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Alternative Financing for Micro-Level Entrepreneur in Sub-Sahara Africa: A Crowd Funding Option

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Authors' contributions

The authors made equal contributions to the work. They read and made corrections before the final stage of the publication.

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ABSTRACT

An inherent problem that entrepreneurs face at the early stage of their entrepreneurial initiative is to source capital. Given the difficulties in raising the needed funds to actualize their ideas through traditional fund lenders such as banks, this paper provided a background on crowd funding as an alternative financing source for micro-entrepreneurship in Sub-Sahara Africa. Literature was reviewed on micro-level enterprises and micro-entrepreneur, describing the concept of crowd funding and models. This paper adopted the equity-based crowd funding model for Sub-Sahara African micro-entrepreneurs because of its potential benefits over other models. It recommended amongst others that development workers, policymakers and aid organizations need to make considerable efforts to bridge the knowledge gap of micro-entrepreneurs in the subcontinent on crowd funding by creating in-depth awareness considering the 0.1% Africa involvement in global crowd funding activity.

Keywords: Crowd funding; alternative financing; micro-level entrepreneur and sub-sahara Africa.

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1. INTRODUCTION

Funding has been a herculean task for owners of micro-level enterprises especially in Africa. Most new entrepreneurs are faced with issues in raising the finance required for the actualization of their ideas through traditional capital providers such as banks and non-banks [1]. Ironically, a lot of Small and Medium Enterprises (SMEs) and entrepreneurs depend on bank lending as their external source of finance, and rarely do they meet the criteria for such funding, and in some cases, the interest rates and charges are too exorbitant for them to consider. Hence, they often rely solely on straight debt to achieve their need for a startup capital. Financing newer, innovative and fast-growing businesses with debt financing is often times not appropriate as it has a higher risk-return profile. The financing gap that affects these businesses is often a “growth capital gap” [2].

Weak and scarce banking and non-banking financing sources for small businesses has made the age long aspiration to strengthen capital structures and to reduce dependence and borrowing more critical [3]. It is, therefore, necessary to widen the alternative financing instruments available to micro-level entrepreneurs to enable them to play a role in growth and innovation and employment generation in the region. Financial inclusion and deepening needs are considered as mutually, reinforcing objectives in the quest for sustainable recovery and long-term growth, as funds provided enhance capacity to raise investment and thereby, increasing productivity and sustainability [3].

Literature search revealed that a lack of awareness and understanding on the part of micro-entrepreneurs on other financing alternatives and modalities and operations constitute a major barrier to their use. Moreover, the financial crisis and subsequent credit crunch presented a major challenge to the financial system. Banks and other financial intermediaries have tightened access to credit, especially for small loans because of cost efficiency concerns for loans to clients who do not have sufficient prudential considerations [4]. This has created a new demand for capital. Access to finance facilitates market entry, growth of entrepreneurs and enterprises as well as promotes innovation and entrepreneurial activity. Aligning with this position, World Bank [5] avers that aggregate economic performance is improved by increasing access to capital. Hence, bringing to the fore, the crowd funding alternative to the front burner.

Crowd funding is considered an alternative among other options to address this important finance gap for responding to the diverse needs of micro-level entrepreneurs in sub-Sahara Africa. Crowd funding can be seen as providing financing support for project by a large number of people (crowd) through the donation of a relatively small amount of money. This money is giving in return for a reward, as a donation or potentially as a return on equity. It capitalizes on the power of the internet and online avenues to spread and publicize a project or product [6].

Naturally, sub-Sahara Africa is gifted and can confidently boast with her rich endowments in human, natural and material resources in the world. The oil and gas natural resources in the part of the world have attracted interest from neighbouring countries and continents of the world. It is highly regrettable to note that despite these huge natural and physical potential embedded in sub-saharan Africa, some of these endowments in some cases and areas lie fallow and untapped, the apparent consequences of this, has been under development nationally and economically. Crowd funding alternative, therefore, seem to be an option for projects and entrepreneurial transformation in the region. It is against this backdrop that the paper looks at crowd funding to see how it could be properly harnessed and used in the region to improve economic activities of especially SMEs.

2. REVIEW OF RELATED LITERATURE

2.1 Micro-Enterprises

The term micro-enterprise, also known as a micro-business, refers to a small business that employs a small number of people. This indicates that a micro-enterprise usually operates with few or, fewer than 10 persons or less, started with a small amount of capital advanced from either a bank or non-bank agencies. Most micro-enterprises specialize in providing goods and services for their local level [7]. These businesses play significant roles in the dynamics of quality of life improvement and also add great value to the economic growth and development of many economies of the world.

