country's post-conflict economic challenges and underdeveloped financial sector.**

In the late 2010s and early 2020s, **average lending interest rates** were in the low-to-mid teens in percentage terms. Lending rates averaged 13–14% annually in recent years (for standard commercial loans) according to Central Bank data. This average encompasses loans across the economy, including larger borrowers; interest rates for smaller enterprises and microloans often exceed this average due to higher risk and transaction costs. Also, substantial fees and charges take the borrowing cost far beyond the nominal interest rate.

When comparing the average lending interest rate in Liberia with selected Sub-Saharan African (SSA) countries, we observe that Liberia's average lending rate (around 13%) is similar to some peer countries but lower than the highest in the region. Countries like Sierra Leone and Ghana, which have faced higher inflation or economic turmoil in recent years, exhibit average lending rates of 20% or above. In contrast, more stable or financially developed markets like South Africa have lower lending rates (around 9–10%). The SSA average hovers around 12%, although with wide variation between countries. Liberia's rate being slightly above the SSA average indicates that local lending costs are elevated, but not an extreme outlier in the African context. Another important factor to consider in the Liberian case is the highly dollarized nature of the economy, with USD being the dominant currency for financial transaction. Therefore, the interest rate is relatively lower than other countries that use only their local currencies.

**Figure 1. Average lending interest rates in Liberia versus selected Sub-Saharan African countries (approximate values around 2020).**




*Source: World Bank World Development Indicators and national central bank reports.*

Liberia's interest rate environment fits the pattern of low-income, higher-risk economies – credit is relatively expensive. A combination of macroeconomic factors (such as inflation and exchange rate risk) and microeconomic factors (like banking sector efficiency and competition) drive these rates. Multiple factors influence interest rates on MSME credit in Liberia, starting with demand-side (borrower-related) factors and then supply-side (lender-related) factors. These factors differ across types of lenders (banks vs. microfinance vs. others).

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# 6. DEMAND-SIDE FACTORS AFFECTING INTEREST RATES

**Demand-side factors are characteristics of MSME borrowers and the nature of demand for credit that can influence the interest rates charged, or whether loans are offered at all. In Liberia, several demand-side issues play a role:**

1. **Limited Collateral and Guarantees:** Most MSMEs have insufficient collateral to secure loans. Borrowers often lack land titles or other high-value assets that banks typically require. This increases the **perceived risk** of lending to them. When collateral is absent or of low quality, lenders compensate by charging higher interest to cover the greater risk of loss in case of default. Many MSME owners report that even when they are willing to pay high interest, they are unable to get loans because they cannot meet collateral requirements, reflecting credit rationing behavior by lenders rather than simply price adjustment.

2. **Informational Asymmetry (Lack of Credit History):** Borrowers in the MSME segment often do not have formal credit histories or audited financial statements. In Liberia, credit information infrastructure is in its infancy – a CBL credit reference system is operational, but is largely rudimentary with limited coverage. The **lack of reliable information** on borrowers' creditworthiness forces lenders to assume a worst-case risk scenario, leading to higher interest rates or outright refusals to lend. Essentially, MSMEs are charged a **risk premium** because lenders cannot easily distinguish between high-risk and low-risk borrowers in the absence of good information.

3. **Small Loan Sizes and High Frequency:** MSMEs often need relatively small loans, sometimes short-term working capital loans, which means they will be borrowing and repaying more frequently. From the borrower's perspective, even if the annualized interest rate is high, they may tolerate it for short-term loans (e.g., a one-month loan at 5% interest might sound acceptable to a business seeking quick turnover, but that equates to a high annual rate of 60%). This **inelastic demand** for quick, short-term credit at high rates (often from informal lenders or microfinance) can keep interest rates elevated, because some MSMEs are willing to pay high rates for immediate funds. Borrowers may focus on whether they can manage the periodic payment, rather than the annual percentage rate, which reduces competitive pressure on lenders to lower rates.

4. **Financial Literacy and Alternatives:** Many small business owners have low financial literacy and may not fully understand or compare interest rate offerings. In Liberia, the formal financial sector's outreach is limited; some MSMEs might not shop around for better rates due to lack of access or familiarity with banks. This can reduce **price sensitivity** on the demand side. Additionally, if MSMEs have limited alternatives (e.g., few banks or MFIs in their locations, or being excluded from formal credit due to documentation issues), they may accept higher rates from informal lenders. The lack of viable financing alternatives means the demand-side pressure to keep interest rates low is weak.

