Crowdfunding in Africa

David Cracknell

Crowd sourcing of funds for managing crisis, or for funding start-ups in Africa is not new. Fund raising through social networks is common practice in Kenya, called Harambe in Swahili. Furthermore, among the most common funding sources for financing start-ups is 'friends and family'. So, crowdsourcing of funds is not new; but crowdfunding through platforms that allow fundraisers to reach far beyond their first and second-degree connections, by comparison - is.

Crowdfunding is said to be a product of the 2008 global financial crisis[1]. Credit constraints combined with a distrust of financial institutions, investors seeking a return, and the rise of technology created fertile ground for alternative financing mechanisms. In a 2020 study, Zeiger et al[2]. noted worldwide person to person consumer lending at USD.195bn, far outpacing other forms of crowdfunding. The same study noted the value of crowdfunding of all types in Africa at only USD209.1m[3]. This blog will highlight reasons why this may be the case.

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[1] Comments by Nir Vulkan, Director, Oxford Fintech Programme 2020

[2] Zeiger Tania et al. (2020) Global Alternative Finance Market Benchmarking Report: Trends Opportunities, Challenges for Lending, Equity and Non-Investment Alternative Finance Models" Available from https://bit.ly/2Y3cvAy Cambridge Centre for Alternative Finance

[3] Crowdfunding in Africa is likely underestimated due to a lack of mechanisms to collect data on crowdfunding.

What is Crowdfunding?

There are four commonly acknowledged forms of crowdfunding. These are:

i. **Donation**: Donation based crowdfunding targets causes. Platforms such as MChang'a[4] target causes relating to health, education, community, and lifecycle events.
ii. **Reward**: Reward based crowdfunding focuses on raising funds in return for future benefits, for example, a games developer promises to deliver the funder a copy of the game he is developing.
iii. **Debt**: Debt based crowdfunding – matches lenders to borrowers, the largest fund of this type in Africa is Kiva[5]. Kiva supplies funds crowdsourced from developed countries, it allows the contributor to specify the sector and the client they provide funds to. Other funds are more specialised, such as FundKiss[6] in Mauritius that funds SMEs, or FarmCrowdy[7] in Nigeria that invests in agriculture.
iv. **Equity**: Crowdfunds are also used to invest equity. There are few equity crowdfunds in Africa, due in part to the complexity of the regulatory environment for investment vehicles. Examples of equity funds include Uprise Africa[8] and Thundafund[9], both based in South Africa.

A growing sub-category of Equity based crowdfunding which is becoming increasing popular in Europe and the USA is crowdfunding for investment in property, are crowdfunds around property - so called Proptech.[10]

A few providers such as Pezesha[11] in Kenya are innovating around the marketplace between SMEs and investors. In 2020, Pezesha received a no objection from the Capital Markets Authority in Kenya[12] to raise and collect funds from investors, contributors, and donors.

Who Are the Investors?

Donation based crowdfunding's core funding typically comes from the extended social network of the campaign and its organisers. In 2019, MChang'a reported that 678,335 funders funded over 40,124 campaigns, with a typical donation of less than $6.

For debt-based platforms the available statistics gathered by CCAF (2020) show majority of funds come from international sources, however, this is likely to be significantly impacted by the market share of the leader Kiva. However, crowdfunds targeting local funds are developing with FundKiss in Mauritius reporting significant growth in its local investor base during 2020.

Challenges

Limited supply of funds:

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[4] See http://www.m-changa.co.ke/
[5] See http://www.kiva.org/
[6] See http://www.fundkiss.mu/
[7] https://www.farmcrowdy.com/
[8] https://uprise.africa/
[9] https://thundafund.com/
[10] Baum, A., Saull, A., and Braesemann, F. (2020). *PropTech 2020: the future of real estate* [online]. Saïd Business School. Available at: https://bit.ly/3hNTEkY
[11] See https://pezesha.com
[12] See https://bit.ly/3bPlfRC

i. Competing investment opportunities: Investment opportunities through crowdfunding platforms are often in the region of 8-12%, with risk. However, there are many other local investment opportunities which offer either higher or safer returns.
ii. Trust in crowdfunding: Many potential investors are not yet exposed to crowdfunding as a potential business opportunity. It takes time for trust to build.
iii. Limited numbers of institutional investors with greater funds investing in crowdfunding.
iv. Existing collective investment mechanisms that pool funds from multiple individuals (called chamas in Kenya).

