AVPA AFRICAN VENTURE PHILANTHROPY ALLIANCE

THE LANDSCAPE FOR SOCIAL INVESTMENTS IN SOUTHERN AFRICA

DEMAND FOR SOCIAL CAPITAL

intellecap
AAVISHKAAR GROUP

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The African Venture Philanthropy Alliance (AVPA) is a unique Pan-African network for social investors, headquartered in Nairobi and committed to building a vibrant and high impact community across Africa. AVPA is aligned with thriving networks in Europe (EVPA - HQ in Brussels with 250+ members) and Asia (AVPN - HQ in Singapore with 600+ members) to form a dynamic global force for social impact.

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The U.S. African Development Foundation (USADF) is an independent U.S. government agency established by Congress to invest in African grassroots organizations, entrepreneurs and small and medium-sized enterprises. USADF's investments promote local economic development by increasing incomes, revenues and jobs, and creating pathways to prosperity for marginalized populations and underserved communities.
Utilizing a community-led development approach, USADF provides seed capital and local project management assistance improving lives and impacting livelihoods while addressing some of Africa's biggest challenges around food insecurity, insufficient energy access, and unemployment, particularly among women and youth.

Over the last five years, throughout Africa, with an emphasis on the Horn, Sahel and Great Lakes regions, USADF has invested more than $115 million dollars directly into over 1,000 African owned and operated entities and impacted over four million lives.

Social Capital Foundation is a Dutch Foundation that partners with social impact first organisations who want to enhance sustainable economic opportunities for communities and small businesses.

SCF supports local talent potential, creativity and innovation with adequate tools, flexible funding and a knowledge network to maximize and scale impact.

The Rockefeller Foundation's mission—unchanged since 1913—is to promote the well-being of humanity throughout the world. Today the Foundation advances new frontiers of science, data, policy, and innovation to solve global challenges related to health, food, power, and economic mobility. As a science-driven philanthropy focused on building collaborative relationships with partners and grantees, The Rockefeller Foundation seeks to inspire and foster large-scale human impact that promotes the well-being of humanity by identifying and accelerating breakthrough solutions, ideas and conversations.

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DEMAND FOR SOCIAL CAPITAL IN SOUTHERN AFRICA

The lack of innovative capital in the region continues to strain the growth of the entrepreneurship ecosystem.

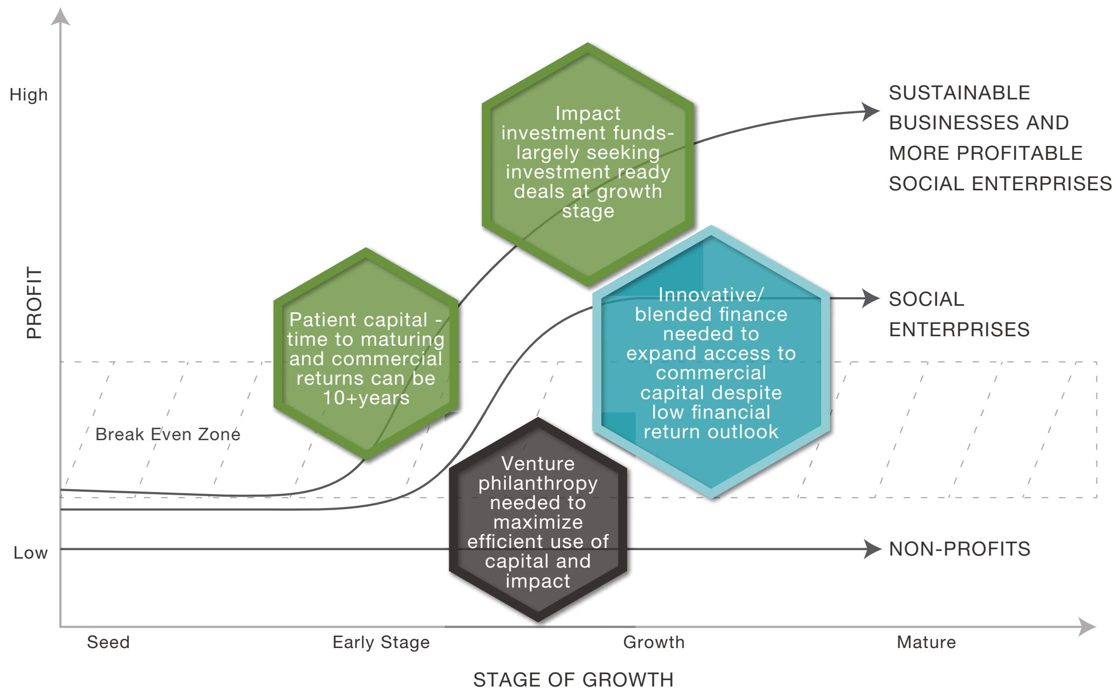
In South Africa, only 7% of the population is engaged in entrepreneurship, compared to 25% entrepreneurship rate in other countries on the continent[78]. This is partly due to financing challenges facing young entrepreneurs, with the majority of them opting to seek employment in the formal sector. The persistently high unemployment rate in the country, however, necessitates more funding to be directed towards building enterprises that can result in job creation. In Zambia and Mozambique,most businesses are in the early-stages with very few venture-stage or mature businesses. For these businesses, the traditional financial service providers (banks, MFIs) are the primary sources of capital. Yet, these providers impose high collateral requirements and interest rates that hinder the businesses from accessing the capital, thereby limiting the growth of such enterprises. Further, as highlighted in previous chapters, the supply of capital for the early-stage businesses is low, with only a handful of deals recorded at the pre-seed and seed level.

