AFRICAN VENTURE PHILANTHROPY ALLIANCE

THE LANDSCAPE FOR SOCIAL INVESTMENTS IN WEST AFRICA

DEMAND FOR SOCIAL CAPITAL

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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 WEST AFRICA

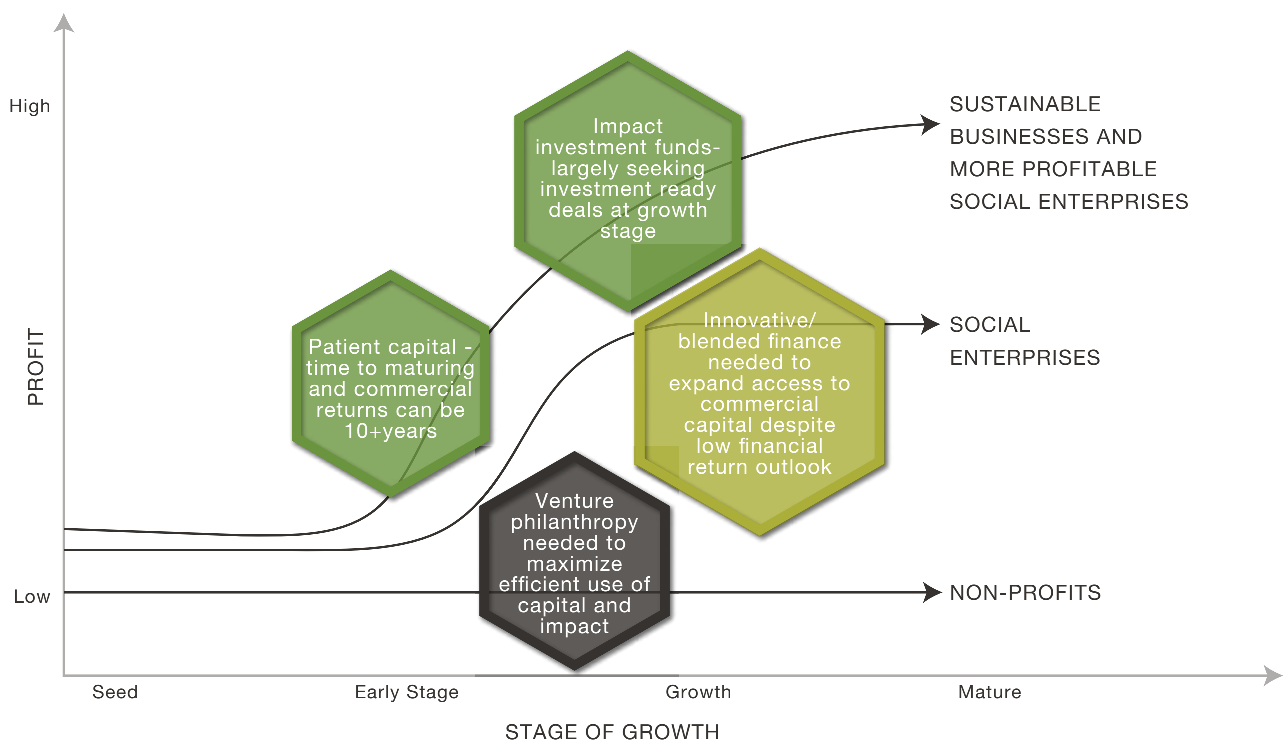
1.1 OVERVIEW OF THE DEMAND FOR SOCIAL CAPITAL

There is a need for more catalytic and innovative capital to support social organisations such as non-governmental organisations (NGOs), social enterprises (SEs), and sustainable businesses that are developing innovative solutions to solve development challenges in the region.

As highlighted in previous chapters, the supply of capital at the pre-seed and seed stages is inadequate as investors primarily focus on financing organisations with already proven models and with established revenue structures. Furthermore, a significant financing gap exists for SMEs, which are considered too big for microfinance institutions (MFIs) and too small or risky for commercial investors—popularly referred to as the "missing middle". There also exists a large opportunity to supply patient growth capital to businesses that demonstrate moderate growth and do not qualify for pure-play equity. Innovative instruments leveraging catalytic funds to de-risk and attract private investments are increasingly becoming crucial and needed to close these gaps. Such structures include loan guarantees, social impact bonds, TA funds as well as crowdfunding, and pooled funds.