Lack of a supportive regulatory environment: Regulation impacts equity-based crowdfunding. Equity crowdfunds, typically must follow detailed national requirements requiring their clients to issue detailed prospectus. However, current regulations are not proportionate to the smaller ticket sizes which are often the target of equity based crowdfunds.

Scale and sustainability: Crowdfunds must reach scale if they are to become sustainable.

"*Platforms in Europe and the USA were able to make progress because the industry was disruptive. However, in Africa we've not been able to reach scale or develop the business models to be disruptive"*.

Elizabeth Howard, ACfA.

There are multiple challenges in reaching scale – a small supply of funders, inappropriate regulations, development costs and the high cost of professional staff (relative to earnings). Few crowdfunding platforms in Africa are making significant profits. They often rely upon a founder who is independently wealthy.

Beyond social capital Many crowdfunding platforms in Africa rely upon social capital. However, crowdfunding only becomes transformational when it reaches investors beyond the requestors own social networks.

"we need to track when crowdfunding breaks out beyond first and second-degree contacts and the extent to which this happens is where the platform is having an impact as a platform."

Elizabeth Howard, ACfA.

For fundraising larger amounts, the quality of the network matters including links to angel investor networks.

Human resource challenges: Whilst the crowdfunding industry is growing, there is are a limited number of people in the industry, even larger platforms such as MChanga, or FundKiss have few permanent staff. The financial position of most platforms makes it difficult to hire staff with additional roles and responsibilities.

Visibility and credibility: With limited regulation to provide a stamp of credibility and low staff levels, creating visibility and building credibility is a perpetual challenge for most crowdfunding platforms. Successful platforms seek professional networking opportunities, publicity, and endorsements. It must be a very deliberate and sustained activity.

Risk management: There is growing awareness of risks within crowdfunding CCAF (2020)[13] lists perceived risks as campaign fraud, loan default, malpractice, regulatory changes, competition, and the

[13] Perceived risks of platforms by region 2020.

emergence of techfin firms. Whilst these are perceived, not recorded risks – given the staffing and sustainability of many crowdfunding platforms there are likely to be under controlled risks.

Transforming Crowdfunding in Africa

So, what steps can be taken to transform crowdfunding in Africa?

1. Create a facilitating regulatory environment for crowdfunding: A framework that provides protections for equity investors which is proportionate to facilitate modest equity investments. The Africa Crowdfunding Association has its own white label framework[14] and facilitates discussions between regulators and the industry.

2. Funding partnerships: Crowdfunds would benefit from funding partnerships tha match individual capital with institutional capital and capital from professional investors and venture capitalists.

3. Capacity partnerships: Crowdfunds can benefit significantly from partnerships aimed at building capacity within the crowdfund. For example:
   a. Publicity and marketing: Media could highlight the platforms, corporate sponsorship could be provided especially for donation based platforms, companies could allow short term placements of their staff to help develop marketing strategies.
   b. Technology: Partnerships with technology service providers or crowdfunds in developed countries to provide technical innovations to reduce costs, enhance UI/UX, or to improve investment decisions.

4. Ecosystem linkages: Linkages to build relationships, credibility, and project pipelines. Partnerships with projects supporting SMEs, or agricultural enterprises. Such partnerships should provide individual investors greater confidence in the viability of the enterprises they are investing in.

What is next? Crowdfunding as a journey

For most founders crowdfunding is a strategic step in a journey. This can include expansion to new types of crowdfunding, or new markets, or as a step in the development of a fully functional lending platform or to leverage and develop investor networks. Ultimately the success of these platforms will be partly measured by how they evolve and how much these wider objectives are achieved.

This blog is one of a series of blogs, should you wish to sign up to receive additional blogs, please write to David Cracknell at david@firstprinciples.consulting. David Cracknell is the Director of First Principles Consulting Limited, based in Nairobi, Kenya. He advises financial institutions, governments, policy makers and donors on financial services, including digital finance, policy and regulation, and inclusive finance.

FIRST PRINCIPLES CONSULTING
42 Riverside Drive
Nairobi
Box 76436 - 00508
Kenya
+254-733-713380
davidjcracknell
david@firstprinciples.consulting
@davidjcracknell
www.firstprinciplesinfinance.com

[14] ACfA Label Framework available on https://bit.ly/3sC99l1