In most entrepreneurship research, the level of analysis in this category - micro-level is predominantly using the form or the individual [8].

This is because, the number of participants are usually small. It is believed by some experts that to be regarded as a micro-enterprise, the number of people that participate in the enterprise should not be more than five. Besides, micro-enterprises are engaged in a great multiplicity of small scale vending services and repair and enterprise activities [9,10].

In Nigeria, micro-enterprises are a big laboratory for innovation with an asset base of not more than 2 million Naira, excluding land, but including working capital and a staff strength of not more than 10 [11]. While a Company can technically be considered a small business even if it has dozens of asset, the business is a micro business if it employs less than six people. [12] sees micro-enterprises as small businesses owned and operated by groups of poor people with the support of sponsoring organization.

Berisha and Pula [13] assert that economic literature contains major differences in the definition of micro-enterprises as displayed. Statistical agencies, international organizations, governments of independent countries emerge with different definitions and categorization for business which does not reflect the differences between them. Although there are contradictions in concept perception, the overall message is that it is open to varied interpretation.

2.2 Micro-Entrepreneur

This is a person who is self-employed and able to have needs met without the pressure of working under constraint hours. The business operations of a micro-entrepreneur is undertaken by a fewer than five - employees; gets personally involved in the operations of the business and likely has no record of credit or assets of the business [14]. Ezenwa [15] opines that micro-entrepreneurs relate to the customer on the smallest level, breaks down the business so that all that is left is the basics for modeling success. They are involved in seeking investment, taking decisions on what to invest, acquire resources, bear risk and most times innovate. Because of the size of their businesses which [16] posit that in nine out of ten cases, the business has no employees besides the owner, most of them are not registered nor formally recognized by the government. This was the position of [17] who opines that a greater percentage of microenterprises in developing countries are not formally registered with the government. Though, they contribute to the economies of these countries, but do not get the necessary support they require, hence the need for an alternative source of funding such as crowd funding.

2.3 Crowd Funding

Crowd funding is a part of a wider spectrum of financial ingenuities occasioned by technological advancements [18]. It is a funding mechanism which operates by seeking small funding from a large number of persons or organizations. Hossain and Oparaocha [19] argue that there-exist the absence of a unifying conceptual foundation, hence, variations in conceptual understanding. Its popularity has culminated to variegated definitions by different people, therefore, no clear definition tend to capture the dynamics of the phenomenon.

Crowd funding has to do with online sourcing of capital by appealing to a great number of individuals or organizations [20]. Belle Flamme, Lambert of Schwienbacher [21] opine that it has to do with an open call, made via the internet, in order to make financial commitment which could be in the form of donation, or in exchange for a future product or services to aid the initiatives for a specific purpose.

Definitions of crowd funding vary as outlined but there is a commonality in key components such as:

- Traditionally, financing a business involves asking a few people for a large sum of money.
- Crowd funding turns this idea around, such that:

- Funds are raised in a small amount
- From many people
- Using the internet (digital technology) to talk to thousands, if not millions
- Those seeking funds set up a profile of their venture on a website.

The definition of “Crowd funding” by [19] was adopted by this study, haven reviewed the integration to a great extent the definitional elements differentiating thus:

Crowd funding is an internet-based funding method for the realization of an initiative through online distributed contributions and micro-sponsorship in the form of pledges of small monetary amounts by a large pool of people within a limited time frame. It is the financing of a task, ideas or project by making an open call for funding, mainly through web 2.0 technologies, which makes it possible for people who wants to participate to donate, pre-purchase a product, lend or invest based on their belief in an appeal in the promise of its founder, and/or the expectation of a return.

2.3.1 Models of crowd funding

There are different models of crowd funding, however, the most common classification of crowd funding features four main categories - donation-based, reward-based, debt-based and equity-based [20,19].

2.3.2 Donation-based crowd funding

This is the most popular and simple model of Crowd funding. It represents the most widespread form and constitutes a significant share of the funding raised by private companies through this channel of providing non-financial benefits to companies and investors. In this model, funds are donated for philanthropic purposes. Such donations are made to social and charitable initiatives, hence, no financial rewards are expected from it. Funders in this category generally donate to a cause they believe in. These funders may receive some symbolic returns, such a message of gratitude from the founders, but there is no material reward.