Declining funding for the non-profit sector from international sources is necessitating the development of more sustainable and innovative financing mechanisms for NGOs.

Non-profits/non-governmental organisations (NGOs) across the region rely almost exclusively on funding from international sources. Besides, the available funding has primarily been focused on supporting programmatic interventions with significant funding gaps identified for capacity building and general administration support to the NGOs. These challenges, augmented by the absence off funders' approach to providing longer-term support to NGOs, hinder the effective implementation of social and developmental programs by the NGOs. There is thus a need to leverage more sustainable approaches, such as venture philanthropy, for deploying both local and international capital to non-profits. Such approaches can create significant social impact by providing long-term funding and support.

Venture philanthropists can leverage the core strengths of non- profit organisations including reach into rural areas, broad community networks and understanding of local context while addressing their capacity challenges particularly in financial management, strategic planning and impact measurement in order to scale the impact created by their capital.

Figure 1: Type of financing requirements for various types of organisations at various stages of growth



Social enterprises and non-profits have different capital needs throughout their growth stage, with many of these not being met by traditional financing structures, as highlighted in the previous paragraphs.

This calls for usage of venture philanthropy and innovative financing structures in the region, as shown in the diagram above.

1.1 TRENDS AND DEVELOPMENT IN THE SOCIAL ENTERPRISE AND START-UP LANDSCAPE IN THE REGION

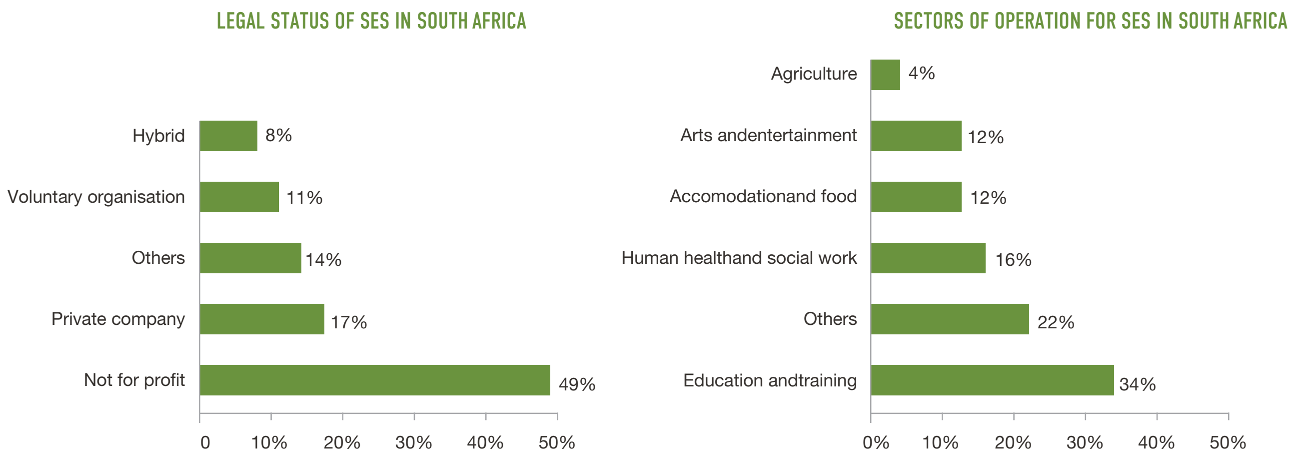
The Southern Africa countries are at varying stages of growth in regards to the social enterprise (SEs) ecosystem.

South Africa has one of the most vibrant social enterprise ecosystems in the region, with over 33,700[79] social enterprises currently operating in the country. A significant proportion of these enterprises operate as non-profits, majorly working at the community level and focusing on education, health, accommodation and food security sector. Data on the number and profiles of SEs in Zambia and Mozambique remains inadequate. However, according to a World Bank report[80], only a small number of organisations in Zambia fit the definition of social enterprise. The social enterprises currently operating in Zambia are primarily working in the energy and health sectors, while faith-based SEs[81] are particularly active in the health sector.

Although only a small proportion of the population is engaged in entrepreneurship, South Africa has maintained its position as the top start-up[82] ecosystem in Africa, with several innovative businesses focused on solving development challenges, particularly in the financial inclusion space.