On the other hand, non-profit/NGOs rely almost exclusively on international sources for their funding. Funding has mostly been going to programmatic interventions with significant funding gaps identified for capacity building and general administration of the NGOs. These challenges hinder the effective implementation of social programs by the NGOs. Thus, there is a need for a more sustainable approach, such as venture philanthropy, to be leveraged for deploying both local and international capital to non-profits. Such approaches can create significant social impact by leveraging the core strengths of the non-profits i.e. reach into rural areas, broad community networks, and understanding of local context. However, the success of these approaches will also require addressing their capacity challenges, particularly in financial management, strategic planning, impact measurement, etc. to scale impact.

Figure 1: Type of Financing Requirements for Various Types of Organisations at Various Stages of Growth



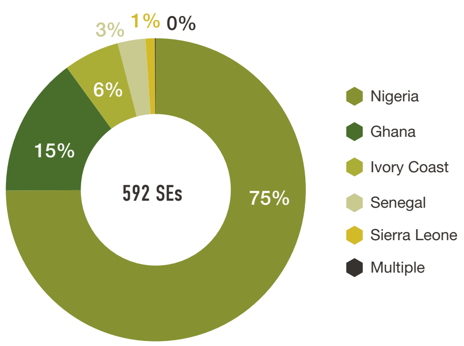
1.2 TRENDS AND DEVELOPMENTS IN THE SOCIAL ENTERPRISE LANDSCAPE IN THE REGION

The number of social enterprises (SEs) in the region is increasing, but the quality of SEs in terms of being investment-ready has a long way to go; only 592[56] SEs operating in the region were able to access funding (debt/equity) between 2015 and 2019.

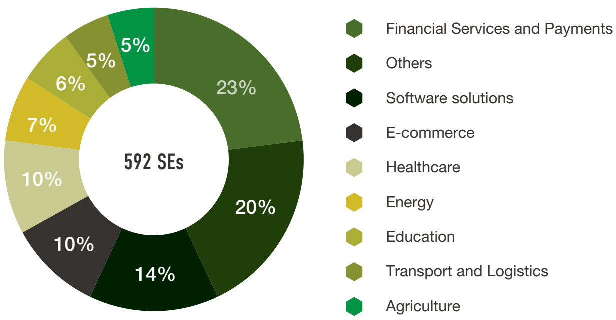
Limited data exist on the exact number of social enterprises operating across the focus countries because of the newness of the concept in the region as well as limited understanding of social enterprises among the stakeholders. Almost half of the self-recognized social enterprises operating in Ghana, for example, were established post-2013[57]. This research identified 592 unique social enterprises in the region, which managed to receive social investments between 2015 and 2019. Most of these enterprises are in the financial services sector followed by healthcare, energy, and agriculture and seek to address the development challenges prevalent in their countries of operation.

Figure 2: Overview of Social Enterprises That Received Funding, by Country and by Sector (2015-2019)

PROPORTION OF ENTERPRISES THAT HAVE RECEIVED FUNDING BY COUNTRY



PROPORTION OF ENTERPRISES THAT HAVE RECEIVED FUNDING BY SECTOR



Source: Intellecap Analysis based on the transaction/deal data collected[58]

The primary focus for venture capital has been on technology-based enterprises.

Nigeria, in recent years, has demonstrated immense growth in its tech-based entrepreneurship sector and is increasingly being referred to as Africa's Silicon Valley (along with Kenya). Key initiatives established include the Silicon Valley – Nigerian Economic Development (SV-NED) – that seeks to bridge the skill gap between Nigeria's technology companies and professionals through on-the-job training in Silicon Valley. In 2019, Nigeria attracted 37%[59] of total venture capital funding in Africa deployed to tech-based start-ups. Venture capital funding, however, needs to focus more on indigenous business models and move beyond its pursuit of outsized returns through tech-enabled businesses and explore other social enterprise models with the potential to achieve 'impact at scale' for mass low-income population residing in the focus countries.

Unlike in East Africa, the West African entrepreneurship space consists of more local entrepreneurs compared to expatriates; the region, however, lags behind East Africa in gender diversity.

In 2019, nearly 37% of enterprise founders/co-founders in Kenya were expatriates compared to 10% in Ghana and 5% in Nigeria[60]. Consequently, more funding in the West African region has gone to locally founded enterprises. In Nigeria, for example, 55% of the total funding in 2019 went to enterprises with local founders compared to only 6% in Kenya[61]. The dominance of locally founded enterprises is further supported by this research data, which showed that nine out of the top 10 deals (in terms of value) made by SFMs were into locally founded businesses. On the other hand, Nigeria and Ghana respectively have only 15% and 13% of enterprises with women co-founders compared to 25% in Kenya[62]. The top 10 investments, as per our research on SFM deals, were made in enterprises founded by men, with two of these enterprises having women co-founders[63]. It is an indication of a higher need for investors to focus on GLI strategies.

