Access to Finance for Young African Entrepreneurs

INSIGHTS FROM YE! COMMUNITY

International Trade Centre

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ABOUT THE PAPER

Young entrepreneurs face markedly higher barriers than their older peers to access finance and expand their business. The International Trade Centre, through its YE! Community, has surveyed young entrepreneurs to understand their main funding needs and challenges they face when trying to obtain finance.

This publication frames the survey results as part of a larger issue of access to finance for youth, especially in Africa, and sets out to understand the main youth-specific barriers. Building on the research results, this paper includes recommendations for policymakers to develop more youth-inclusive ecosystems and help young entrepreneurs access finance.

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For more information on YE! Community, see: https://yecommunity.com/

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FOREWORD

Recent years have put the strength of the global economy to the test, amid crises from outbreaks of conflicts to the growing toll of climate change. But against these same challenges, we have also seen where resilience and innovation lie – especially when it comes to the entrepreneurial spirit of youth.

This dynamic is clearly visible across the African continent, which is witnessing an increase in the number of young individuals eager to launch and expand their enterprises. These young people now own and operate the majority of Africa's innovative micro, small and medium-sized enterprises (MSMEs), and together they are having a transformative impact on the continent's private sector.

These young entrepreneurs are risk-takers and change agents within their communities and countries. Their successes, in turn, lead to profound benefits for society and the global economy. Yet, to truly achieve their full potential, these youth-led firms must have the capacity to invest in and expand their businesses. This prospect is closely linked to their access to financial resources – but, unfortunately, this is often where these youth-led businesses struggle.

The statistics tell a compelling story: a considerable number of youth-led MSMEs require financial support, yet many are hesitant to approach traditional financial institutions. Even when they do so, they encounter a higher likelihood of rejection, particularly young entrepreneurs in the early stages of their business journey and women entrepreneurs who face unique barriers.

This publication is a call to action aimed at addressing the financing gap that impedes the progress of these promising young enterprises. It offers comprehensive insights into the financing needs of youth-led MSMEs and underscores the challenges they face. It also provides actionable recommendations, from nurturing the skills and bolstering the confidence of young entrepreneurs to collaborating with financial service providers to de-risk youth-led ventures.

As a result, the paper sets out a detailed roadmap for action, one that illustrates why supporting these young people matters for the goals we wish to achieve as a society. Policymakers, development partners and other stakeholders should take heed of the paper's findings and work together to forge an environment that enables the success of these dynamic, young entrepreneurs.

By addressing the financing needs of young entrepreneurs, we can empower them to realize their dreams, foster innovation and steer towards a brighter economic future throughout Africa.

Pamela Coke-Hamilton
Executive Director
International Trade Centre

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ACRONYMS

Unless otherwise specified, all references to dollars ($) are to United States dollars, and all references to tons are to metric tons.

FSP	Financial service providers
ITC	International Trade Centre
MSME	Micro, small and medium-sized enterprises
SMEs	Small and medium-sized enterprises
SMECS	SME Competitive Surveys

Executive summary

Young people are more entrepreneurial than ever. They are more likely to start a business than older generations.[1] As digital natives, they are more familiar with technology and often less risk-averse than their older peers. This situation is reflected in Africa's private sector, in which young entrepreneurs own and operate most micro, small and medium-sized enterprises (MSMEs).[2,3]

Promoting youth-led businesses can yield important societal and economic benefits, as they often drive and spread innovation within their communities and countries. To do so, young entrepreneurs must be able to invest in and expand their businesses, which depends partially on their ability to obtain finance. However, youth-led small firms face unique challenges in finding and securing funding.[4]

