

CROWDFUNDING



AN OPPORTUNITY TO INCREASE ACCESS TO FINANCE FOR MSMEs IN ACP COUNTRIES

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CROWDFUNDING:

AN OPPORTUNITY TO INCREASE ACCESS TO FINANCE FOR MSMEs IN ACP COUNTRIES

EXECUTIVE SUMMARY

Access to finance is amongst the main challenges faced by micro, small and medium-sized enterprises (MSMEs) in creating and growing their business in African, Caribbean and Pacific (ACP) countries. Meanwhile, crowdfunding is disrupting the financial services industry by democratising access to capital for individuals and businesses and revolutionising the way they interact with financial products. Despite its relatively slow development in ACP countries, crowdfunding has great potential for increasing access to finance for MSMEs by enabling them to tap into alternative sources of funding.

Crowdfunding presents both opportunities and challenges if developed in ACP countries. On the one hand, crowdfunding offers opportunities to tackle development challenges, including by increasing the supply of new sources of capital to bridge the finance gap for MSMEs, boosting and channeling diaspora remittances to productive investment in their countries of origin, and fostering financial inclusion.

On the other hand, there are some challenges and risks that are constraining the full potential of crowdfunding such as the lack of crowdfunding awareness and trust in its stakeholders (crowdfunding platforms, regulators, funders, etc.). Additional structural factors exist that may challenge the development of crowdfunding, such as the low penetration of the internet and social media in some countries, the low utilisation of electronic payments, and the ability of the legal framework to meet the needs of the crowdfunding industry.

Finally, the paper recommends that policymakers engage in relevant policies for wider public adoption of crowdfunding by:

1 »» building crowdfunding ecosystem capacity (see page 22)

2 »» strengthening technology infrastructure for crowdfunding (see page 23)

3 »» enacting regulatory frameworks to support crowdfunding (see page 24)

BACKGROUND

Micro, small and medium-sized enterprises (MSMEs) play a significant role in driving job creation and economic activity and they are likewise an important vehicle of social inclusion in African, Caribbean, and Pacific countries (ACP). Despite this major role, MSMEs often struggle to obtain the necessary finance to start and grow their businesses.

In emerging economies, the lack of credit information, high cost to reach MSMEs, lack of collateral, and informality are among major barriers to financial access for MSMEs. The IFC estimates that the finance gap for formal MSMEs in emerging economies is approximately \$5 trillion – this includes \$357 billion for ACP countries.¹ Moreover, according to Boston Consulting Group (BCG)², Africa GDP could increase by around 7% if both men and women had an equal share in entrepreneurship. This could potentially provide a significant boost to the African economy, equivalent to a staggering \$200 billion.

Therefore, there is a pressing need to develop new options for MSME financing that strengthen their capital structure, allow them to boost long-term investment, and seize growth opportunities.

Recent technology innovations have produced new digital financial products that are disrupting the financial services industry and revolutionising the way people interact with financial products. Crowdfunding is one such product offering an additional financing model that can help to close the MSME finance gap. Digitalization has greatly facilitated crowdfunding, as it is much easier to connect projects searching for financing and potential funders.

Crowdfunding is the practice of funding a project or a venture by raising money from many people who each contribute a relatively small amount, typically via the internet.³ Financial institutions are gradually getting involved in this practice alongside individuals. Crowdfunding is growing rapidly around the world, but it is still nascent in the ACP countries. It can potentially enable and widen financial access in underserved or unserved areas and populations.

This paper aims to present crowdfunding as a digital finance product that can contribute to bridging the finance gap within the ACP countries. It provides several policy recommendations to support sustainable crowdfunding development in the ACP region.

The paper is structured in three parts:

- »» **Introduction to crowdfunding and overview of its global development** (see page 5)
- »» **Presentation of opportunities and challenges to developing crowdfunding in ACP countries** (see page 15)
- »» **Recommendations for policymakers** (see page 22)

¹ Source: <https://www.smefinanceforum.org/data-sites/msme-finance-gap>

² Source: BCG, 2019: "Want to Boost the Global Economy by \$5 Trillion? Support Women as Entrepreneurs"

³ Source: <https://www.lexico.com/definition/crowdfunding>

OVERVIEW OF CROWDFUNDING DEVELOPMENT IN ACP COUNTRIES

CROWDFUNDING

Crowdfunding was developed in an organized way in the wake of the financial crisis of 2008 when traditional financial institutions were less willing to provide financing to businesses.

Crowdfunding platforms have grown considerably in the last few years. They have become a popular choice for MSMEs that would have difficulty securing capital from traditional financial institutions. Furthermore, individuals use these platforms as an alternative investment option with their savings. Crowdfunding platforms are serving as market makers enabling fundraisers and funders to interact via a common trusted system.

DEFINITION⁴

“Crowdfunding can be defined as the provision of funding for projects, individuals, commercial and non-commercial entities by raising funds, small and large, from large groups of individuals and institutions”.

“Crowdfunding is a large subset of the broader field of ‘Alternative Finance’ which includes activities that have emerged outside of the incumbent banking systems and traditional capital markets. In particular, the capital raising alternative finance ecosystem comprises various lending, investment, and non-investment models that enable individuals, businesses, and other entities to raise funds via an online marketplace. Typically, these fundraisers satisfy their funding needs through pooled monies from a ‘crowd’ or network of retail and/or professional investors.”

⁴ Source: The Cambridge Centre for Alternative Finance (CCAF)

CROWDFUNDING MODELS

Four main crowdfunding models allow raising funds for different types of projects:

- **Donation crowdfunding** consists of individuals donating to a charitable project while receiving no financial or material return. Donors have a social or personal motivation for putting their money. They may seek to support a beneficial social impact but do not expect a financial return.
- **Rewards-based crowdfunding** consists of individuals donating to a project or business with the expectation of receiving a non-financial reward in return, such as goods or services at a later stage. A common example is a project or business offering a unique service (rewards) or a new product (pre-selling) in return for investment. Through this crowdfunding model, a business can obtain a secure cash flow from pre-booked orders and gathers an audience before a product launch.⁵
- **Crowdlending** consists of individuals lending small amounts of money to a company in exchange for a financial return. It then connects MSME borrowers with investors that have the capital to invest through an online platform which serves mainly as a matching mechanism. Selection, credit risk evaluation, and interest rate calculation are carried out for each loan request by the crowdlending platform. Initially, investors in this model were individuals but nowadays, most of them are institutional investors (funds and banks).
- **Equity crowdfunding** involves raising capital from a large number of investors online through the sale of securities in a private company, typically a start-up or SME. Equity crowdfunding platforms carry out due diligence and provide transparent information to investors so they can evaluate the potential investment opportunity. Although most investors on equity crowdfunding platforms are individuals, business angel networks, and Venture Capital firms (VCs) are increasingly co-investing with them.

TABLE 1: Crowdfunding models summary

| CROWDFUNDING MODELS | FORMS OF CONTRIBUTION | FORMS OF RETURN | CROWDFUNDERS MOTIVATIONS |
|-----------------------------------|-------------------------|--|--|
| Donation crowdfunding | Donation | Intangible benefits | Intrinsic and social |
| Rewards-based crowdfunding | Donation / Pre-purchase | Rewards but also intangible benefits | Combination of intrinsic and social motivation and desire for reward |
| Crowdlending | Loan | Repayment of a loan with interest. Some socially motivated lending is interest-free. | Combination of intrinsic, social and financial motivation (getting back the lending capital) |
| Equity crowdfunding | Investment | Return on investment, if the business is a success. Rewards may also be offered. Intangible benefits such as social and environmental impacts are another factor for many investors. | Combination of intrinsic, social and financial motivation |

Source: The venture crowd: crowdfunding equity investment into business, NESTA, 2012

⁵ Crowdfunding Explained: A guide for small and medium enterprises on crowdfunding and how to use it, European Union, 2015

As rewards-based crowdfunding, crowdlending, and equity crowdfunding are the three most common models used by MSMEs, this paper will focus on these models.