Nigeria, which has one of the most advanced start-up ecosystems in the region, lost 12 spots in the start-up ecosystem ranking in 2020 compared to 2019[64]

Nigeria has seen a sprout of technology-based innovations seeking to address financial inclusion, health, and agriculture challenges in the last decade. However, challenges such as unreliable power and poor internet connection, as well as a large concentration of businesses majorly in Lagos and Abuja, hinder the growth of the start-ups and the impact achieved. The country was ranked 3rd in Africa after South Africa and Kenya in the 2019 start-up ecosystem ranking[65]. However, in 2020, Nigeria slipped 12 spots in the global ranking

[56] SEs where deals (debt, equity) were mapped by the researchers as covered in previous sections of this report
[57] British Council: The state of social enterprises in Ghana, 2016
[58] Data collection – the methodology section in Chapter 1
[59] Partech: 2019 Africa Tech Venture Capital Report
[60] Timon and Briter Bridges: Compensation Study, 2019 – 778 start-ups across four African countries were analysed as part of this study
[61] Victoria Ventures, 2019
[62] Timon and Briter Bridges: Compensation Study, 2019
[63] Intellecap Analysis
[64] Startup Blink: Startup Ecosystem Ranking, 2020
[65] Startup Blink: Startup Ecosystem Ranking, 2019

and was also overtaken by Rwanda in the Africa ranking. Conversely, Lagos was the 2nd best start-up ecosystem in Africa. It highlights the fact that if the real impact of SEs is to be realised at scale, countries like Nigeria and others in the region will need to expand their start-up ecosystem beyond few cities and cover the rural areas. Ghana's ecosystem is also slowly growing and is ranked 2nd in the West Africa region. Senegal is the most mature market in Francophone West Africa with critical factors like an increasing number of incubators, entrepreneurs and angel networks, and the recently launched start-up Act[66], driving growth in the country.

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

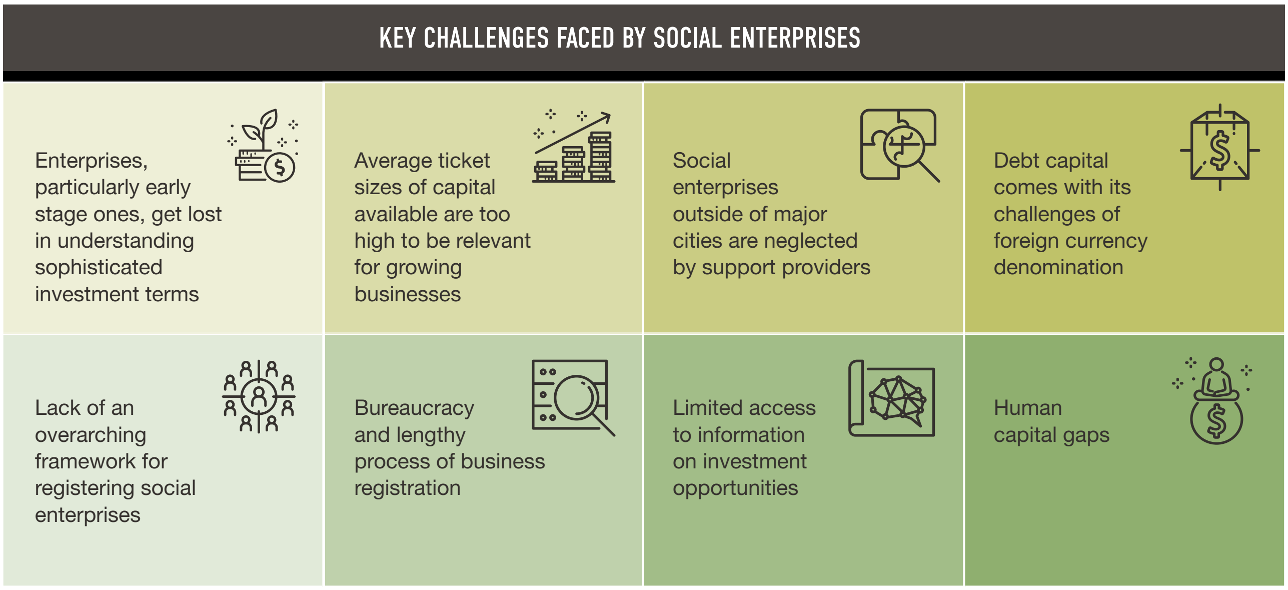
Startup Blink: Startup Ecosystem Ranking, 2019 and 2020