South Africa is among the best-placed countries for the start-up ecosystem in Africa, ranked 52 in the Start-up Ecosystem Ranking[83] 2020. The country boasts of a well-developed ecosystem comprising of investors, accelerators, incubators, and other support agencies. Cape Town, which is home to 60% of all South African start-ups, is amongst the top 150 cities, ranked 146; while Johannesburg leaped 88 spots as compared to 2019, and is ranked 160[84]. In Africa, these two cities were ranked 3rd and 4th, respectively[85]. Cape Town remains an important hub for financial services, retail, and tourism and has experienced significant progress with the emergence of technology-based solutions such as mobile payment apps and online learning platforms. Johannesburg's start-up ecosystem has become financial inclusion hub with 30% of the start-ups in the city operating in fin-tech space. Only two other countries in the region - Botswana and Zambia appeared in the 2019 ranking at the position 90 and 92 respectively but did not feature in the 2020 ranking[86], an indication of the nascent start-up ecosystem in the region.

Figure 2: Legal status and sectors of operation for SEs in South Africa, 2018



Source: Gordon Institute of Business Science, South Africa: SE report, 2018

[79] GIBBS: Social Enterprises in South Africa Report, 2018

[80] World Bank: Emerging Social Enterprise Ecosystems in East and Southern Africa countries, 2017

[81] Refers to Faith Based Organisations who serve the community based on religious motivations and with the objective to increase social and environmental impact.

[82] Some startups are classified as Social Enterprises; detailed segmentation and classification of the same however does not exist

[83] Startup Ecosystem Ranking Report, 2020, Startup Blink

[84] Startup Ecosystem Ranking Report, 2020, Startup Blink

[85] Startup Ecosystem Ranking Report, 2020, Startup Blink

[86] Startup Ecosystem Ranking Report, 2020, Startup Blink

Figure 3: Global and Africa Start-up ecosystem ranking

START-UP ECOSYSTEM RANKING, 2019

	AFRICA RANK	GLOBAL RANK
South Africa	1st	51st
Kenya	2nd	52nd
Nigeria	3rd	56th
Egypt	4th	60th
Rwanda	5th	64th

START-UP ECOSYSTEM RANKING, 2020

	AFRICA RANK	GLOBAL RANK
South Africa	1st	52nd
Kenya	2nd	62nd
Rwanda	3rd	65th
Nigeria	4th	68th
Egypt	5th	81st

Source: Startup Blink – Startup Ecosystem Ranking report

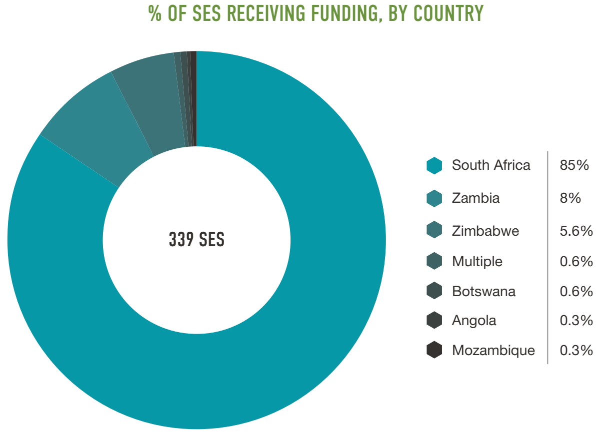
> *Social investors in the region prefer funding for-profit social enterprises with a proven business model, particularly in the financial services sector.*

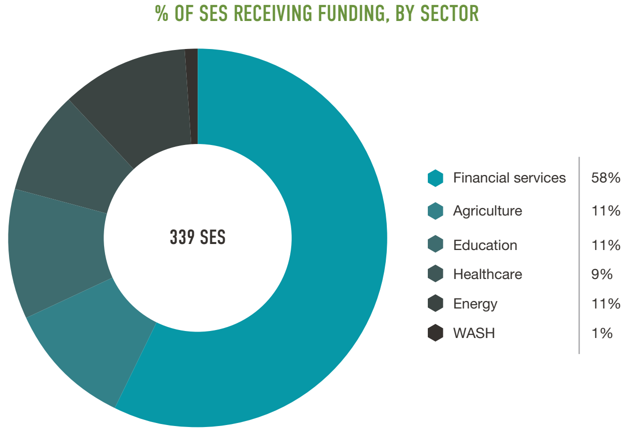
The digital era has resulted in a fundamental shift in the economy of Southern Africa, resulting in the upsurge of enterprises using technology for addressing the social and environmental challenges. Our research identified over 339[87] social enterprises in the region that received funding from social investors between 2015 and 2019. Most of these enterprises focused on addressing challenges in financial inclusion, healthcare and education sectors.

Further, as highlighted in earlier chapters, the number of deals decreased significantly between the <US$ 0.1Mn and US$ 0.5-1Mn ticket sizes indicating challenges in accessing finance for scaling up businesses.