In summary, the demand-side factors in Liberia contribute to high interest rates primarily by increasing the risk profile of borrowers (lack of collateral and information) and by reducing the competitive pressure to lower rates (inelastic demand and lack of alternatives). Borrowers' needs and behaviors allow lenders to charge more or force them to do so to cover risk.

# 7. SUPPLY-SIDE FACTORS AFFECTING INTEREST RATES

**In Liberia, several supply-side factors drive up the interest rates on MSME loans:**

1. **High Cost of Funds:**
   Banks and formal lenders often face a high cost of capital. The country's financial system is dollarized, and banks sometimes rely on expensive foreign credit lines to attract funds. If the Central Bank's policy rates or treasury bill rates are high (as a risk-free benchmark), they set a floor below which banks won't lend. For example, if government T-bills yield 5-7%, banks would only lend to MSMEs at a significantly higher rate to compensate for the higher risk and effort. For microfinance institutions, the cost of funds can be even higher, since they may borrow from commercial sources or international lenders at substantial interest. The high cost of funds translates directly into higher lending rates to maintain a margin.

2. **Operational and Administrative Costs:**
   Lenders in Liberia, particularly MFIs and rural banks, face **high operating costs.** Infrastructure challenges (poor roads, electricity issues, need for manual processes) and the small scale of the financial sector mean that serving customers is expensive. Banks in Liberia must cover costs for security, generators, imported banking technology, and skilled labor, at high cost. When loans are small (as with MSMEs), the cost per loan as a percentage of the loan amount is significant. For instance, whether a bank processes a $5,000 MSME loan or a $50,000 corporate loan, the administrative effort is similar, but the smaller loan generates far less interest income to cover those costs. As a result, lenders charge higher interest rates or fees on smaller loans to make lending commercially viable.

3. **Credit Risk and NPLs:**
   The perceived and actual **credit risk** of MSME lending in Liberia is high. Many MSMEs operate in volatile sectors (like trading, agriculture) and are vulnerable to shocks (e.g., commodity price changes, weather and climate impact, epidemics). Lenders price in a substantial risk premium to cover expected loan losses. The banking sector has experienced high non-performing loan (NPL) ratios – well into double-digit percentages of total loans. When past loans have gone bad at significant rates, banks respond by keeping interest rates high to compensate for the losses on defaults. This becomes a vicious cycle: high rates themselves can strain borrowers and increase default risk, but banks feel compelled to protect themselves given uncertain default recovery rates (which are low in Liberia due to weak contract enforcement).

4. **Limited Competition in the Financial Sector:**
   Liberia's formal financial sector which caters to MSMEs is small. A few institutions, including microfinance institutions, dominate the market. Limited competition can lead to **high-interest rate spreads** because there is less pressure to lower lending rates. If all banks face similar cost structures and risk environments, they tend to all charge similarly high rates. Moreover, if one or two banks perceive certain MSME segments as too risky and avoid them, the remaining lenders who do serve those segments effectively face little competition and can charge a premium. The same goes for microfinance: with

with only a few significant MFIs and very high demand for small loans, MFIs often have the latitude to charge interest rates that cover their costs without fear of losing clients to a competitor.

5. **Regulatory and Macro Environment:** Unlike some countries, Liberia does **not have interest rate caps** on loans – which means lenders are not legally constrained from charging high rates (aside from general usury laws, which are not strictly defined in Liberia for microloans). In some East African countries, interest caps were introduced (e.g., Kenya had a cap in 2016-2019) which forced rates down for a period; Liberia's policy-makers have not taken that route, partly for fear it would dry up credit supply. Additionally, macroeconomic instability (such as episodes of high inflation or sharp depreciation of the Liberian dollar) leads lenders to increase rates to protect the real value of their capital. If inflation is, say, 10%, a lender will want the loan rate for local currency to be significantly higher than 10% to ensure a real return. In the 2018–2020 period, Liberia experienced inflation above 20% at times, and although some loans are in USD (mitigating currency risk for those loans), Liberian dollar loans saw interest rates climb in response. The uncertainty and volatility in the economy encourage a more conservative, high-rate lending stance among financial institutions.