2.3.3 Reward-based crowd funding

In this model, potential customers are invited to pre-order their products, offering some times at a lower-than-usual price. Further, reward-based crowd funding enables beneficiaries to access capital at a lower cost compared to traditional resources for reasons - better outreach; monetization of assets and technological innovation. Reward-based model otherwise called sponsorship model displays a mechanism whereby contributors receive a pre-defined reward, token of appreciation or some type of services [2]

2.3.4 Debt and lending-based crowd funding

Debt Crowd funding is also known as market place lending or peer-to-peer (P2P) lending. It allows funders (lenders) to directly lend to fundraisers or invest in debt obligations through a platform. Also, investors receive interest and principal at the end of the lending period and on the other hand, the model may be on "revenue-sharing" principle, that is, where creditors are not paid interest at the end of the defined lending period, rather an amount which includes an agreed share of the earnings, in case of good performance of the debtor.

2.3.5 Equity-based crowd funding

Equity-based crowd funding is most suitable for start-ups and SMEs, in particular. It is a model whereby funders expect a financial return on their investment, thereby allowing individuals and institutional investors to invest in unlisted entities (issuers) in an exchange for shares in the entity through the medium of an online platform. Investors receive a share in the business and may acquire voting rights. This model is also referred to as a profit-sharing model.

A recent updated general crowd funding statistics displays the following figures based on each category and the crowd funding revenues for each region of the word.

2.4 Sub-Sahara Africa and Crowd Funding as Finance Alternative

The countries of Sub-Sahara Africa are yet to arrive at a policy framework which takes into account capital, land and natural resources, and institutions for development practice [22]. The neoclassical growth model which is a guided development policy since the 20th century emphasizes capital and labour as the necessary inputs in production. Our emphasis in this article is the “Capital gap” otherwise the business fund or finance. Capital is taken as the scarce factor of production whose return is to be optimized.

Table 1. Crowd funding categories and amount raised

Crowd Funding Category	Amount (USD Billion)
Donation and Reward-Based Crowd funding	$ 5.5
Lending Based Crowd Funding	$ 25
Equity Base Crowd Funding	$ 2.5

Source: FUNDLY [33], fundraising for all (2019). https://blogfundly.com

Table 2. Regional crowd funding revenue statistics

Regional Crowd Funding	Revenue (USD Amount)
North American	$17.2 billion
Asian	$10.54 billion
European	$ 6.48 billion
South American	$ 85.74 million
Oceanic	$ 68.8 million
Africa	$ 24.16 million

Source: FUNDLY [33], fundraising for all (2019). https://blogfundly.com

In Africa, approximately 600 million people operate as micro-entrepreneurs (farmers, forest keeper, fishers or pastoralists, processing firms, artisanship, small ICT shops etc) [23,24]. The majority of these micro-entrepreneurs operate in the rural areas or semi-urban settings that are relatively isolated from markets due to lack of capital for infrastructural and further investments, therefore, often produce for self-consumption and small exchanges with their communities. There exist a discomfort of these micro-enterprises from integration with the global market system and creation of value to satisfy their customers and to make profits. Hence, makes the contribution of these micro entrepreneurs very negligible as against their potential when fully integrated to the global market and financial system available. The World Bank recognizes this fact that Sub-Sahara Africa's future economy in the global order is bleak and uncertain. According to [25]: The average growth rate in Sub-Sahara Africa is projected to rise to a modest 2.6% in 2019 from 2.5% in 2018, which is 0.2% points lower than the earlier forecast.

Opportunities are bound in Sub-Sahara African's, but severe challenges encumber the potential of the region from being actualized. This is even made worse with rising debt profile with its concomitant debt servicing. Also, debt risks are on the rise which could jeopardize debt sustainability in some of the countries in the region. In light of these assertions, it is believed that without robust productivity growth, the number of people living in poverty will continue to rise. Robust productivity can only occur as a catalyst in the economic development of the Sub-continent, where proper financing of micro-enterprises exists. Many small scale enterprises in the region lack the capital to continue their businesses and are forced to shut-down because they are unable to access required funds [1]. It is a known fact that funds provided to SMEs to enhance capacity to raise investment and, thereby, increase productivity is infinitesimal, thus the "Crowd funding" alternative.

Crowd funding is a method of collecting many small contributions (Public donation), utilizing online funding pattern, to finance or capitalize a popular enterprise [26,27,28]. Funding for start-ups in Africa is no doubt scarce, so crowd funding helps in the early stage of financing. It emerged as a novel source of funding to support innovations; entrepreneurial ideas and ventures. Some fundamental elements distinguish crowd funding from traditional investors. Furthermore, crowd funding harnesses the influential power of the internet, particularly through social media. Younghwan and Junseok [29] affirm that the additional advantages of crowd funding include the ability to utilize diverse interpersonal networks via social network services (SNS).