[87] SEs where deals (debt, equity) were mapped by research team as covered in previous sections of this report

Figure 4: Overview of social enterprises that received funding, By Country and By sector (2015-2019)



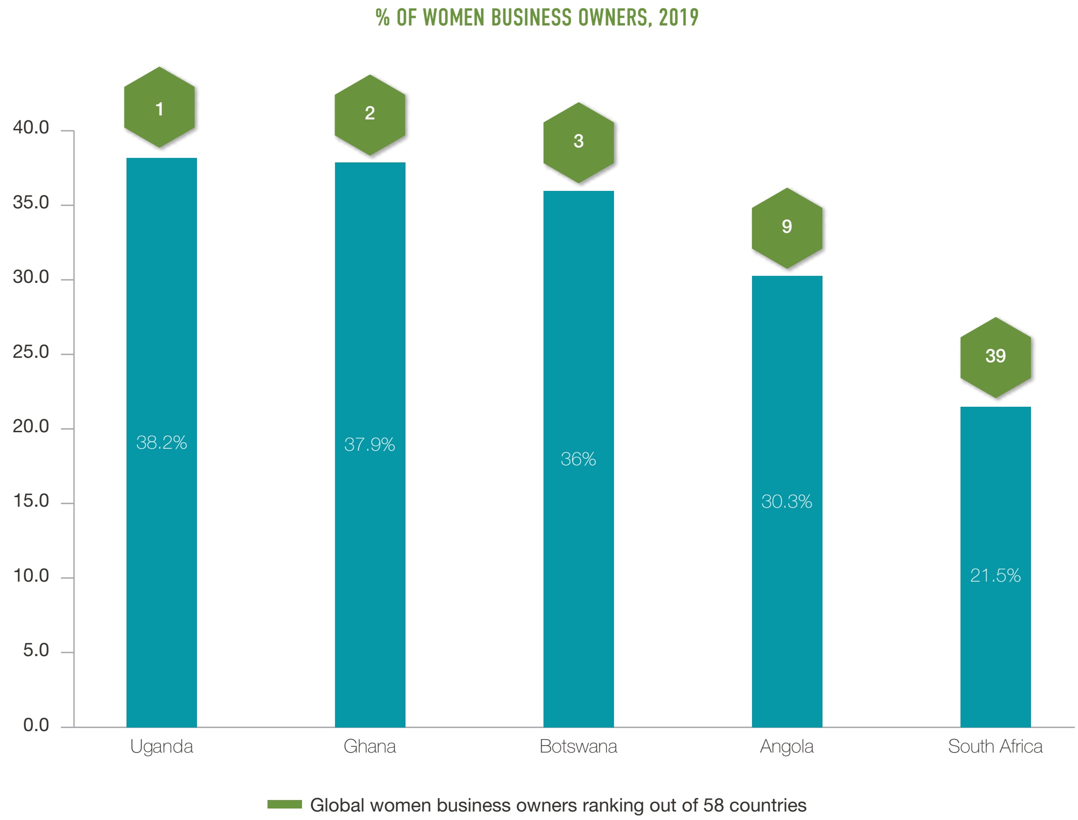


Source: Intellecap Analysis based on transaction/deal data collected

Women-led enterprises, especially in the technology domain, are increasing; however, they continue to face more challenges when compared to their male counterparts.

Southern Africa, like other regions in the continent, is observing a slow but increasing growth of female-run businesses with Botswana and Angola ranked top 10 in the global ranking of women entrepreneurs in 2019[89]. Approximately 36.0% and 30.3% of businesses were owned by women in these two countries, respectively[90]. However, similar to other parts of the world, women-led and owned enterprises in the focus countries are strapped for funds in comparison to male businesses with male-owned enterprises receiving six times more capital than female-owned enterprises in South Africa[91]. According to a study by VentureBurn, only 4.5% of all disclosed tech start-up deals by VCs and angels in South Africa went to women-led start-ups in 2019[92].

Figure 5: Top African countries in the global ranking of women business owners, 2019



NB: Other focus countries did not appear in the ranking
Source: MasterCard Index of Women Entrepreneurs

[88] Data collection methodology section in Chapter 3
[89] The MasterCard Index of Women Entrepreneurs, 2019
[90] The MasterCard Index of Women Entrepreneurs, 2019
[91] World Bank: Profits from parity – unlocking the potential of women's businesses in Africa
[92] VentureBurn Article: What percentage of VC and angel investing goes to SA startups with women founders, 2019

The small market size and low purchasing power in some focus countries create challenges for growth and scale-up of social enterprises and sustainable businesses.

Except for South Africa and Angola, the other focus countries have a relatively smaller size of the economy. These countries also have low purchasing power and high poverty levels. Zambia and Mozambique, for example, have a per capita income less than that of the average for Sub-Saharan Africa[93]. In the same vein, the population living below the poverty line is as high as 58%[94] in Zambia and 46%[95] in Mozambique. Enterprises that engage in providing non-essential services or products cannot survive in such socio-economic conditions as the purchasing power for such services and products is very limited. This indicates a need for hybrid financing and operating models in these countries for achieving the SDGs.

A significant proportion of the enterprises have sprung up out of necessity and lack innovation resulting in high failure rate.