These supply-side factors create an environment where the baseline lending rate for MSMEs is elevated. These factors often interplay with each other – for example, high NPLs (credit risk) can be both a cause and effect of high interest rates, and high operational costs coupled with low competition virtually ensure that those costs will be passed to borrowers rather than absorbed or offset by efficiency gains.

# 8. INTEREST RATE DIFFERENCES BY TYPE OF LENDER

**The landscape of MSME credit in Liberia includes various types of lenders, chiefly commercial banks, microfinance institutions, and other lenders such as credit unions, Village Savings and Loan Associations (VSLAs) or informal moneylenders.**

Each of these handles interest rates differently based on their business model and clientele.

1. **Commercial Banks:**
   Most banks in Liberia provide loans to the upper tier of MSMEs (often the medium enterprises or more formally established small businesses). They usually charge the lowest interest rates among the lenders discussed here, but that is relative – bank loans to MSMEs might come with annual interest rates in the range of 14% to 18%. Well-collateralized or lower-risk small business clients (for instance, those borrowing in USD or those with steady contracts) might secure lower rates, while less established MSMEs or those borrowing in Liberian dollars face higher rates. Banks also add various fees that increase the effective cost. They tend to be **risk-averse** and may simply not lend at all to micro-enterprises perceived as high-risk, preferring to ration credit rather than charge exorbitant rates. So, while bank interest rates might look “lower” on paper, access is restricted.

2. **Microfinance Institutions (MFIs):**
   MFIs cater to micro and small enterprises, including market vendors, small farmers, and traders who usually cannot meet bank requirements. MFIs in Liberia charge higher interest rates than banks, often in the range of about 3-5% **per month** on the loan balance. This translates to effective annual rates easily between 40% and 70%, once fees are included. Unlike banks, MFIs typically do not require traditional collateral; they may use group lending mechanisms or take other forms of security (like business assets or guarantor systems). The higher rates are necessary for MFIs to cover their higher operational costs – they often do door-to-door collection, financial literacy training, and have smaller loan sizes. For example, an MFI loan of LRD 50,000 (about US$250 at an exchange rate of 1USD to L$200 in August 2025) might have a flat monthly interest that seems small in currency terms but is high in percentage terms. MFIs justify these rates by pointing to the intensive work involved in serving their clients and the lack of economies of scale. In Liberia, MFIs have been crucial for MSME finance, but their loan interest rates reflect the reality of microlending economics in a challenging environment.

3. **Credit Unions and VSLAs:**
   A few credit unions and savings and loan cooperatives (VSLAs) exist in Liberia. They are typically member-based and might offer slightly more favorable terms to their members than commercial banks would, since their motive can be more community-oriented. Interest rates in credit unions could be lower than MFI rates, perhaps closer to bank rates or even less for short-term loans (some credit unions in West Africa offer single-digit interest on short-term loans to members, funded by member savings). However, the scale of these institutions in Liberia is quite small, and not many MSMEs have access to them. Their impact on the overall credit market is limited, and they often face the same challenges of defaults and limited capital, which can drive their rates up if not subsidized.

4. **Informal Moneylenders:**
A significant portion of micro-entrepreneurs in Liberia rely on informal lenders or family networks for credit. Informal moneylenders (such as local merchants who extend supplier credit, or professional moneylenders including some money exchangers) charge the **highest interest rates** of all, often calculated on a short-term basis. It is not uncommon for informal loans to have interest of 20-25% **per month** for very short durations (for instance, "borrow 10,000 LRD today, pay back 12,500 LRD in one month" is effectively a 25% monthly rate). This can equate to astronomical annual rates (well over 200% if compounded), although such loans are usually not meant to be long-term. These lenders fill the gaps when formal institutions deny credit. They operate based on personal relationships and are outside regulatory oversight. Because they take on extreme risk (no collateral, no legal enforcement guarantees) and because they have their own opportunity cost (lending out personal cash), they charge accordingly. The presence of such high-rate lending indicates a desperate demand for credit among some MSMEs and a lack of sufficient formal options.

Table 1 below summarizes typical interest rate ranges for different lender types serving MSMEs in Liberia.

