OPINION | The dream of Africa's economic emancipation can't be deferred any longer

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Picture: Deon Raath/Rapport

As new municipal councils gradually take their place following the 2021 municipal elections, we hope they will do more to create conditions for change, rather than squabble over ideological differences over the next five years, write ***Solly Moeng & Rinku Vij****.*

Given the continued, seemingly, general disinterest by the political elites across the continent to invest fully in empowering Africans to take more control of African economies, the discussion must continue about what is needed and how things can be changed.

As new municipal councils gradually take their place following the 2021 local government elections in South Africa – a country still, arguably, regarded as an economic force to reckon with in African affairs – we hope they will do more to create conditions for needed change, rather than squabble over ideological differences over the next five years. Africa cannot afford to have its dream of economic emancipation deferred any longer.

First, Africa must invest in its own future

A fully fledged 4IR in Africa will need to build on strong and sufficiently financed African businesses. This requires stable and liquid national and regional capital markets, as well as an attractive environment for inward foreign direct investment. In Africa, as in many parts of the world, the largest part of the business base consists of micro, small and medium enterprises (MSMEs). Sub-Saharan Africa alone has 44 million MSMEs, of which some 37 million are in Nigeria.

Overall, 97% of Sub-Saharan African enterprises are micro-enterprises, i.e. they have fewer than 10 employees. More than half of Sub-Saharan African micro-enterprises (52%) and SMEs (54%) are to some extent credit constrained, which means they have limited access to external financing or have faced issues obtaining it in the past. The World Bank estimates that around 18% of MSME potential financing demand in Sub-Saharan Africa is not currently met.

Firms in Sub-Saharan Africa identify by a large margin access to finance as the key constraint in their business (23.6%), followed by electricity (13.6%) – of which the margin is galloping ahead in South Africa – competition from the informal sector (11.3%) and political instability (10.3%). Across Africa, in 18 out of 47 surveyed countries, access to finance is the most significant obstacle to business, followed by political instability (eight countries) and reliable electricity supply (seven countries).

Overall, 85.2% of all firms in Sub-Saharan Africa surveyed for the World Bank Enterprise Survey have a bank account. However, when it comes to accessing debt finance for their business, on average only 21% have a line of credit. Consequently, only 20% of firms use banks to finance investments and therefore only 9.4% of investments in Sub-Saharan Africa are financed by debt through banks. A total of 74% of investments were financed internally without any assistance from equity providers or financial intermediaries, which indicates the presence of severe barriers when growing and scaling up businesses.

The currently available financial sector support to MSMEs, but also to individuals, is dominated by banks. Moreover, stock markets and market instruments such as bonds are under-developed in most of Africa, and mostly not relevant to MSMEs.

Due to the low competition, as well as the high lending and low deposit rates, some African countries still have double-digit interest margins for loans. This is also partly caused by attractive high-yielding government bonds which crowd out lending to SMEs. These high-yielding government bonds are more attractive to banks than high-risk SME lending. SME lending often only happens with substantial portfolio guarantees from international financial institutions.

Nevertheless, some African countries have seen interest rate improvements in the last two decades. In addition to crowding out by government bonds, there are problems with credit risk assessments due to the poorly developed public registries and problems with African citizens proving ownership of their assets. Information asymmetry is notably leading to high costs of capital.

Funding sources must be diversified

Business angels, wealthy individuals who support projects with their own savings, are not widespread in Africa, notably in French-speaking Africa, for several reasons. First, there is no regulatory framework for this type of investor. Also, diplomas are favoured over experience, which makes potential investors very cautious in their choices given that many entrepreneurs have a low level of education and/or training in entrepreneurship.

The number of people with sufficient levels of wealth to become business angels is also limited. On top of this, potential business angels often choose to invest their money in developed countries, where the return on investment is more attractive than in Sub-Saharan Africa. Recently, initiatives such as Ivoire Business Angels and the Cameroon Angels Network have emerged.

Africa also faces low rates of foreign direct investment, which currently only accounts for 2.9% of the global share of global inward foreign direct investment estimated to represent around $41.8 billion in 2017. UNCTAD data shows that the top host countries, in terms of US$ value of inflows, are Egypt ($7.4billion), Ethiopia ($3.6 billion), Nigeria ($3.5 billion), Ghana ($3.3 billion), and Morocco ($2.7 billion). Key investors in 2017, based on the total Foreign Direct Investment (FDI) stock, were the United States ($57 billion), the United Kingdom ($55 billion), France ($49 billion), China ($49 billion) and South Africa ($24 billion). The most significant change since 2011 has been significant volumes of investment from China, which more than doubled from $16billion in 2011 to $40 billion in 2017. Italy and Hong Kong have also significantly increased their share of investment in the region.

Moreover, in recent years FDI inflows dropped both in terms of absolute numbers, as well as in terms of global share. Key 4IR sectors such as motor vehicles and transport equipment, transport, storage and communications, as well as business services, make up a relatively small share of greenfield FDI investment. However, the electricity, gas and water service sector accounts for more than a third of all FDI.

On a more positive note, FDI inflows into 4IR-relevant technologies are taking place, for example in Nigeria, Kenya and Tanzania. In Nigeria, technology start-ups are receiving support from venture capitalists. The country is also witnessing sustained Chinese investments into the manufacturing sector, as well as investments from US technology companies such as Facebook and Uber. Facebook and Uber are also investing in Tanzania. Furthermore, US firms such as Microsoft and Oracle are also responsible for increasing ICT investments in Kenya.

SMEs and start-ups

Where it concerns SME and start-up financing, there is also a growing number of private equity funds specialising in the sector that have emerged, particularly in eastern, western, and southern Africa (e.g. Aureos Capital Funds, Business Partners International Kenya SME Fund - Beck & Cull, 2014). The positive experiences of these funds help to attract donors and private investors. It is clear that the availability of private equity can have positive spill-over effects on the managerial skills of the companies that it finances, which fills the gap in their administrative and financial management (BafD, 2011).

Private equity funds mainly finance companies with high innovation potential; more than two thirds of the companies they finance have introduced new services and/or products. Mobile money services now flourish in countries where dominant mobile networks are able to exploit largely unbanked populations while, in countries like South Africa and Nigeria, where populations are significantly banked, the take-up of mobile money services has been much slower.

The regulatory impact

Recently adopted financial and telecom regulations have been key to financial inclusion enabled by mobile money platforms. For example, the flourishing of mobile money in Uganda is attributed to non-binding regulatory guidelines. For instance, despite the country introducing mobile money guidelines in 2013, the guidelines are not binding. However, in countries such as South Africa and Nigeria, where the regulations are more stringent, the scope of mobile operators has been limited and the development of mobile money is modest. For example, according to the "RIA (Research ICT Africa) After Access" survey, Nigeria, despite its rhetorical commitment to mobile money and the wish to emulate Kenya, has the lowest mobile money take-up at only 1%.

There is evidence of the merging of traditional banking services with wider fintech services and applications. Several banks have invested in, or acquired, fintech start-ups or businesses. Banks are also collaborating with peer-to-peer lenders and innovative payment systems. For instance, third-party mobile wallets are being used by established banks. South Africa has also seen the advent of the fintech bank where three entities, relying on their sophisticated technology platforms, have applied for and were granted banking licences.

In the end, Africa is a vast continent of divergences and convergences. The much-celebrated African Continental Free Trade Area must serve as a platform for financing innovation to support and exponentially grow the African MSME.

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