An MSME's stage of maturity and funding needs will determine which crowdfunding model is best suited to its needs. The following table showcases the matching between business maturity stages and crowdfunding models:

TABLE 2: Crowdfunding models depending on business maturity stages

| BUSINESS MATURITY STAGES | EQUITY CROWDFUNDING | REWARDS-BASED CROWDFUNDING | CROWDLENDING |
|-------------------------------------|---------------------|----------------------------|--------------|
| Pre-trading stage | – | × | – |
| Pre-profit stage | × | × | – |
| Profitable growing business | × | – | × |
| Launching new product/service/brand | × | × | × |
| Investing in new facilities | – | – | × |
| In need of capital restructuring | × | – | × |

Source: ICAEW Corporate Finance Faculty

CROWDFUNDING NON-FINANCIAL BENEFITS

Crowdfunding can offer more than just financial benefits for firms. It also:

- enables start-ups to validate their proof-of-concept through a reality check with a huge audience of individuals. A successful crowdfunding campaign provides strong market validation, while failure imparts feedbacks and insights that are also beneficial to the business.
- serves as a powerful marketing tool for MSMEs, since crowdfunding campaigns are real marketing campaigns that raise awareness of the company's brand and its products or services. In addition to reaching investors, crowdfunding campaigns help gain new customers.
- creates financial leverage with other forms of financing, since a successful crowdfunding campaign helps to strengthen the company's financial structure (e.g. in the case of equity crowdfunding) and highlights that there is a potential market for its business. These are useful arguments to convince banks, VCs, and angel investors when seeking additional funds.
- helps promote gender equality by opening up a new market to the crowd, rather than being dominated by a small number of gatekeepers. It also promises to reduce cultural barriers typically faced by participants in traditional financial markets.

GENDER DYNAMICS ON KICKSTARTER⁶

A study was conducted to examine the behavior of male and female entrepreneurs in raising early stage capital on kickstarter, a leading reward-based crowdfunding platform.

It showed that :

- women are often concentrated in stereotyped sectors, but do not set lower funding goals than men. For example, there is a higher proportion of female filmmakers on the platform compared to the film industry as a whole, suggesting promise for crowdfunding.
- women are more likely to be backers than project leaders, they make up nearly half of all backers on Kickstarter platform.
- female backers tend to discriminate against female entrepreneurs, while female backers become agnostic to gender over time.
- women were more successful than men in obtaining funds on Kickstarter, in contrast to their performance with angel investors.

The study concluded that in context of crowdfunding women are more confident to start their own projects with a more diverse pool of funders and smaller amounts of capital involved. They also set funding goals similar to men and enjoy higher rates of success than men.

- »» *According to these findings from Kickstarter, women possess the drive and ability to come up with innovative ideas and secure funding for them. However, it is the traditional financial systems that impede the progress of female-led businesses. Hence, there is a requirement for policies that can facilitate changes in societal norms regarding the perception of women entrepreneurs.*
- »» *Kickstarter has implemented policies to support gender equality indicating its dedication to diversity and inclusivity. For instance, Kickstarter has launched the Patrons program, designed to provide additional funding to underrepresented groups, including women and people of colors, by matching pledges made by individual backers, up to a certain amount.*

CROWDFUNDING OVERVIEW AROUND THE WORLD

Note that as crowdfunding models account for the bulk of Alternative Finance volumes, particularly in emerging markets, this paper will use the terms “**crowdfunding**” and “**Alternative Finance**” interchangeably.

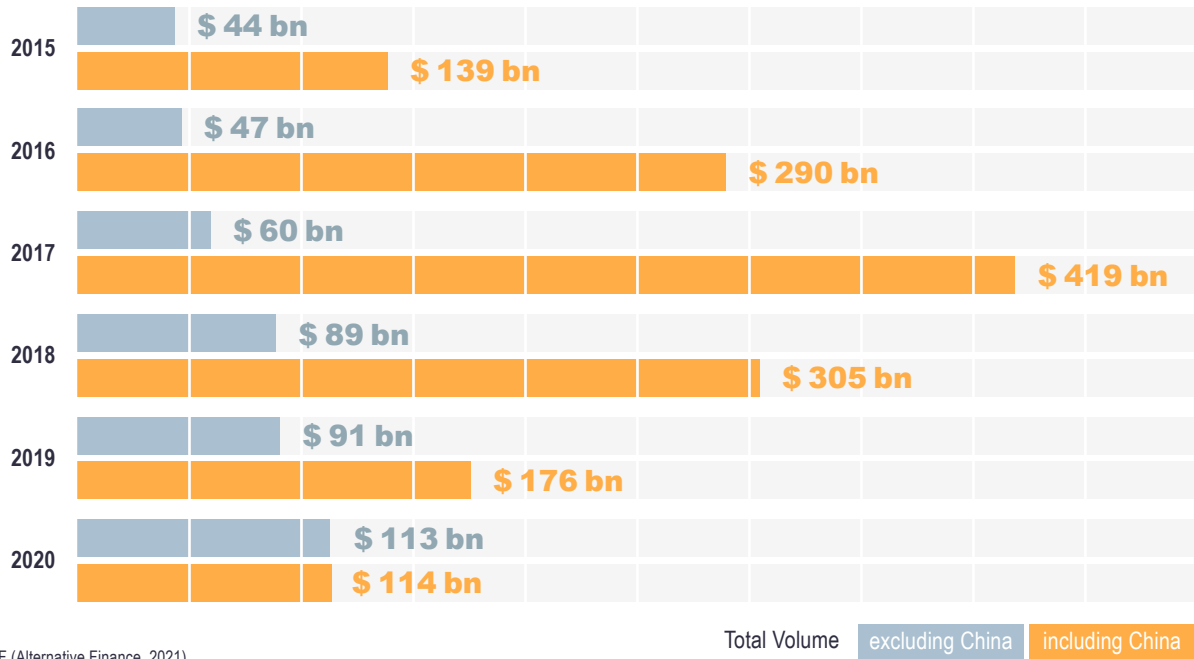
All statistics related to crowdfunding presented in the current chapter are drawn from the recent report undertaken by the Cambridge Centre for Alternative Finance (CCAF): “*The 2nd Global Alternative Finance Market Benchmarking Report⁷*”, issued in June 2021.

⁶ Source: Gender Dynamics in Crowdfunding (Kickstarter)Review of Finance, Volume 25, March 2021

⁷ Source: The 2nd Global Alternative Finance Market Benchmarking Report

GLOBAL MARKET HIGHLIGHTS

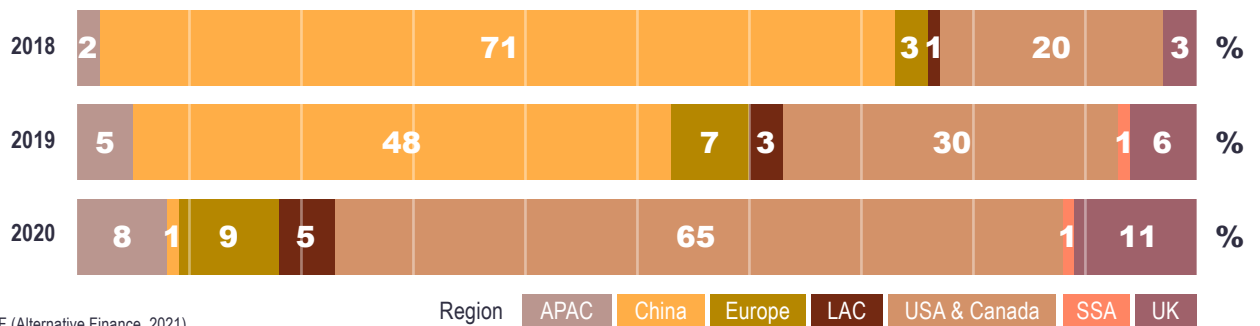
FIGURE 1: Total Alternative Finance volume (2015–2020), billion USD (bn \$)



In 2020, Alternative Finance facilitated \$ 114 billion in transaction volume globally. This volume represents a 62% decline compared to 2017, mainly due to a sharp decline in crowdfunding activities in China.