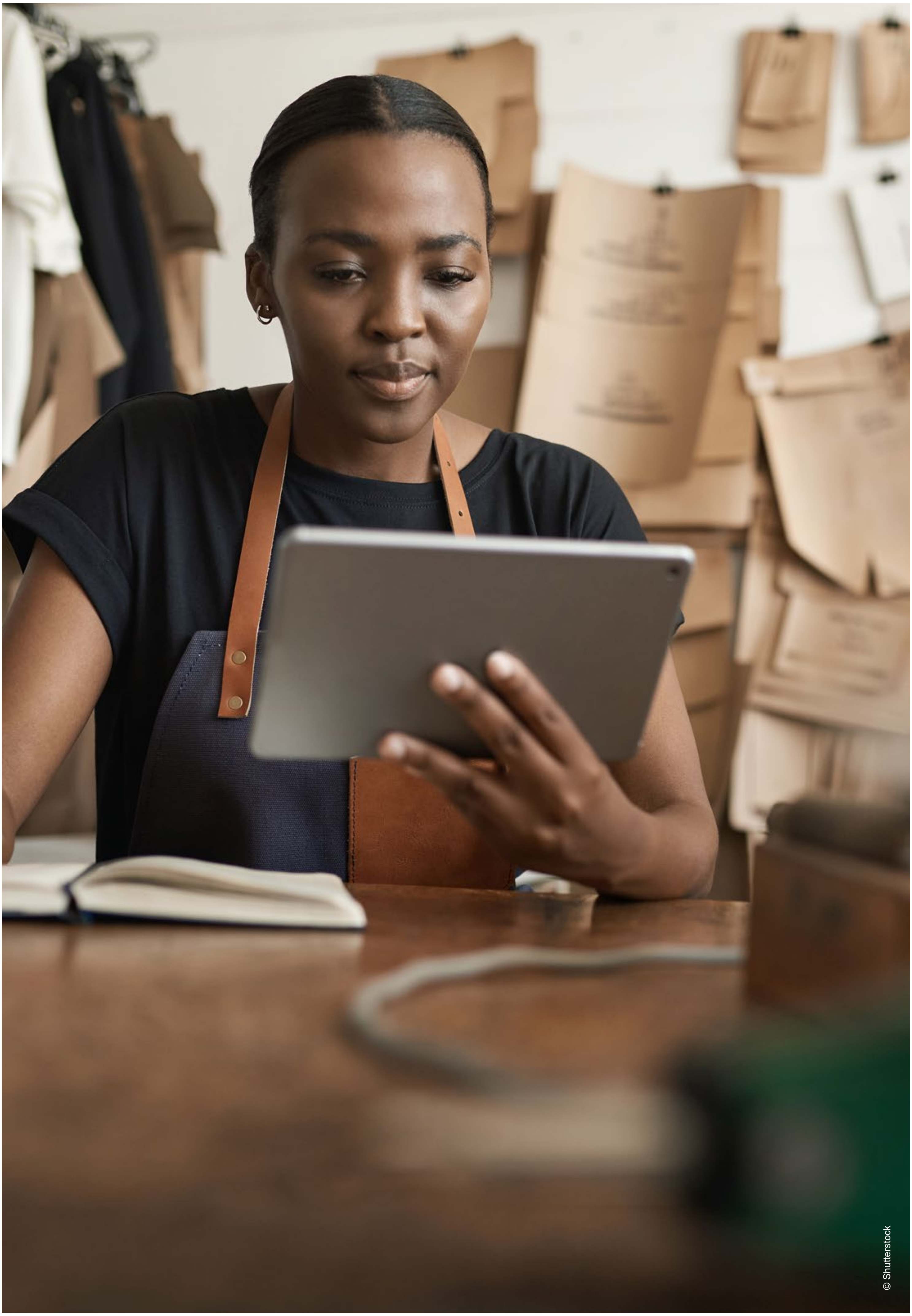
Many of the issues confronting older business owners – and small firms in general – also affect young entrepreneurs, but the owners' age often exacerbates them. For instance, younger people have shorter credit histories and fewer assets to use as collateral, further disadvantaging their companies.

Youth-led businesses are more likely to struggle to secure financial resources, particularly from traditional or formal institutions. In a previous survey conducted by the International Trade Centre (ITC) in selected countries, 76% youth-led firms identified access to financial institutions as an obstacle to current operations. This compares with 59% of non-youth-led companies.[5]

This paper sheds light on the financing needs of youth-led MSMEs in Africa. It finds that:

- More youth-led firms need finance. As they become more numerous and try to expand, many youth-led MSMEs seek external sources of finance.
- Youth-led MSMEs are less likely to approach traditional sources, such as banks and other formal financial institutions.
- When they do approach financiers, youth-led companies are less likely to obtain funding. The situation is worse for the very young and women entrepreneurs.
- As a result, youth-led firms are turning to alternative – and sometimes suboptimal – sources of finance, such as own savings and family and friends.