With the burgeoning issue of unemployment that the region is facing - the youth unemployment rates are as high as 21% in Zambia and 56% in South Africa[96]. - youths have been establishing social enterprises/start-ups to earn an income and support their livelihoods. Business models of such enterprises however, have minimal innovation and result in many similar types of businesses competing with each other. Without a competitive edge, such businesses are not able to scale and fail within the first few years of their establishment. In South Africa, for example 70-80% of the businesses fail in the first 3 years and only about half survive in the next five years[97]. In Zimbabwe, small businesses and startups account for 94% of the total businesses. Still, they contribute only 15% to the country's economy because of the high failure rate in the first five years of establishment[98].

SOUTH AFRICA	ZIMBABWE
85-90% of enterprises in South Africa fail within the first five years	Small businesses make up 94% of total businesses and only contribute 15% to the country's economy due to high failur rate
Source: OECD financing SME's and entrepreneurs 2020	*Source: Barbra sibanda walden university - sustainability of small businesses in Zimbabwe*

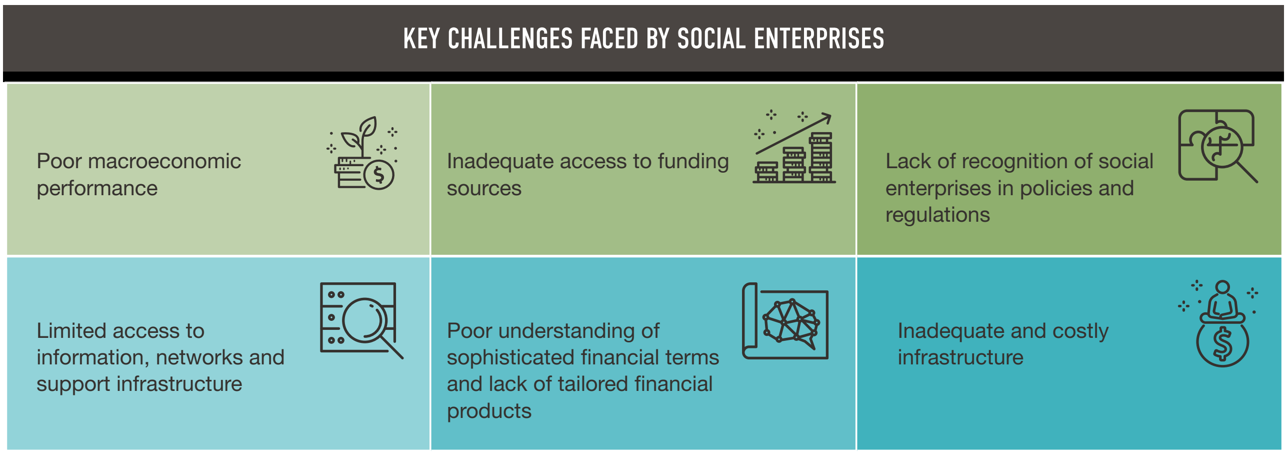
A large amount of aid money in key social sectors makes it difficult for profit-making SEs/Start-ups to scale business models that can compete with subsidized products and services in those sectors.

Owing to the high poverty levels in Zambia (57.5%) and Mozambique (62.9%) as well as frequent natural disasters facing these countries, donors continue to play a vital role in providing aid for solving development challenges, particularly in the health, agriculture, energy, and education sectors. Most of this funding is in the form of grants to non-profits, which provide the related products and services either at subsidized rates or for free. In such cases, for-profit social enterprises/ start-ups find it very difficult to compete with the NGOs in a financially sustainable manner. This reiterates the need for hybrid models to support the development of the NGOs and social enterprises in such less developed markets.

1.1.1 CHALLENGES FACED BY SOCIAL ENTERPRISES IN THE REGION

Social enterprises in the region face multiple challenges that hinder their scale-up with most failing within the first few years of establishment, as previously highlighted. Some of the critical demand, supply and ecosystem challenges facing enterprises are discussed below;

Figure 6: Top challenges to the growth of social enterprises in Southern Africa



[93] World Bank Development Indicators, 2018
[94] World Bank Development Indicator
[95] World Bank Development Indicator
[96] World Bank Development Indicator
[97] Organisation for Economic Cooperation and Development (OECD): Financing SMEs and Entrepreneurs, 2020
[98] Sustainability of Small Businesses in Zimbabwe During the First 5 Years,, Barbra Sibanda Walden University, 2016

a) **Macro-economic challenges plaguing the growth of SEs/start-ups:** Several focus countries in the Southern Africa region have faced poor macro-economic performance due to factors such as natural disasters, over-dependency on the oil and mining industry, currency depreciation, and insurgency, among others. In Zambia, for example, economic growth has slowed in the past years due to the reduction in mining activities, in turn resulting in the decrease in export credits for the country. Mozambique recently suffered from a debt crisis and cyclones Idai and Kenneth in 2019, which had devastating effects on its economy. The country has also been facing a growing insurgency. Angola, on the other hand, is still suffering the effects of lower oil prices and production levels. These macro-economic challenges significantly impact the performances of businesses in the region.