However, excluding China, the global market volume has continued to grow despite the COVID-19 crisis. The global volume rose from 2019 by 24% to reach \$ 113 billion in 2020.

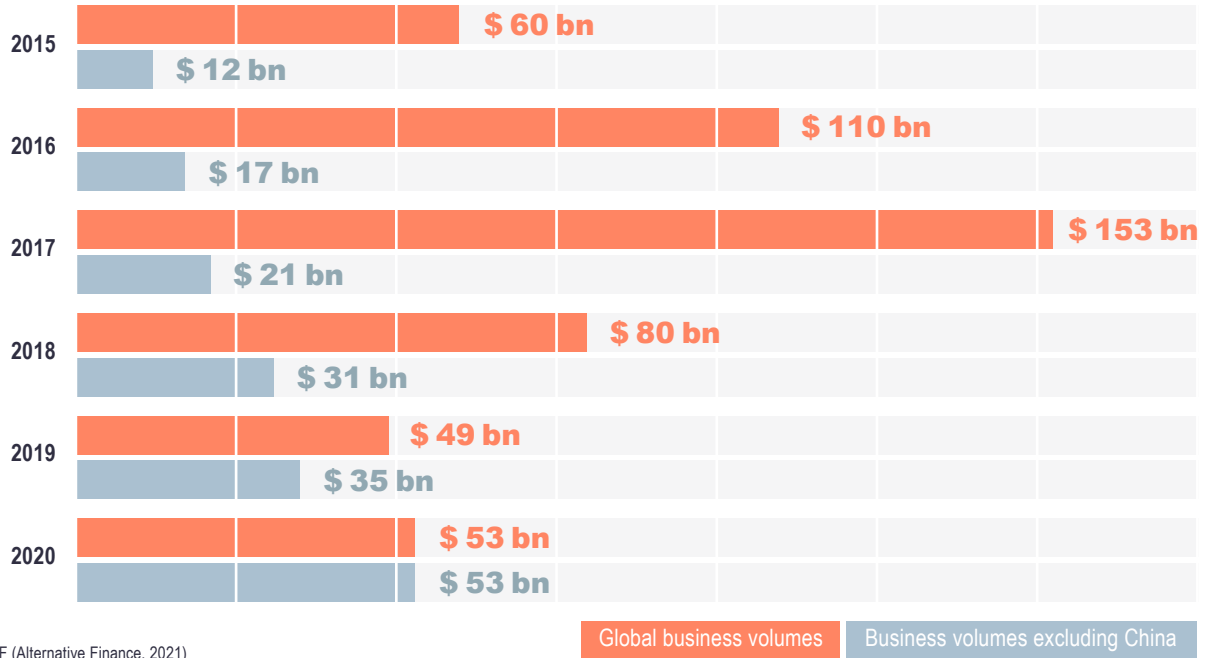
FIGURE 2: Market share by region (2018–2020), per cent (%)



Accordingly, in 2020, the USA and Canada represented the largest Alternative Finance market and accounted for 65% of the global market volume.

The market share of all the regions except China has grown consistently over the past three years.

**FIGURE 3: Total Alternative Finance volume
Attributed to business fundraisers (2015–2020), billion USD (bn \$)**

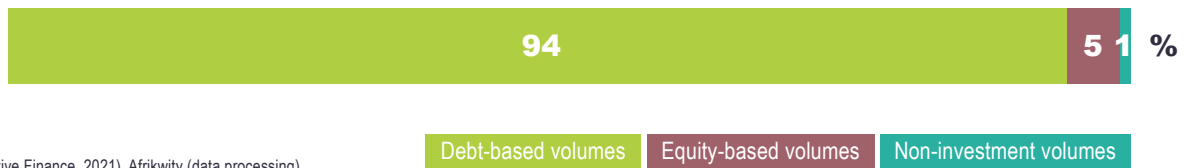


Source: CCAF (Alternative Finance, 2021)

In 2020, Alternative Finance funding directed to business has shown steady growth over the last five years and reached \$53 billion globally representing 47% of the total volume.

The USA accounted for almost 60% of global alternative business funding volumes in 2020.

FIGURE 4: Breakdown of business financing by models (2020), per cent (%)



Source: CCAF (Alternative Finance, 2021), Afrikwity (data processing)

Crowdlending remains the largest fraction (94%) of the total volume allocated to businesses. In the meantime, the equity crowdfunding market has demonstrated steady growth over the last years to reach approximately \$2.2 billion in 2020.

The involvement of institutional investors (banks, pension funds, mutual funds, and family offices) is rapidly increasing. Indeed they provided 42% of global funding in 2020 which

represents a 53% growth from 2019. However, the institutional contribution ranges from 20% in the Middle East and North Africa (MENA) to 98% in the USA.

Given the headroom for growth in more advanced markets and the fact that crowdfunding is still substantially underdeveloped in many emerging markets, Alternative Finance is likely to continue experiencing growth in coming years.

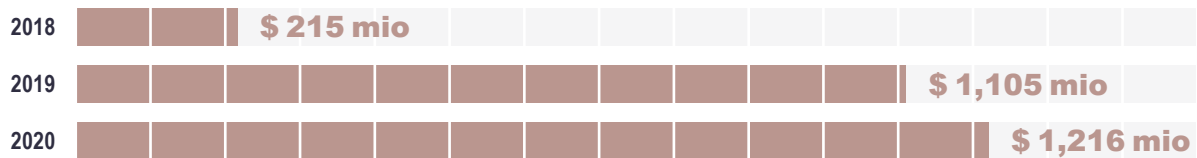
CROWDFUNDING OVERVIEW IN ACP COUNTRIES

Currently, there are limited resources for tracking crowdfunding volumes in all ACP countries, so it is difficult to get an accurate view of the growth and trends over the last few years.

Moreover, publicly available statistics and figures shown hereafter underestimate the global Alternative Finance volumes in ACP countries because they neither account for informal fundraising via social media Apps nor mobile money transfers.

ACP MARKET HIGHLIGHTS

FIGURE 5: Total Alternative Finance volume, ACP countries (2018–2020), million USD (mio \$)