As shown, there is a clear gradient in interest rates, with commercial banks offering the lowest rates (but to the most creditworthy MSMEs) and informal lenders the highest (to those with no other option). This underscores that interest rates for MSME credit are heavily dependent on where the enterprise can access finance. Most MSMEs that can borrow do so at the higher end of the spectrum, since the smallest and riskiest firms are effectively shut out of bank credit and must rely on MFIs or informal loans.

**Table 1. Typical interest rate ranges by type of lender for MSME loans in Liberia**

| Lender Type | Typical Annual Interest Rate (APR) | Notes |
|---|---|---|
| Commercial Banks | ~14% - 18% | Lower end for well-established SMEs with collateral; higher end for riskier small businesses. Additional fees common. |
| Microfinance Institutions (MFIs) | ~40% - 70% (effective) | Often charged as 3%-5% per month flat interest. Small loan sizes, high service costs. Group lending or alternative collateral methods used. |
| Credit Unions/VSLAs | ~15% - 25% | Rates vary; sometimes lower for members if subsidized. Limited reach; not a major share of MSME credit. |
| Informal Moneylenders | Very high (often 15-25% per month) | Short-term lending with interest calculated monthly. Used for quick cash needs; extremely high effective annual rates. |

*(APR = Annual Percentage Rate. Ranges are indicative; actual rates vary by specific institution and loan terms.)*

# 9. COMPARATIVE PERSPECTIVE: LIBERIA VS. SUB-SAHARAN AFRICA

**Many of the factors identified in Liberia's case are common across Sub-Saharan Africa, especially in low-income and post-conflict countries.**

Many of the factors identified in Liberia's case are common across Sub-Saharan Africa, especially in low-income and post-conflict countries. High interest rates for MSMEs are a regional challenge: **Sierra Leone** and **Guinea** also have limited financial infrastructure and high lending costs, often resulting in bank lending rates around 20% or more. In **Ghana**, until recently, even prime borrowers faced interest rates in the high teens, and SMEs often paid above 20%, driven by years of double-digit inflation and tight monetary policy.

On the other hand, some SSA countries have managed to attain relatively lower MSME lending rates. In **Kenya**, with its innovative financial sector (including mobile money and digital lending), competition and efficiency has helped bring SME rates down into the low to mid-teens percent (aside from a period of a legally imposed cap). **Rwanda** invested heavily in credit information systems and has had moderate inflation, contributing to lower lending rates for SMEs (sometimes in the low teens). **South Africa**, a middle-income country with a well-developed banking sector and lower inflation, has SME rates often in the single digits or just above 10%.

Comparatively, Liberia's situation is in the higher end of the cost-of-credit spectrum, thanks to factors such as high operational costs, credit risk, and lack of competition. In contrast, countries that have reduced those specific frictions have seen lending rates fall. In **Tanzania** or **Ghana**, functional collateral registries and credit bureaus have improved lenders' ability to assess and secure MSME loans, which can reduce risk premiums. Some economies also have government or donor-backed schemes that lower the effective interest rates for MSMEs - such as partial credit guarantee schemes that encourage banks to lend to SMEs by sharing the default risk, or subsidized credit lines for priority sectors. In Liberia, such schemes are limited in scale; although there have been some, including an SME credit stimulus facility after Ebola and during COVID-19, which offered loans at slightly reduced rates through banks and MFIs and the current MSME Line of Credit (LOC) under the Liberia Investment Finance and Trade (LIFT) project.

It is also instructive to look at **interest rate spreads** (the difference between lending and deposit rates) as a measure of financial intermediation efficiency. **Financial intermediation efficiency** refers to how effectively financial institutions, especially banks, **mobilize savings and allocate credit** to productive sectors of the economy at the lowest possible cost and risk. It measures how well banks perform their core role of intermediating between savers (depositors) and borrowers (investors, businesses, households). In Liberia, interest rate spreads have often been above 10 percentage points, which is high by global standards. This indicates inefficiencies and high costs in the system (according to the CBL's annual report, as of December 2024, the average deposit rate was about 2%, and average lending rate about 12%). Many SSA countries have spreads in the 5-10 percentage point range, while more advanced markets are lower. The high spreads in Liberia align with the narrative of costly and risky lending. Reducing these spreads - and hence lending rates - would likely require structural changes (more competition, better information, macro stability) as demonstrated by the trajectory of other countries.