b) **Inadequate access to funding sources:** Other than in South Africa, domestic credit provided to the private sector as a proportion of GDP remains lower than the SSA average[99]. This means that small businesses are often locked out of the formal financial system, given the inherent challenges associated with lending to such businesses. Interest rates are also significantly high in some countries - 19% in Mozambique and Angola and 16% in Zimbabwe in 2019[100]. Social enterprises continue to rely on donations/grants, particularly from corporate and corporate foundations in South Africa and donors in Zambia and Mozambique.

c) **Lack of recognition of the concept of social enterprises:** None of the focus countries has policies and structures explicitly regulating social enterprises. The closest structure to an SE that exists in South Africa is a Non-Profit Company (NPC)[101]. NPCs can qualify as Public Benefit Organisation (PBO) and thus can be eligible for tax incentives. In Zambia and Mozambique, SEs can either register as NGOs or as businesses. Clearly defining and developing regulatory frameworks for SEs, as has been the case in developed countries like the United Kingdom,fosters multiple benefits for the SEs.

d) **Limited access to information, networks and support infrastructure:** Similar to other SSA regions, ecosystem support for social enterprises is concentrated in major cities – Cape Town and Johannesburg in South Africa, Lusaka in Zambia and Maputo in Mozambique. Rural based enterprises thus face challenges accessing the information on funding opportunities, networking with potential investors, and capacity-building support. Further, most of the ecosystem support is primarily geared towards tech-based enterprises.

e) **Poor understanding of sophisticated financial terms and lack of tailored financial products:** Understanding of financial terms and instruments such as mezzanine debt, equity and blended finance remains low among social enterprises. Additionally, investors haven't developed many customized financing products that can mobilize more capital for these enterprises.

f) **Inadequate and costly infrastructure:** While South Africa has more advanced infrastructure compared to other countries in the region, the cost of accessing electricity and telecommunication services still remains quite high. For example, the country has one of the most expensive internet in the world, with an average price of 1GB data at US$ 4.3 compared to US$ 1.1 in Kenya and US$ 1.4 in Nigeria. The internet cost is also quite high in the other focus countries; US$ 13.9 in Botswana, US$ 5.3 in Angola, and US$ 3.3 in Mozambique[102].

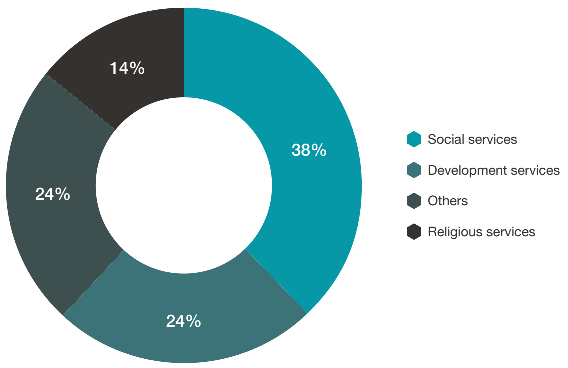
1.2 TRENDS AND DEVELOPMENT IN THE NON-PROFIT LANDSCAPE IN THE REGION

> *The non-profit sector across the focus countries plays an integral role in solving societal and development challenges evident through an increase in the number of NGOs over the recent years.*

In South Africa, voluntary community- based organisations make up 93% of the non-profit sector while non-profit organisations and trusts make up the rest[103]. NGOs play a crucial role in driving the development agenda of the country and have been highlighted as key government implementation partners in the country's 2030 National Development Plan. Notably, the NGOs have played a significant role in promoting the quality of education in the country. Most of the non-profits registered in the country operate in social services sector, such as education, health and employment sector.

Figure 7: Proportion of non-profits registered in South Africa by focus area

PROPORTION OF NON-PROFITS REGISTERED IN SOUTH AFRICA BY FOCUS AREAS



Source: USAID/FHI: CSO Sustainability Index report, 2018

[99] World Bank Development Indicators: Domestic Credit to the private sector as a proportion of GDP

[100] World Bank Development Indicators, 2019

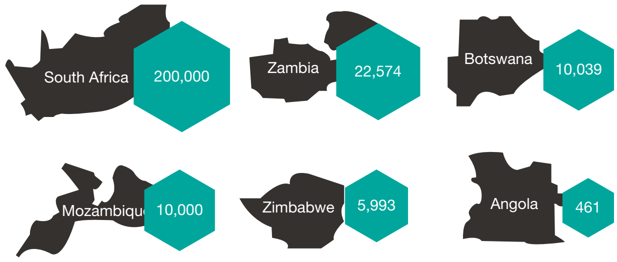
[101] An NPC is defined in South African law as "a company incorporated for public benefit or other object relating to one or more cultural or social activities, or communal or group interest".

[102] Cable.co.uk: Worldwide Mobile data pricing

[103] USAID/FHI: CSO Sustainability Index report, 2018

In Zambia and Mozambique, NGOs/Civil Society Organisations (CSOs) operate with limited support and engagement with the government and primarily focus on areas such as advocacy, provision of health services (particularly HIV/AIDs) and economic empowerment. With low number of social enterprises active in these countries, NGOs/CSOs remain a critical stakeholder for solving societal and development challenges. The number of CSOs has been growing in the region. An estimated 20,000 – 30,000 CSOs are registered in South Africa annually while the number of CSOs grew by more than 85% between 2017 and 2018 in Zambia[104].