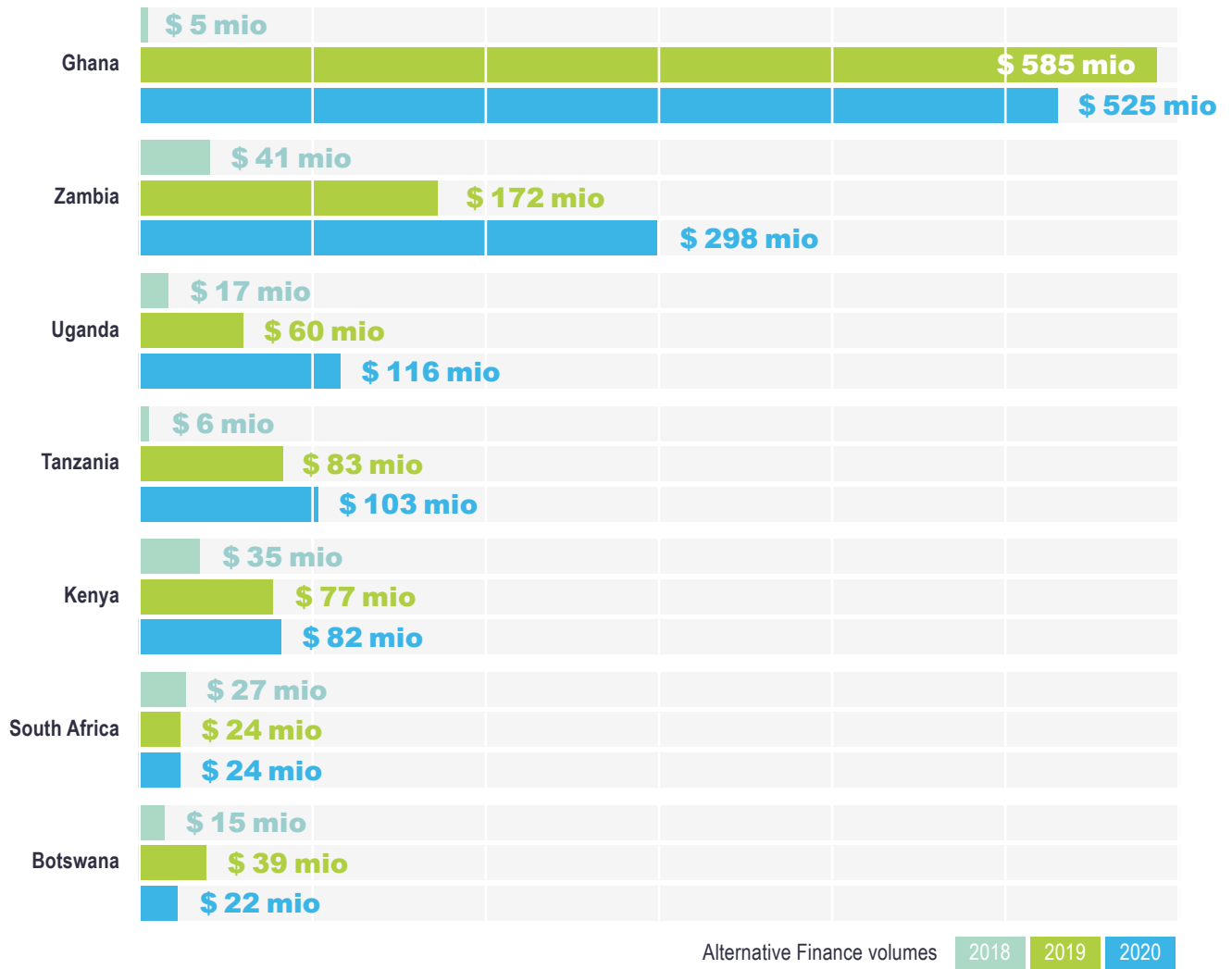


Source: CCAF (Alternative Finance, 2021), Afrikwity (data processing)

In 2020, Alternative Finance facilitated almost \$1,216 million in transaction volume in ACP countries. The stagnation in growth from 2019 and 2020 could be explained by the

struggle of many platforms during the COVID-19 pandemic and the depreciation of some African currencies (i.e. SA Rand, Zambia's Kwacha, Kenyan Shilling) against the USD.

FIGURE 6: ACP countries with Alternative Finance volume > \$20 million (2020), million USD (mio \$)

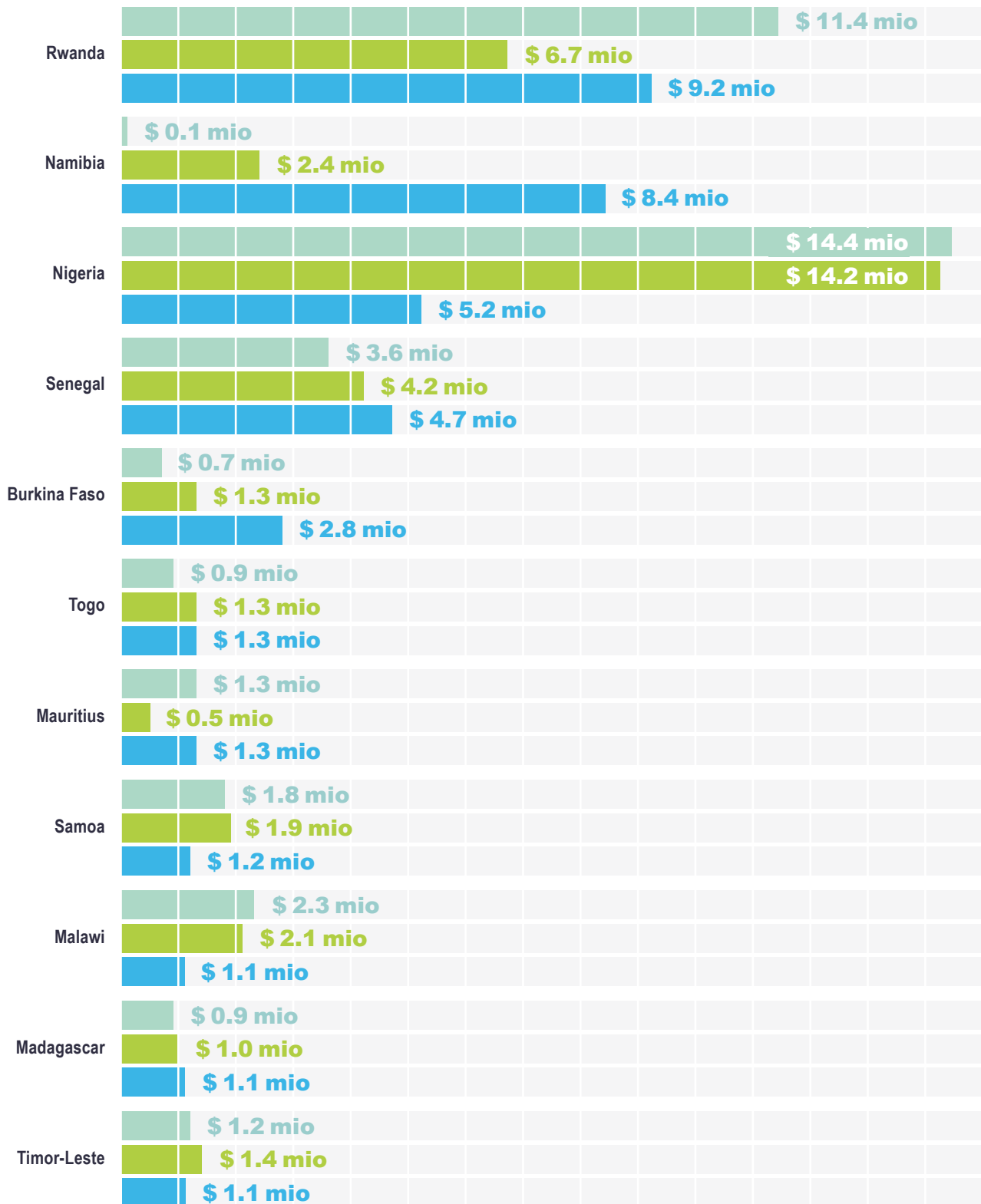


Source: CCAF (Alternative Finance, 2021), Afrikwity (data processing)

In 2020, the Sub-Saharan Africa (SSA) region accounted for 99,58% of the ACP global market volume with an outstanding increase of 582% from 2018.

This growth was mainly driven by crowdlending for consumers in Ghana, Zambia, Uganda, Tanzania and Kenya.

FIGURE 7: ACP countries with Alternative Finance volume ranging from \$1–\$20 million (2020), million USD (mio \$)



Source: CCAF (Alternative Finance, 2021), Afrikwity (data processing)

- East and West Africa regions recorded a large share of 95% of the Alternative Finance market in SSA.
- No Alternative Finance activity was recorded in 38 of 79 ACP in 2020. In 23 countries, the total amount raised was inferior to \$ 1 million.
- In Africa, 91% of all alternative financing was in form of loans for consumers. Moreover, only \$44 million was allocated to businesses with a decrease of 42% from 2019. However, a large share of loans granted to individuals represent loans for micro-entrepreneurs who struggle to get funding from traditional financial institutions.
- In 2020, Africa is the region with the highest cross-border inflows (87%).⁹ The West African region had the highest inflow rate (99%) followed by Central Africa (97%).
- In ACP countries, of the 180 international platforms from Europe and North America reported activities in Africa and only 26 are local platforms.
- The leading countries in terms of numbers of local crowdfunding platforms – Kenya (9), Nigeria (5) and South Africa (3) – are among the leading national markets in terms of fund-raised volumes in the ACP countries.
- In Africa, 22% of crowdfunding platforms utilized mobile payment services, whose popularity across the continent facilitated this form of fundraising.
- Despite a higher concentration of individual investors in the Sub-Saharan Africa (SSA) region, the participation of institutional investors grew from 21% (\$215 million) in 2019 to 31% (\$330 million) in 2020. However, the Latin America and the Caribbean (LAC) region reported the highest decrease from 58% (\$3.16 billion) in 2019 to 49% (\$2.93 billion) in 2020. This decline is probably due to the pandemic.