[66]Discussed in detail in Chapter 5

1.2.1 KEY CHALLENGES FACED BY SOCIAL ENTERPRISES IN THE REGION

The research identified common challenges facing most social enterprises across the countries ranging from limited availability and customization of capital, lack of linkages with ecosystem support organisations and networks, lack of infrastructure to test and prototype business models, among others. These challenges are more pronounced amongst youth enterprises due to lack of work experience, business, and technical capacity, and knowledge of formal business practices. The key challenges facing enterprises in the region are discussed below:

Figure 4: Key challenges faced by social enterprises



a) **Enterprises, particularly early-stage ones, often find it challenging to comprehend complex investment terms:** The average financial literacy in the focus countries in West Africa is 31%[67], indicating a lack of knowledge in financial services generally and investment terms specifically. Many enterprises across the focus countries are mainly aware of debt (loan) and grants as funding instruments. It is the lack of understanding of other instruments such as equity, convertible notes and mezzanine that disadvantages the entrepreneur during negotiations with the investors. A number of young entrepreneurs who are just testing their business ideas, in several cases, are ignorant of the financial aspects, including fundraising and financial modelling.

b) **Average ticket sizes are too high for growing businesses:** As per the findings of this report, the average transaction size of the investment provided by SFMs is above US$ 4.05 million, which is much higher than required by most enterprises. Despite growing, access to seed level financing remains inadequate to support the growing social enterprise ecosystem. Most of the social enterprises, especially those started by young entrepreneurs, thus rely on personal saving, friends, and family for the initial capital. Furthermore, angel investors and venture capitalists are only willing to invest in revenue-generating enterprises. Traditional capital providers such as SACCOs and MFIs also impose high collateral and interest requirements on the early-stage businesses – domestic credit to the private sector (% of GDP) was very low at 10.5 % for Nigeria, 12.4% for Ghana, and 19.6% for Ivory Coast.[68]

c) **The concentration of support providers is in urban areas:** Most of the ecosystem support organisations are located in main cities with minimal reach to enterprises operating in rural areas. Thus, these rural-based enterprises face multiple challenges around business model development, financial management, and fundraising due to the limited access to capacity-building support. Young entrepreneurs, who usually lack the capacity, knowledge, and experience to work in a formal business environment, in the absence of support providers, go down the failure route.

> *"We identified a high financing gap for SMEs – those that are too large for MFIs and too small for commercial banks. As such we will, starting from 2020, explore direct investments into these SMEs in addition to the lines of credit and guarantees that we give financial institutions"*
>
> *A DFI in Ghana*

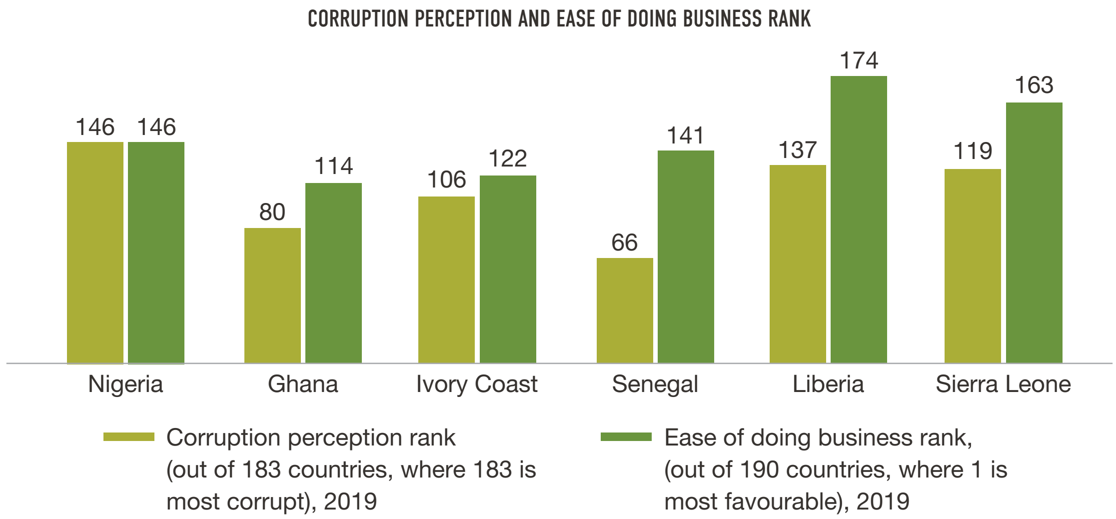
d) **Debt capital comes with its challenges of foreign currency denomination:** Most of the social investments in the region are from international sources and thus deployed in foreign currencies (dollar, pound, and euro). This makes capital deployed particularly in the form of debt, expensive for the businesses that earn in local currency but have to repay in foreign currency. This is mainly due to frequent currency depreciation experienced in the region. The currency has depreciated by 18%, 15%, and 15% in Liberia, Nigeria, and Ghana over the past 5 years[69].