Figure 8: Number of CSOs registered across the focus countries, 2018

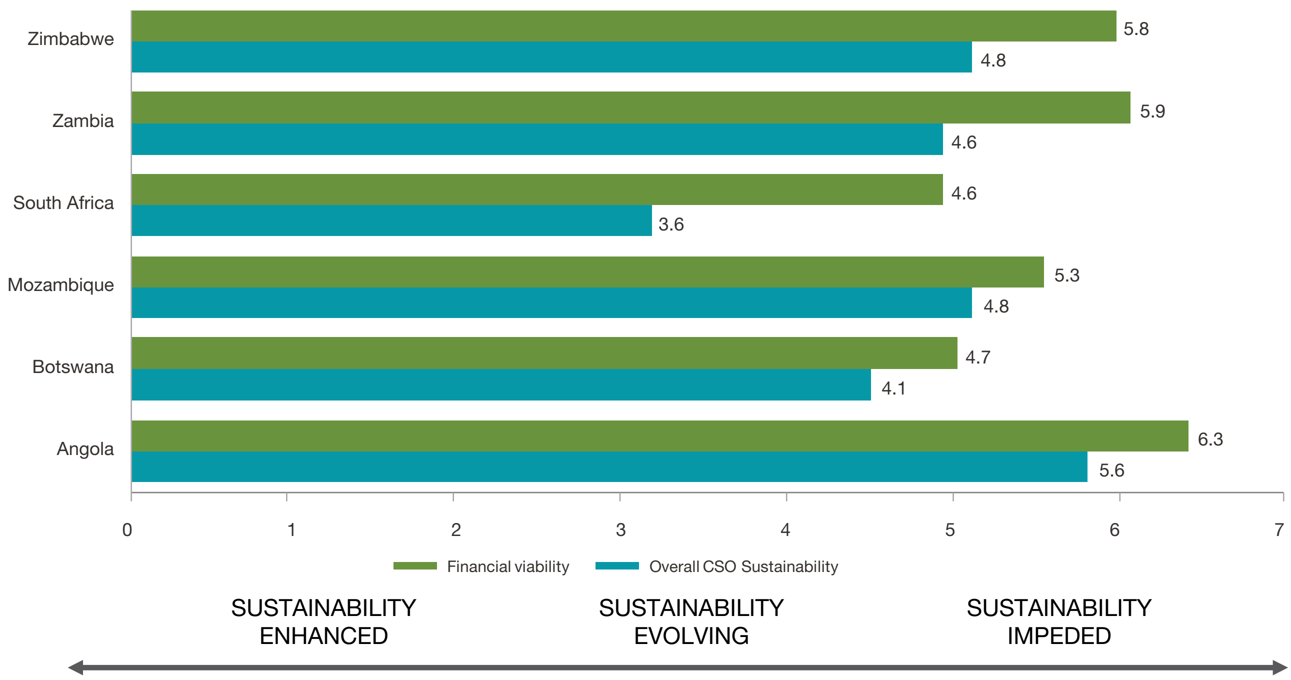


Source: Civil Society Organisation Sustainability Index, 10th Edition, 2019

The overall CSO sustainability index across most of the countries has shown minor improvements; the financial viability score has, however, been deteriorating for most of the countries.

The CSO sustainability index measures the performance of CSOs in seven key dimensions including; legal environment, organisation capacity, financial viability, advocacy, service provision, sectoral infrastructure and public image. CSOs' financial viability has deteriorated in Zambia, Mozambique, Zimbabwe, and Angola due to declining support from donors who are their main funders in these countries. In Zambia, the shift in the country's status to lower middle income has seen several donors reducing their funding to the country with major donors such as Embassies of Norway and the Netherlands closing their funding programs completely. The same was the case in Mozambique, where several non-profits closed in 2018 due to reduced foreign funding. High dependency on donors prevents CSOs from quickly responding to emerging needs as donor funding usually has limited flexibility.

Figure 9: CSO Sustainability score, 2018



Source: FHI 360/USAID CSO Sustainability report, 2018
NB: 7 is the maximum positive score given by the index

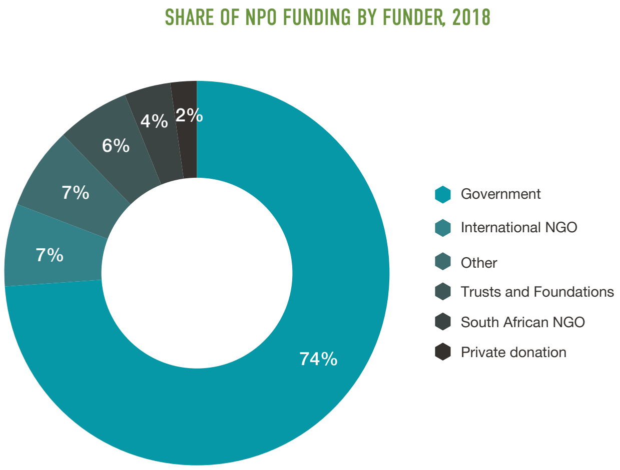
Unlike in other countries, the government is a key partner for NGOs in South Africa, not only providing the largest proportion of funding for NGOs but also providing capacity-building support.