GENDER DYNAMICS IN ACP COUNTRIES

During 2019 and 2020, female funders⁹ were largely underrepresented in Sub-Saharan Africa across all crowdfunding models, except for donation-based crowdfunding platforms, where they accounted for 57% of funders in 2019. However, female fundraisers¹⁰ appeared to be well-represented across different crowdfunding models, particularly on microfinance crowdfunding platforms, where the percentage of female fundraisers reached 89% in 2019. In terms of sub-regions, Central Africa showed the highest proportion of female funders and fundraisers in both 2019 and 2020.

This discrepancy between the underrepresentation of women funders and the higher proportion of women fundraisers highlights the need to address gender inequality in access to finance in Sub-Saharan Africa. The low engagement of local women in investment funding behavior suggests the need to investigate the underlying reasons and to provide resources and support to encourage their participation.

Furthermore, the fact that international female funders represent a significant portion of female funders raises questions about the impact of foreign investment on local economies. However, encouraging and supporting local female funders in Sub-Saharan Africa can promote a more inclusive and representative industry while contributing to economic growth and development in the region.

⁹ A funder refers to an individual or organization that contributes money towards a crowdfunding campaign. Funders can be individuals who support a cause or project, or they can be investors seeking to provide funding for a new business venture.

¹⁰ A fundraiser refers to the person or organization that creates the crowdfunding campaign and seeks to raise funds from supporters or investors. Fundraisers are responsible for developing a compelling campaign, setting a fundraising goal, and promoting the campaign to potential funders.

OPPORTUNITIES AND CHALLENGES TO DEVELOPING CROWDFUNDING IN ACP COUNTRIES

Despite its relatively slow development in ACP countries, crowdfunding has great potential for increasing access to finance for MSMEs and contributing to the further development of entrepreneurship, innovation and financial inclusion in developing economies in general.

This potential is based on the following enabling factors:

- the relatively low penetration of financial services in many countries in the ACP region¹¹
- the growing utilization of the Internet and social media in most ACP countries
- the growing adoption of digital finance and mobile money, particularly in Sub-Saharan African countries (157 mobile money operators and 160 million active accounts)¹²
- crowdfunding's culture fits with some traditional funding practices such as credit associations in the African context¹³
- the large and steady contribution of diaspora in funding social and economic projects in their countries of origin (more than \$520 billion of remittances to low-and middle-income countries in 2018).¹⁴

CROWDFUNDING OPPORTUNITIES FOR DEVELOPMENT

Crowdfunding offers opportunities to tackle some of the development challenges in ACP countries.

This includes:

Increasing the supply of new sources of capital to bridge the finance gap for MSMEs

First, reward-based crowdfunding could enable entrepreneurs to test the market before making significant investments and the opportunity to pre-finance their products by pre-selling them. Moreover, crowdlending can also provide loans to MSMEs that are unable to access banks and micro-finance institutions because they do not have enough collateral or lack guarantees. With crowdlending, MSMEs can finance their needs of working capital and boost long-term investment. Finally, equity crowdfunding can provide equity capital required to develop early-stage businesses and to help MSMEs to get access to bank loans, as it improves the capitalization of the business and the debt-to-equity ratio.

- »» Despite the slow development and low volumes in most countries, crowdfunding is starting, in some small but also large economies, to represent significant amounts compared to the finance offer (supply: banks and MFIs) or the finance gap.
- »» Data is limited to explain the factors that enable crowdfunding to reach these levels or whether this is a deep-rooted trend.

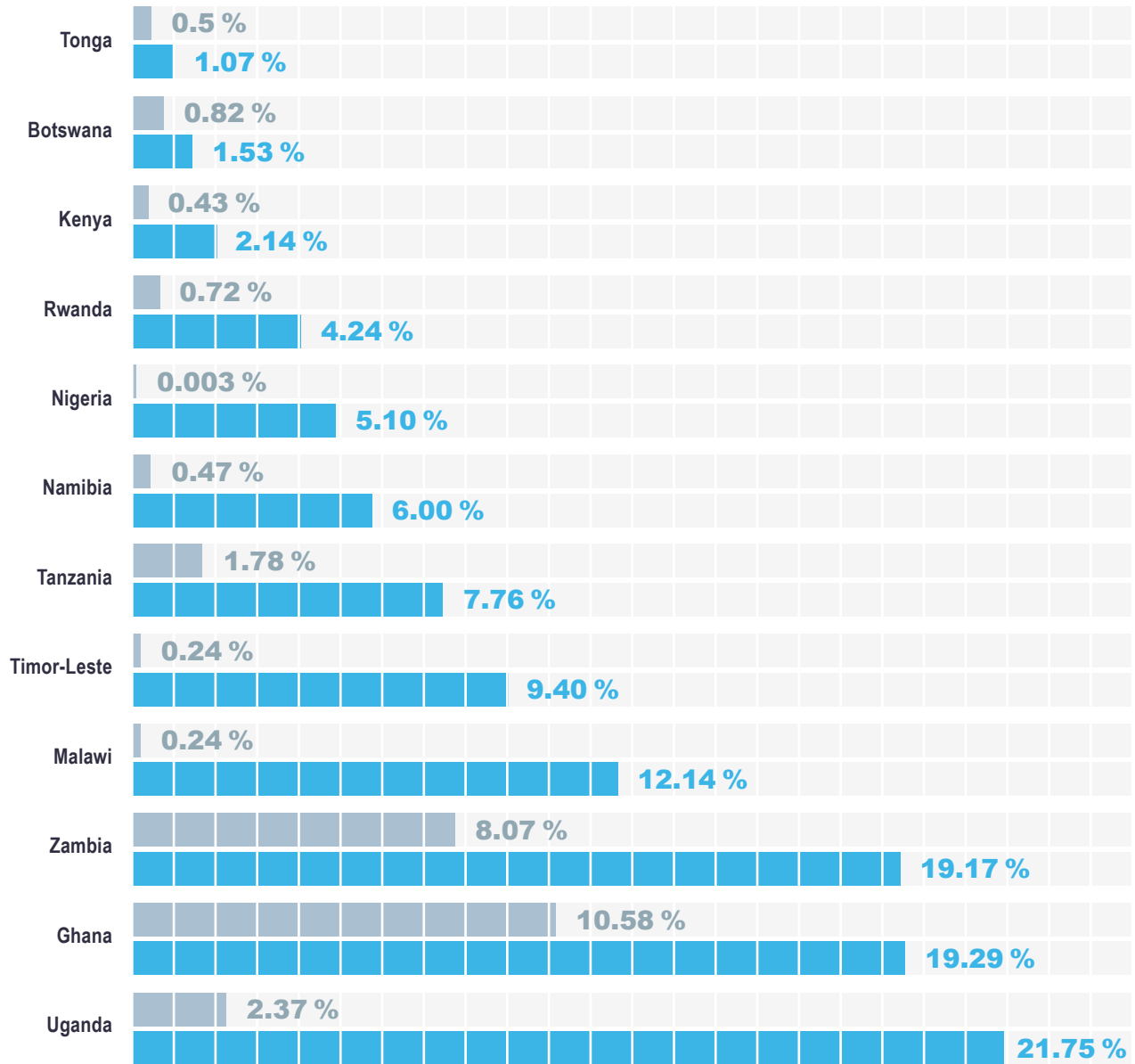
¹¹ *The Global Findex database is the world's most comprehensive data set on how adults save, borrow, make payments, and manage risk*

