2014 LSE Africa Summit : African entrepreneurs and the struggle to gain financing

LSE's Mairi Tejani discusses ways in which Africa's credit financing gap can be filled.

African entrepreneurs are running on empty. The International Finance Corporation estimates that up to 84% of small and medium-sized enterprises (SMEs) in Africa lack adequate financing. The continent is plagued by a credit financing gap worth USD 140 billion to 170 billion, a credit financing gap worth approximately 17 times the GDP of Burkina Faso. Inadequate financial markets coupled with poor access to traditional growth capital (debt and equity) remain exacerbated by insufficient infrastructure, regulatory measures and government policies.

Can venture capital help plug the credit financing gap on the African continent?

In 2009, the McKinsey Quarterly found that 80% of adults in sub-Saharan Africa were "unbanked", that is, without access to the services of a bank or a similar financial organisation. More recent estimates linger around 70%. While it must be acknowledged that rates of financial inclusion are low throughout most of the developing world, the fact remains that they are particularly low across sub-Saharan Africa. Challenges to accessing finance are partly (but not entirely) a supply side problem stemming from the risk-reward structure of many financial institutions.

With 9 in 10 entrepreneurial ventures failing within the first five years of operation, the risks associated with lending to entrepreneurs in frontier markets are paramount. This in turn translates into high costs of funding for those borrowing and consequently acts as a strong deterrent for SMEs. The Omidyar Network found that in some cases, banks require 150% of the borrowed amount in collateral, thereby automatically disqualifying many from funding eligibility. Even those few institutions striving to serve the lowest income entrepreneurs have limited product offerings, often operating as credit-only, excluding the role of savings which lie at the heart of capital accumulation.

Venture capital and seed funding are popular forms of equity financing used to fund high-risk, high-return businesses in the developed world and can be instrumental in boosting finance for small to mid-scale African ventures. An additional benefit is that "angels" (as investors are called) can offer entrepreneurs business expertise alongside their capital, providing a support system that some may otherwise lack. With seed funding and venture capital forming less than 10% of funding for entrepreneurs on the continent, there is a limited appetite of venture capitalists for early stage investments in Africa and foreign investors remain wary of currency shocks. There is a need to initiate local venture capital investing ecosystems to ensure that the most appropriate sources of funding are available for sustainable business development.

Services such as M-PESA offered by Safaricom in Kenya are harnessing the power of technology to create opportunities for entrepreneurs via microfinancing. However, these small loans are not sufficient for those firms wishing to significantly increase their market penetration rates or break out of the informal sector. Thus, the question we must ask becomes: How can we improve access to capital for SMEs?

This is just one of the questions that the 2014 LSE Africa Summit intends to address on 4-5 April 2014. With an underlying theme of entrepreneurship, the Summit will be a forum for Africa enthusiasts to address salient topics on the continent. It is also an opportunity to celebrate Africa's entrepreneurs: their resilience, their drive and their passion.

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