[67] Global Financial Literacy Excellence Centre
[68] World Bank Development Indicators, 2019
[69] World Bank Development Indicators

e) **Lack of an overarching framework for registering social enterprises:** While there are a few developments in the regulatory frameworks, only Senegal currently has a framework for registration of SEs (specifically start-ups). SEs can, thus, either be registered as for-profit (sole proprietorship, partnership, or limited liability) or non-profit organisations. This presents some challenges; while registering as a for-profit is crucial in building sustainable models and attracting commercial capital, businesses registered as such do not enjoy tax benefits. On the other hand, registering as a non-profit limits flow of commercial capital as any surplus generated can only be re-invested in the business.

f) **Bureaucratic and lengthy process of business registration:** Most of the countries in the region rank unfavourably in the corruption perception and ease of doing business rank, indicating bureaucracies and challenges in the business and investment environment. Significant challenges in this regard include regulatory complexities such as lack of information on business registration, high cost of doing businesses, and inadequate tax incentives.

Figure 5: Corruption Perception and Ease of Doing Business Rank



Source: Transparency International, World Bank

g) **Limited access to information on investment opportunities:** Most social investors and ecosystem support organisations operate from the main cities – Lagos, Abuja, Accra, and Dakar. Social enterprises operating outside these cities, thus, face significant challenges in accessing the information on potential investment opportunities, and, when they do, they are not well equipped to close the investment deals. Young entrepreneurs with limited access to networks and relevant events are further restricted to the information related to investment opportunities.

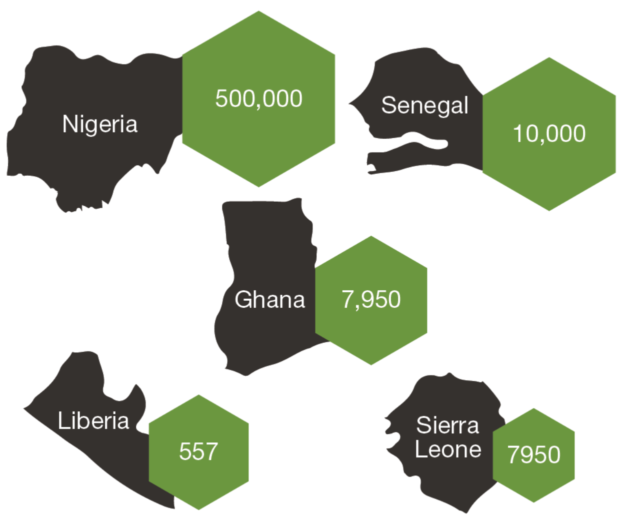
h) **Lack of adequate local skills:** Key skills required to run tech start-ups e.g. software development skills, are lacking in the region. Thus, most enterprises resorted to hiring expensive foreign talent or outsourcing these skills to other parts of the world e.g. India and Portugal.

1.3 TRENDS AND DEVELOPMENT IN THE NON-PROFITS LANDSCAPE IN THE REGION

Given their grassroots presence, Non-profits (NGOs/Civil Society Organisations) play an essential role in solving critical development and social issues.

NGOs/CSOs are particularly active in advocacy and implementation of projects in areas such as human rights, democracy, disaster relief, governance, justice, peace and security, health, women, disabled people, and children's rights, environment, and education. Impact investors, social enterprises, and companies with a sustainability focus may shy away from many of these causes, as they are not able to solve the issues in a profit-making way. NGOs remain crucial in the region given the intensity of these issues there. For instance, NGOs in Nigeria have been at the forefront of solving the humanitarian crisis arising from insecurity and tension, particularly in the Northern region of the country.