¹² State of the Industry Report on Mobile Money 2021, GSMA

¹³ Credit associations work on the principle of communal reciprocity, where individuals usually contribute money periodically into a communal fund and the collected amount is either shared among the community members or invested on their behalf. E.g: Susu in Ghana, Mabati in Kenya, Ekub in Ethiopia, Tontine in Mali, and Stokvels in South Africa

¹⁴ Migration and Remittances: Recent Developments and Outlook, Migration and Development, World Bank, 2019

FIGURE 8: The weight of crowdfunding in business finance (2020), per cent (%)



Source: CCAF (Alternative Finance, 2021), Afrikwity (data processing)

Alternative Finance Finance gap Finance supply

Boosting and channelling diaspora remittances to productive investment in their countries of origin

Diaspora investments are often hindered by a lack of appropriate financial instruments and access to information. Crowdfunding platforms could provide diaspora communities with a qualified deal flow of projects to invest in and with different financial instruments (equity, debt, donation) secured by a financial professional, the crowdfunding platform. Furthermore, crowdfunding platforms could help to formalize informal diaspora remittance flows and provide

more accurate data and insights on diaspora investment behaviours and interests.

»» In ACP countries, some of the first businesses to try crowdfunding on US and EU-based platforms (e.g. Kickstarter, Indiegogo, Ulule, etc.) first targeted their diaspora as early investors before convincing international investors or donors.

Fostering financial inclusion

By using crowdfunding platforms, entrepreneurs can not only raise funds for their businesses but also increase their visibility, create brand recognition on a global scale. This can lead to expanding their customer base and ultimately, generating more revenue. Furthermore, crowdfunding can also play a crucial role in promoting financial literacy among entrepreneurs. By using these platforms, they can gain valuable knowledge on various financial instruments and strategies to secure funding. This can also provide them with insights on financial planning, budgeting, and cash flow

management, which are essential financial management skills necessary for making sound financial decisions in the future. However, this impact is particularly important for women entrepreneurs, who often experience greater levels of financial exclusion than their male counterparts. Overall, the use of crowdfunding platforms by women entrepreneurs can be highly beneficial for their businesses' growth and development, as well as their financial education and empowerment.

THE TADAMON CROWDFUNDING ACADEMY

TADAMON was founded and sponsored by the Islamic Solidarity Fund for Development (ISFD), managed by the Islamic Development Bank (IsDB), and implemented by the United Nations Development Programme (UNDP). TADAMON's aim is to serve as a bridge between civil organizations, program partners, crowdfunding platforms, and citizens.

Tadamon Crowdfunding Academy is an intense online training programme, which utilizes digital platforms to ensure that the training is more accessible to broader audience and customized capacity building in a post-COVID era. The training program have developed campaigns, amounting to a total value of over 1.6 million USD.

Several crowdfunding campaigns were dedicated to increase women empowerment such as :

- [*Help Moroccan women cheesemakers to restart their income generating activities*](#)
- [*Help 10 young women attend the FIRST female university in Somaliland*](#)
- [*A Model of Inclusive School in Senegal*](#)
- [*Help the women of Azilal, Morocco irrigate the saffron fields*](#)
- [*Create jobs for 75 poor Somali women to enable them to support their families and realize their potential*](#)
- [*Supporting women's entrepreneurship in Morocco towards a more equal society*](#)
- [*Empower women in weaving in East Nusa Tenggara, Indonesia*](#)
- [*Help 500 Great Women Farmers receiving lifeskill training, entrepreneurship, and venture capital financing*](#)

In addition, crowdlending platforms use new data sources (social media and digital behavioural insights when navigating on the platforms) in combination with alternative credit scoring methods to evaluate in new ways the creditworthiness of individuals and MSMEs. This is particularly relevant for unbanked people (e.g. women, youth) and MSMEs without a credit history.

»» In Africa, most users seeking funding on crowdfunding platforms are either unbanked (49%) or unbanked (48%).¹⁵ This suggests that crowdfunding improves access to finance in Africa.

¹⁵ Unbanked (not served by or without access to any traditional financial service), underbanked (with access to some basic financial services, but not a complete suite), and banked (users that have access to a full suite of financial services).

Synergies between traditional financing players and crowdfunding.

ACP country's formal financial sector often suffers from a lack of liquidity and the banking sector is often characterized by a high level of non-performing loans.

Synergies could be developed between the CF and traditional players in the financial market (especially banks and investment funds) to better meet the needs of SMEs.

KIVA: CROWDFUNDING AND ENABLING ACCESS TO CREDIT ¹⁶

[Kiva.org](https://www.kiva.org), a crowdfunding platform, is building the credit bureau of the future together with UN agencies in Sierra Leone where 80 % of citizens are unbanked. This program was launched in September 2018 as part of Africa's first blockchain and decentralized identity platform with the support of the United Nations Capital Development Fund (UNCDF), and the United Nations Development Programme (UNDP).

Two of the major barriers to accessing financial services are a lack of formal identification and a lack of verifiable credit history. This Kiva Protocol is a digital identification system whereby individuals have digital wallets based on distributed ledger technology¹⁷ to give people secure and complete ownership of their personal data and information. The Kiva Protocol initiative in Sierra Leone is designed to address both of those barriers enabling formal and informal institutions to contribute to a person's verifiable credit history. This means that a wide range of financial transactions, from bank loans to credit with a local shopkeeper, can be recorded in an individual's credit history. With this, a credit history that goes beyond traditional institutions can be built up. This solution, a key part of Sierra Leone national strategy for financial inclusion, aims at providing all citizens with access to the financial sector.

¹⁶ Source: *Kiva Protocol*

¹⁷ Distributed Ledger Technology (DLT) is a protocol that enables the secure functioning of a decentralized digital database. Distributed networks eliminate the need for a central authority to keep a check against manipulation. (Source Investopedia)

CHALLENGES TO DEVELOPING CROWDFUNDING

There are some challenges and risks that are constraining the full potential that crowdfunding could bring to increase MSMEs access to finance.

The supply-side challenges: crowdfunding awareness and trust in its stakeholders.

In most ACP countries, individual savings are very low at national and regional levels¹⁸ and financial, business and digital literacy can be limited by global standards. Furthermore, individuals with savings to invest may be unaware of crowdfunding mechanisms, and awareness is the step in their financial education that leads to their utilization. They also lack trust in online financial services as the financial fraud risk is high in the ACP region.

Moreover, risk averseness¹⁹ may hamper investments in general and makes it difficult to channel funds through crowdfunding platforms to early-stage and small business projects.

Promoting awareness of crowdfunding and trust in crowdfunding platforms are required to facilitate a thriving crowdfunding market.

The technology challenges: technological infrastructure and internet and social media penetration rates.

Since the development of crowdfunding heavily depends on internet and social media access, countries with low-level internet penetration will have more difficulties mobilizing local investors or contributors on crowdfunding platforms. In the context of ACP countries, Internet penetration rates range significantly between regions and countries, with rates of below 15% in countries such as Eritrea and the Solomon Islands and of 80% or above in countries such as Kenya and the Bahamas.²⁰

In developed countries, the financial services sector has been undergoing large-scale digital transformation and crowdfunding platforms combine existing digital capabilities to launch their own services or build completely new offerings on top of existing digital solutions. However, in many ACP countries, crowdfunding platforms do not benefit from a solid foundation of existing digital capabilities in the industry. Consequently, they must build from scratch

most of the capabilities required to support their value chain and services (online payments, escrow account management, connecting to custodians, digital signature, etc.). This requires a heavy investment that their business models can rarely afford.

To overcome these challenges, crowdfunding platforms operating in ACP countries should innovate and adapt crowdfunding practices to their local realities: leveraging mobile technology including USSD²¹ and mobile payment, using popular social messaging apps (e.g. WhatsApp, Messenger, Viber), and collaborating closely with mobile operators.