In summary, Liberia shares many of the same root causes of high MSME lending rates as its regional peers, but it also faces some unique post-conflict challenges and a very shallow financial sector. The comparative data suggests that progress is possible: as conditions improve (stability, infrastructure, financial sector development), interest rates for MSMEs can come down, as seen in other SSA countries that implemented reforms.

# 10. CONCLUSIONS AND POLICY IMPLICATIONS

**The interest rates on credit to MSMEs in Liberia are the product of a complex interplay between demand-side and supply-side factors.**

**Demand-side factors** such as lack of collateral, absence of credit history, and low financial literacy among borrowers contribute to a high-risk perception and weak bargaining power for MSMEs, which in turn allows or forces lenders to charge high rates.

**Supply-side factors** – including expensive funding costs, high operational expenses, significant credit risk, limited competition, and a challenging macroeconomic environment – directly inflate the cost of lending that financial institutions must pass on to borrowers. In Liberia, these issues are particularly acute given the country's stage of development and post-war context, resulting in lending rates for small businesses that are high by global standards and burdensome for entrepreneurs.

While many SSA countries contend with similar issues, the extent to which these factors manifest can be greater in Liberia due to its smaller economic base and nascent financial infrastructure. High interest rates on MSME loans impede business expansion, as a large portion of profits must go to servicing debt. They can also push businesses to rely on internal funds or informal lenders, thereby limiting their growth and the overall development of the formal financial system.

**Policy implications** from these findings point to several areas of intervention:

1. **Improving Credit Information and Reducing Risk Premiums:**
   Strengthening the credit reference and collateral registry systems would help reduce information asymmetry. If lenders can more accurately assess MSME creditworthiness and securely register collateral (including movable assets), the perceived risk declines, and interest rate premiums can be trimmed. In addition to legal reforms, the ongoing support to Liberia's credit reference and collateral registry systems under the Liberia Investment Finance and Trade (LIFT) project could be impactful.

2. **Enhancing Competition and Efficiency:**
   Encouraging new entrants in the banking and microfinance sector or supporting alternative lending channels (like fintech solutions for MSMEs) could increase competition, pressuring incumbents to become more efficient and lower rates. Additionally, promoting digital financial services could reduce transaction costs – for example, if loan applications, disbursements, and repayments can be done via mobile platforms, it may lower the operational costs that currently inflate interest rates.

3. **Macro Stability and Financial Sector Support:**
   Maintaining a stable macroeconomic environment (low and stable inflation, stable exchange rates) is fundamental. It reduces the uncertainty premium in interest rates. The Central Bank of Liberia has a key role to play by continuing its pursuit of prudent monetary policy. Additionally, in keeping with its third mandate of supporting the overall economic policy of the government, the CBL should provide low-cost refinancing facilities for SME lending. Care must be

taken, however, as forcing rates down (e.g., through caps) without addressing underlying costs could lead to reduced credit supply. A balanced approach is needed, possibly including targeted credit guarantee schemes or interest rate subsidies for priority sectors such as agriculture and manufacturing, to temporarily ease rates while longer-term fixes take hold.

4. **Building MSME Capacity:**
   Helping MSMEs become more "credit-ready" can make a difference. This includes business development services that improve financial record-keeping, encouraging a savings culture to build relationships with financial institutions, and training on how to prepare loan applications. If MSMEs can present themselves as lower-risk clients, they can negotiate better terms. Over time, a track record of successful MSME lending can convince lenders that this segment is viable at lower interest spreads. The CBL through the Development Finance Department and in collaboration with the Liberian Business Association and the Chambers of Commerce could roll out activities aimed at building the capacity of MSMEs.

In conclusion, lowering the cost of credit for MSMEs in Liberia will require concerted efforts on multiple fronts. There is no single silver bullet; rather, a combination of financial infrastructure development, market competition, macroeconomic stability, and capacity-building of both lenders and borrowers is needed. By addressing supply-side inefficiencies and demand-side constraints, Liberia can move towards a more inclusive financial system where MSMEs can access loans at affordable rates. This, in turn, would spur entrepreneurship, job creation, and economic growth – reinforcing a positive cycle of development.

Future research could build on this study by quantitatively modeling the impact of specific reforms (for example, how much a functioning credit bureau might reduce default risk and interest margins), or by surveying MSMEs and lenders directly to gain more data on the sensitivity of loan demand and supply to interest rate changes in Liberia. Such research would further inform policy and help track progress as interventions are implemented.

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