Figure 6: Number of CSOs Registered across the Focus Countries



Source: USAID/FHI CSO sustainability Index Report, 2018

Overall, the region has been recording improvement in the CSO sustainability index, albeit not substantially over the past years.

The CSO sustainability index measures the performance of CSOs in seven key dimensions, including the legal environment, organization capacity, financial viability, advocacy, service provision, sectoral infrastructure, and public image. Across the focus countries, financial viability ranks the lowest as CSOs struggle to raise funding for their activities. Additionally, CSOs, especially those in the areas of governance, democracy, and human rights, face constant harassment from government officials.

- ***Internal revenue-generating models:*** Some NGOs are incorporating a membership fee and annual subscription model to complement their external funding. An example is Enablis Senegal that requires the entrepreneurs it supports paying a specific membership fee to access certain services.
- ***Hybrid models:*** In order to diversify their income and drive sustainability, some NGOs operate a for-profit (commercial model) and utilize the profits to fund a non-profit subsidiary, which delivers services to those unable to afford. Examples of this include Soronko Solutions (for-profit) and Soronko Foundation (not for profit), Sangy Nursing Services (for-profit),

Figure 7: CSO Sustainability Score, 2018

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

Funding from donors and international foundations for NGOs has been declining, highlighting an emerging need for NGOs to identify alternative and more sustainable funding models.

NGOs across the focus countries remain largely dependent on foreign donors and foundations for funding of both the programmatic interventions and general administrative activities. International funding has, however, been fluctuating in recent years as indicated in earlier chapters. This shift is urging NGOs to both identify and explore alternative funding sources; three key trends were observed in this regard as described below:

and the Sangy Foundation (not for profit) and Smart Information Systems Company Limited (for profit) and IT4Teens (not for profit) all operating in Ghana.

- ***Leveraging crowdfunding models:*** Technology-based crowdfunding models are becoming a common platform for NGOs to mobilise funds from both local and international sources. Platforms such as donate.ng, Kickstarter, NaijaFund in Nigeria, Payputt, Gofundme, and Mightycause are increasingly being leveraged by NGOs to raise funds for various causes.

1.3.1 KEY CHALLENGES FACING NON-PROFITS IN THE REGION

The NGOs/CSOs in the region continue to face various institutional capacity challenges largely due to limited funding to this sector.

Figure 8: Key challenges faced by Non-profits

KEY CHALLENGES FACED BY NGOs/CSOs			
Inadequate capacity building support for NGOs/CSO	Human capital issues impacting the growth of NGOs/CSOs	Lack of impact measurement mechanisms particularly with local NGOs/CSOs	Decreasing funding for NGOs/CSOs

a) **Inadequate capacity building support:** Across the West African focus countries, most NGOs/CSOs have limited technical and organisational capacity, particularly in the areas of strategy development and implementation, fundraising, financial management, governance, project management, leadership, and human resource management. While there are several support providers for social enterprises, there are very few support providers that are focusing on building the capacity of NGOs/CSOs as inadequate funding has been directed towards capacity building of NGOs/CSOs. However, some philanthropic institutions such as the Ford Foundation, TrustAfrica, and the African Women's Development Fund (AWDF) have been supporting the growth and development of NGOs in the areas of capacity building and governance.

b) **Human capital challenges:** Most of the funding received by NGOs/CSOs is for programmatic interventions with limited funding for operational expenses. As such, most of the NGOs are not able to hire experienced staff. Most of the staff members work on contractual terms renewed based on projects, and thus it is difficult to strengthen the human resource capacity. Further, funding limitations prevent many non-profits from hiring staff members with adequate experience or offering training opportunities to core employees.

c) **Lack of impact measurement mechanisms, particularly with local NGOs:** While most local NGOs continue to have a positive impact on their communities, they rarely develop mechanisms to measure the impact generated. Only a few large local NGOs review their programs regularly and engage independent evaluators to assess their impact or do so at donors' directive. The absence of impact measurement also hinders the capacity of local NGOs to raise subsequent funding as they are unable to showcase the impact that they have been able to create.

d) **Decreasing funding for NGOs/CSOs:** Donors and foundations have started to view NGOs as unsustainable, particularly in sectors where alternative models exist and are looking for such models through which they can get better value and returns for their investments. Social enterprises are considered to be better alternatives, and, therefore, many social investors are shifting their funds from NGOs towards social enterprises. Some interviewees also remarked that there is a large push to NGOs by global donors and foundations to more aggressively engage with the private sector and develop alternative sources of funding.