However, crowdfunding ecosystems in ACP countries need to be aware of the existence of gender biases and work to eliminate them by using fair algorithms and eliminating gender stereotypes.

18 *Adjusted savings: net national savings (current US\$) – Pacific island small states, Caribbean small states, Sub-Saharan Africa, World Bank database*

19 *Crowdfunding's Potential in The Caribbean: A Preliminary Assessment, World Bank, 2017*

20 *Individuals using the Internet, World Bank database*

21 USSD is a communications protocol used by GSM cellular telephones to communicate with the mobile network operator's computers

HYBRID FORMS OF CROWDFUNDING

In the African context where crowdfunding is still at its early stage of engagement, it is a common practice for crowdfunding campaigns, whether on local or international platforms, to use a combination of online and offline channels to raise funds.

Indeed, the online campaign is complemented with traditional community funding or mobile money use for collecting funds outside the crowdfunding platform. As a result, most online contributors are diaspora members and offline contributors are locals who don't have payment cards or prefer to use mobile money or direct bank transfers.

Such practices can be characterized as hybrid forms of crowdfunding and they are observed mainly in donation-based crowdfunding.

The regulation challenges: new approaches to regulate crowdfunding without hindering its development.

To our knowledge, no ACP country has designed a bespoke crowdfunding regulation. Nevertheless, ACP countries have existing financial services regulations that could be applied in part to crowdfunding.

Regulating equity crowdfunding activity by means of a strict capital market securities law and regulating crowdlending activity through heavy banking regulation could be inappropriately burdensome for new entrants such as crowdfunding platforms.

Typically, crowdfunding is considered a financial activity that should be appropriately regulated to protect financial market integrity and prevent many risks related to its activities. The key risks identified are:

- money laundering and terrorist financing
- consumer protection issues, notably the risk of over-indebtedness and fraud
- investor protection (risk disclosure, suitability assessment, etc.)
- the breach of personal and financial data
- lack of recourse mechanisms for borrowers
- lack of credit information sharing and potential bias in the data used for credit risk assessment models that could lead to discrimination
- liability in case platforms malfunction.

The lack of regulatory clarity and the cost of understanding country-specific regulations remains among the main factors that impede the development of crowdfunding platforms. These platforms leverage digital and new uses of technology to provide innovative financial services that require new regulation practices to protect investors and market integrity. It is challenging for regulators to design crowdfunding regulatory frameworks that meet the needs of innovative forms of finance and upgrade the capacity of regulators and ecosystem stakeholders to supervise them effectively.

In this context, some regulators in ACP countries are creating regulatory sandboxes²² as controlled environments allowing crowdfunding platforms to test their innovative services on a small scale and under specific conditions. The sandboxed platforms receive practical guidance from regulators on supervision and are required to submit periodical reports including financial, risks, and operational KPIs.

Examples of ACP countries that have created regulatory sandboxes are Nigeria, Kenya, South Africa, Mauritius, Ghana, Rwanda, Mozambique, and Sierra Leone.

²² Regulatory Sandbox: Environment in which Fintechs and innovators can test their products and services on a small scale and supervised by regulators.

REGULATORY SANDBOX IN KENYA²³

Kenya's regulatory sandbox, approved in March 2019, is under the Capital Markets Authority of Kenya (CMA). The CMA issued a Regulatory Sandbox Policy Guidance Note that document outlines the steps needed to apply for the regulatory sandboxes and the eligibility criteria used. Once admitted in the Kenyan's regulatory sandbox, the company gets a 12-month period to run tests on the product or service, sending interim reports on the progress to the CMA.

After the testing period is completed, the CMA shall take any of the following decisions:

- a) Grant the Participant a license or approval to operate in Kenya subject to compliance with existing legal and regulatory requirements; or
- b) Grant the Participant permission to operate in Kenya subject to compliance with the terms of a letter of No Objection;
- c) Adopt new regulations, guidelines or notices pursuant to Section 12 and 12A of the Act, based on insights gained from the Regulatory Sandbox test, where there is a need for a broader legal or regulatory reform (for example, the design and adoption of a new regulation to govern a specific class of business model or innovation that is not adequately addressed under existing regulation); or
- d) Issue a denial of permission for the Participant to operate in Kenya under prevailing legal and regulatory requirements.

REGULATING ALTERNATIVE FINANCE²⁴

The Global Regulators Survey is a study intended to understand the global regulatory landscape for Alternative Finance by surveying and collecting data from 111 regulators around the world with 30% of them representing middle or low-income jurisdictions.

The key findings related to the context of ACP countries are:

- Policymakers are optimistic about the potential of Alternative Finance to improve MSMEs (79%) and consumers (65%) access to finance and stimulate competition in financial services (68%).
- Alternative Finance is still unregulated in most jurisdictions: only 22% formally regulate crowd-lending and 39% regulate equity crowdfunding. When it is regulated, it is generally subject to a bespoke regulatory framework. However, most regulators have declared they will be regulating crowd-lending by mid-2021, and more than a third intend to regulate equity crowdfunding.
- Regulators' top priorities in terms of regulation are Know Your Customer and Anti Money Laundering (KYC/AML) requirements and misleading promotions or the misuse of client money.
- Regulators are facing difficulties in supervising platforms because of limited technical expertise, limited resources, difficulties in coordinating multiple supervisory bodies, and often a lack of reliable and empirical data.
- Globally, 22% of regulators have already created regulatory sandboxes; the number of created sandboxes is expected to at least double in the coming 5 years.
- Regulatory innovation initiatives are rare in Latin America and the Caribbean, while, in Sub-Saharan Africa, a regulatory sandbox is in place or in development in nearly one in three jurisdictions (32%).
- Finally, 34% of regulators from lower-income countries received support from Development Banks to develop Alternative Finance.

²³ Source: Regulatory Sandbox Policy Guidance Note, CAPITAL MARKETS AUTHORITY – KENYA, March 2019

²⁴ Regulating Alternative Finance: Results from a global regulator survey, World Bank & Cambridge Alternative Finance, 2019

KEY RECOMMENDATIONS FOR POLICYMAKERS

To facilitate access to finance for MSMEs through digital technologies, policymakers should provide regulatory certainty, steer market development in support of national sustainable development priorities and mitigate the risks brought by crowdfunding.

Policymakers can adopt policies that can be part of a national strategy to promote crowdfunding, as part of other national strategies (financial inclusion, digitalization, etc.). These policies would ideally be designed by involving all relevant stakeholders, including the supply-side (investors, diaspora), the demand-side (MSMEs), the crowdfunding platforms and the ecosystem partners (financial institutions, regulators, business support operators, consumer protection associations, etc.).

Our policy recommendations that lead to a conducive environment for the formation and growth of crowdfunding are clustered around the challenges types discussed above.

They have been split into three areas:

- 1 »» building crowdfunding ecosystem capacity
- 2 »» strengthening technology infrastructure for crowdfunding
- 3 »» enacting regulatory frameworks to support crowdfunding

RECOMMENDATION 1: PROMOTE CROWDFUNDING CAPABILITIES AND BEST PRACTICES

For wider public adoption, it is important to raise crowdfunding awareness by building users' capabilities through education and technical assistance.