The government's funding to the non-profit (NPO) sector in South Africa not only accounts for the largest proportion of funding but has also been exhibiting an increasing trend over the past years. Government funding stood at 74% of total NPO funding in 2018, a substantial increase from 39% in 2012[105]. Governments, however, rely largely on international capital from donors and international foundations to fund the activities of the NPOs. Post the

[104] USAID/FHI: CSO Sustainability Index report, 2018
[105] NPO Accountability in a disconnected and divided South Africa, 2018

apartheid period, a significant amount of international funding was redirected away from the non-profit sector and towards the government agencies through bilateral aid. The government then leverages this funding to fund non-profits. In addition to being the main source of funds, the government also supports organisational development through training workshops and other capacity building initiatives delivered through the Department of Social Development (DSD).

Figure 10: Share of NPO funding in South Africa by funder, 2018



Source: NPO Accountability

1.2.1 CHALLENGES FACING NON-PROFITS IN THE REGION

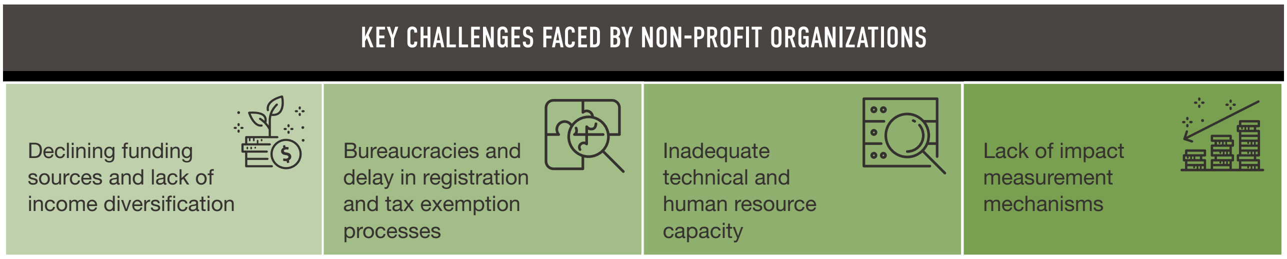
The Non-profit sector in the focus countries faces multiple challenges in various areas, including; funding, institutional technical and human capacity, and legal and regulatory challenges.

in these countries allow NGOs to participate in income-generating activities, they lack skills to do so and thus shy away from the same. Further, the NGOs are allowed to bid for government contracts in many countries in the region, but they rarely do so, assuming that they have no chance of winning the contracts.

b) **Bureaucracies and delays in the registration and tax exemption processes:** CSOs in most countries cite challenges and bureaucracies in the legal processes, particularly in the application for registration and tax exemptions. In Zambia, for example, it is reported that while the law provides for exemptions on excise duties, value-added tax, and income tax for all non-profit making entities, it is mostly international CSOs that are able to receive the exemption. Local CSOs lack access to required information on the process and are unable to get such exemptions. In Mozambique, on the other hand, CSOs registered as public utility institutions receive tax exemptions and deductions on income from grants, but only 5%[107] of CSOs in the country have public utility status as most organisations are not aware of this possibility or are overawed by the intricacies of the application process.

c) **Inadequate technical and human resource capacity:** High staff turnover is a major challenge for CSOs across all the focus countries. Only well-resourced national and international CSOs are able to retain qualified staff with smaller and less-resourced CSOs, often losing their staff members to the government and private sector, which offers better remuneration and job security. Declining funding from donors has also resulted in CSOs not being able to maintain adequate human resources or

Figure 11: Key challenges faced by Non-profits



a) **Declining funding sources and lack of income diversification:** As indicated previously, CSOs in most of the focus countries are facing challenges in seeking funding as the biggest proportion of their funding comes from international sources – majorly donors. Local philanthropic organisations such as family foundations and trust and corporate social investors were active investors for the CSOs and NGOs only in South Africa but also to a limited extent. Trusts and foundation, for example, only accounted for 6% of CSO funding in South Africa[106]. The decline in the financial viability score for CSOs and NGOs in most of the focus countries indicates their increased vulnerability. While certain regulations

pay them well and thus primarily rely on volunteers. Most CSOs identify inadequacy of staff in technical areas such as leadership, financial management, monitoring and evaluation, and project management as a key challenge for their growth and sustainability.

d) **Lack of impact measurement mechanisms:** While most local NGOs/CSOs continue to have a positive impact on their communities, they rarely develop mechanisms to measure and manage the impact generated. Only a few large local NGOs/CSOs review their programs regularly and engage independent evaluators to assess their impact either voluntarily or at donors' directive.

[106] NPO Accountability in a disconnected and divided South Africa, 2018
[107] USAID/FHI: CSO Sustainability Index report, 2018