Crowd funding is a marketing channel and encourages unique ideas to be tested by the public and ultimately realized [19]. It provides new and improved access to finance, thereby contributing to enhanced financial inclusion for greater majority of people and businesses. It provides rapid lending opportunities with fewer protocols, hence, it competes more favourably with traditional lending channels. It thus, helps small business and the poor who are either unbankable or unbanked with access to cherished funds.

Crowd funding improves access to finance by excluded and underserved individual and SMEs. Again, it opens access to more complex investment products for resilience and asset building. What is more, it may also deepen the financial market, thus providing benefits to broader groups excluded from certain segments of the financial system because of limited financial sector development [20].

The core characteristics of crowd funding are the features that distinguish it from traditional finance method. Therefore, crowd funding mechanism motivates founders to raise fund, provides easy-to-use and organize platform where distributed financial contributions can be solicited and collected from many people, therefore allowing nascent entrepreneurs to engage in production activities which is suitable for the Sub-continent where financial supply is greatly constrained. The potential of crowd funding is capitalized on the new form of funding. In other to raise money, it widens the finance source horizon and provides avenue to list what motivates the diverse group to donate.

The total crowd funding market for Africa-based platform raised about $32.3million, which indicates that it is still in its infancy stage in the region. Overall market potential in Sub-Sahara Africa is estimated at $2.5 billion by the World Bank by 2025 [30]. Thus, statistics indicate that there is under usage of crowd funding alternatives by micro-entrepreneurs in Sub-Sahara Africa, no doubt finance is low for any meaningful venture.

A further breakdown on money raised by crowd funding platform in 2015 is estimated as seen in table 3 below. A gap in statistics update 2015-2019 (4 years interval) on crowd funding in Africa by Africa crowd funding platform may be an indication of low-performance activities in the fundraising alternative.

Table 3. Money raised by crowd funding platform models in Africa in 2015

Crowd funding models	Amounts USD
Loans-based	$ 17.5m
Equity-based	$ 13.9m
Rewards-based based	$ 569.3k
Donation-based	$ 327.7

Source: AfrikStart [30]

2.5 Arguments for Equity Based Model for Sub-Sahara African Micro Enterprises

Equity crowd funding serves as funding of legal entities that can raise fund by selling their equities. It is suitable for start-ups and SMEs, in particular [20]. Equity financing allows for the sale of a percentage of the business to an investor, in exchange for capital. It involves money paid into an individual business by an outside entity. The fund comes from an investor, not a lender.

In the option of equity crowd funding, the founders do not make repayment or pay interest. Instead of paying back a loan, profits are shared with investors. The investors are authenticated to gain some ownership of the business, by investing. There are advantages of equity-based crowd funding over the lending-based. Peavler [31] asserts as follows:

i. Founders of enterprise have fewer risks than with lending
ii. Funds are not paid back
iii. Investor's network could help founders business gain credibility
iv. Investors do not expect to see an immediate return on investment (ROI).
v. Founders have more cash in hand without repayment.
vi. Funders have access to investment opportunities
vii. Good quality investors
viii. Pooled investments
ix. Larger investments
x. Increased transparency

From the foregoing, it is clear that equity-based crowd funding has potential benefits over other models. Sub-Sahara micro-level entrepreneurs who create entrepreneurship needs to explore these advantages for new investments and expansion. Although, there may be ethical issues such as fake campaigns, loss of privacy, abuse of fund and break of commitments [32].

3. CONCLUSION AND POLICY RECOMMENDATIONS

The issue of inadequate finance to micro-enterprises in Sub-Sahara Africa has continued to inhibit growth and development. Thus, the imperatives of crowd funding as an alternative to micro-entrepreneurs in the Sub-continent especially the equity-based crowd funding is vivid. Sources of funding are decreasing, so crowd funding needs to be considered as an essential alternative source for various entrepreneurship activities, as traditional bank finance poses challenges to small businesses, in particular to newer and innovative enterprises, with a higher risk-return profile.

Thus the paper recommends the following:

a) Development workers including policymakers and organizations need to divot considerable efforts to bridge the "knowledge gap" of micro-entrepreneurs in the sub-continent on crowd funding by creating index awareness considering the 1.0 % Africa involvement in global crowd funding activity.

b) Financial leadership in the sub-continent need to develop a clear regulatory and legal framework to guide participant both on the demand and supply sides, thus decreasing unethical behaviour in “crowd funding ”.

COMPETING INTERESTS

Authors have declared that no competing interests exist.

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