The following actions are recommended:

- Support the development of educational materials on crowdfunding for all stakeholders (investors, diaspora, MSMEs, ecosystems partners) and ensure their dissemination widely through offline and online channels. For instance, the World Bank Group developed an eight-week free online course 'Crowdfunding for Caribbean Entrepreneurs'²⁵ that provided support on crowdfunding fundamentals and how to prepare and launch a fundraising campaign for 244 entrepreneurs.
- Implement policies that support gender equality and inclusivity within the crowdfunding sector. These policies would aim to inform women about the benefits of crowdfunding and to foster the launch of programs that provide additional funding to women entrepreneurs by matching the funds contributed by individual backers. By implementing such policies, the crowdfunding sector can create a more inclusive and supportive environment for women led-businesses.
- Build trust in crowdfunding platforms by creating a recognized national label and promoting the benefits of using crowdfunding for MSMEs and investors.
- Support the creation of a national crowdfunding association that gathers national crowdfunding platforms and ecosystem players. The mission of this professional association could be to foster crowdfunding adoption and facilitate policy dialogue with national authorities and regulators. In addition, the national crowdfunding association could promote industry best practices among platforms by providing technical training alongside direct coaching. Expertise France is currently assisting the Tunisian authorities on a 'national crowdfunding

²⁵ *Crowdfunding for Caribbean Entrepreneurs: Free Online Course*, World Bank, 2016

- plan' that includes providing support to the creation of a 'Tunisian crowdfunding association'.
- Provide market incentives to channel savings into the financing of local sustainable development projects.
- Promote sector-specific crowdfunding initiatives targeting, for instance, technology start-ups, creative industries and handicraft producers, and Social Solidarity Economy organizations, because they can benefit from their community and affinity group's effects to raise funds through crowdfunding.
- Engage diaspora through crowdfunding initiatives by including crowdfunding in the national diaspora mobilisation strategy.
- Encourage partnerships between crowdfunding platforms and financial institutions (banks, funds, MFI) which allow, on the one hand, platforms to become more professional and get resources to strengthen their financial structure; and, on the other hand, traditional financial institutions to adopt innovation and efficiency. One way to foster such partnerships is through matching funds.

MATCHING FUND TO INCENTIVIZE CONTRIBUTIONS CROWDFUNDING

The Cheetah Fund of €400,000 supported African pioneers with seed money to kick-start or boost their projects. It is a Danish program run in Kenya in partnership with the 1 per cent Club crowdfunding platform. The Cheetah Fund provided 70% of a company's target crowdfunding goal once that company raised the initial 30% from private investors. The matching fund provides an incentive for investors despite their lack of familiarity with the crowdfunding funding mechanism.

RECOMMENDATION 2: STRENGTHEN THE TECHNOLOGY INFRASTRUCTURE FOR CROWDFUNDING DEVELOPMENT

Policymakers should ensure technological building blocks are in place for crowdfunding to function organically within the economy.

The following actions are recommended:

- Encourage private investments to increase Internet coverage and foster competition to reduce costs for consumers and MSMEs.
- Provide technical support to local crowdfunding platforms and promote networking and partnerships between local and international platforms.
- Provide incentives that support digital financial infrastructures, such as infrastructure sharing, interoperability, and good standards for digital IDs and digital signatures.
- Encourage interoperability of different local and international payment solutions (i.e. mobile money from different operators, payments cards, banking transfers, etc.) to facilitate their integration on crowdfunding platforms and offer multiple ways for investors to participate.
- Digitize public services like company registration and tax filing and payment. This would create the first set of digital data footprints for MSMEs that could help credit information availability.

RECOMMENDATION 3: ENACT REGULATORY FRAMEWORKS TO SUPPORT CROWDFUNDING

To achieve the benefits of crowdfunding and mitigate the associated risks, an appropriate regulatory framework should be in place. Regulators should then consider taking appropriate, risk-based approaches that support responsible innovation in financial services while maintaining financial stability and promoting market competition.

The following actions are recommended:

- Conduct a regulatory gap analysis to study whether existing financial regulation covers crowdfunding and to identify the appropriate regulatory responses.
- Consider implementing a ‘regulatory sandbox’ to determine whether crowdfunding platforms can comply with existing regulatory requirements and, if not, whether there are alternative means that would enable them to meet the underlying regulatory objectives.
- Allocate dedicated resources to further deepen expertise on Alternative Finance within regulators bodies and consider creating an innovation office.
- Coordinate regulatory works and align crowdfunding regulatory frameworks with those in neighbouring ACP countries. This would represent an opportunity to align crowdfunding regulatory frameworks at regional levels with international best practices.

CROWDFUNDING REGULATION IN MOROCCO AND TUNISIA

In Morocco and Tunisia, the development of crowdfunding activities was kicked off in 2014 by local ecosystem players who pushed their respective regulators to devise new crowdfunding regulatory frameworks. In both countries, draft laws were presented in 2020 to parliaments that unanimously voted them into law. The resulting decrees governing the operations of Crowdfunding platforms are expected to be enacted at the latest by end of 2021. In 2016, Tunisian authorities have received technical assistance from GIZ to issue a first draft of the legal framework for crowdfunding in Tunisia.

This technical assistance delivered the following reports and documents:

- A study on the fundamentals of crowdfunding and good international practices in this domain;
- A benchmark of international crowdfunding regulatory good practices;
- A policy brief on the Tunisian financial context and the contribution of crowdfunding for the development of SMEs;
- A concept note on the online payment systems in Tunisia – State of play and prospects for development;
- An analytical paper on the various legal transactions used by the crowdfunding industry to identify their legal qualification in Tunisian law and to target any text that may be amended and new principles that may be applied in the framework of a reform of crowdfunding;
- A draft legal framework for the development of crowdfunding in Tunisia.

Since 2019, Expertise-France is assisting the Tunisian regulators and ecosystem through Innovi, an EU funded program, on the effective implementation of crowdfunding after the adoption of the crowdfunding legal framework by the Tunisian parliament. The technical assistance provided in this domain aims at defining a national crowdfunding development plan for Tunisia. This plan covers many aspects such as technical assistance to regulators, support to the emergence of local crowdfunding platforms, promotion of crowdfunding good practices, support to the creation of a crowdfunding national association, etc.

HOW CAN THE ICR FACILITY HELP YOU?

If you are a public policymaker, or represent a public or private organisation originating from an ACP country, and are interested in developing crowdfunding as a means to facilitate access to finance for MSMEs, the ICR Facility can support you, to implement some of the recommendations of this report.

For example, technical assistance could support:

- the development of educational materials on crowdfunding for all stakeholders,
- the creation of a recognized national label,
- the creation of a national crowdfunding association to facilitate policy dialogue,
- an analysis of the existing regulation and how to improve it,
- etc. ...

This paper was authored by Thameur Hemdane. This paper is part of a series of ICR reports on innovative financing solutions and financial regulations for start-ups, MSMEs, social enterprises and inclusive businesses.



Other ICR reports in this series are:

ICR report: *[Honour loans: a comprehensive mechanism to foster development by supporting MSMEs](#)*

ICR report: *[Startup Acts: an emerging instrument to foster the development of innovative high-growth firms](#)*

All ICR reports have been produced after discussions at live events, which have been recorded and can be accessed at the ICR Facility's Knowledge Hub: <https://www.icr-facility.eu/knowledge-hub>

LISTINGS

LIST OF ABBREVIATIONS

| | |
|-------------|---|
| ACP | African, Caribbean and Pacific countries |
| AML | Anti-Money Laundering |
| APAC | Asia Pacific |
| CFT | Countering Financing of Terrorism |
| IFC | International Finance Corporation |
| KPI | Key Performance Indicators |
| LAC | Latin American and Caribbean States |
| MENA | Middle East and North Africa |
| MFI | Microfinance Institution |
| MSME | Micro-, small- and medium-sized enterprises |
| SDGs | Sustainable Development Goals |
| SSA | Sub Saharan Africa |
| USA | United States of America |
| UK | United Kingdom |
| USSD | Unstructured Supplementary Service Data |
| VC | Venture Capital |

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About the ICR Facility

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The ICR Facility supports public and private stakeholders in ACP countries to improve their investment climate and business environment via public-private dialogue. The Facility supports specific and targeted interventions at the economy-wide, sectoral, and value-chain levels with Technical Assistance for up to 90 days based on requests. It also works to strengthen national and subnational development financial institutions and compiles and shares good practices for improving the business environment and investment climate.

For more details on the ICR Facility or to submit a request for Technical Assistance, visit: www.icr-facility.eu.

IMPRINT

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