Youth-led businesses have considerable potential to mitigate unemployment and leverage Africa's demographic dividend. To turn this potential into reality, focused and prompt action is needed to close their financing gap. This publication offers recommendations on how this can be done, based on insights from young entrepreneurs in ITC's YE! Community- a global hub connecting over 40,000 young entrepreneurs, fostering collaboration, and providing resources for sustainable business growth.

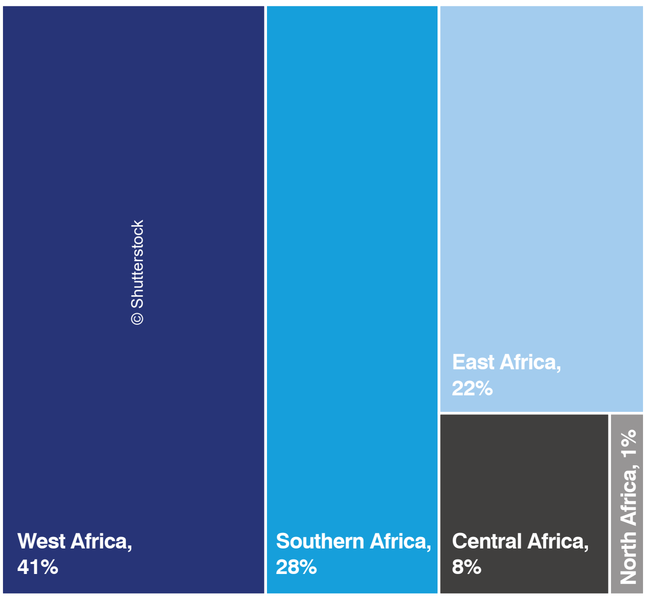


CHAPTER 1
Financing Needs

Assessing financing needs of youth-led African firms

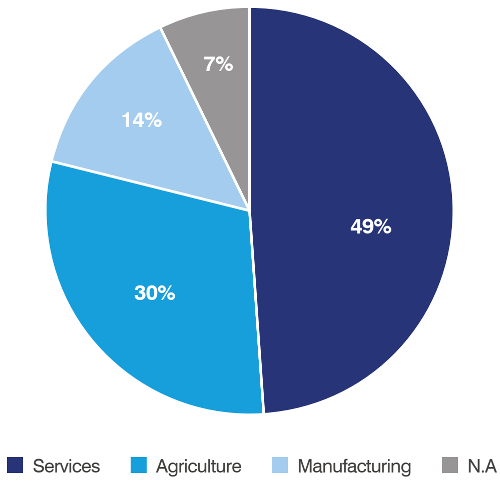
In 2021, the International Trade Centre (ITC) conducted a survey to assess how young business owners seek and access funds from different sources. The Access to Finance Needs of Youth in Africa survey focused on youth-led micro, small and medium-sized enterprises (MSMEs), with data gathered from 207 firms in Botswana, Cameroon, Democratic Republic of the Congo, Egypt, Gambia, Ghana, Kenya, Liberia, Malawi, Nigeria, Rwanda, Senegal, Sierra Leone, South Africa, Togo, Tunisia, Uganda, United Republic of Tanzania, Zambia and Zimbabwe.

Figure 1 Young entrepreneurs across Africa were surveyed



Source: ITC calculations based on the Access to Finance Needs of Youth in Africa survey.

Figure 2 Sector of activity



Source: ITC calculations based on the Access to Finance Needs of Youth in Africa survey

All companies surveyed were classified as MSMEs (i.e. with fewer than 99 employees). Almost half of respondents (49%) were active in the services sector, 30% in agriculture and 14% in manufacturing (Figure 2). More than 67% of respondents were male, with the remaining 33% female.

This paper complements the findings of the Access to Finance Needs of Youth in Africa survey with data from other ITC surveys conducted between 2018 and 2022 – particularly small and medium-sized enterprises (SME) Competitiveness Surveys, which use a representative sample of national companies to assess the strengths and weaknesses of firms and their business ecosystem.[6]

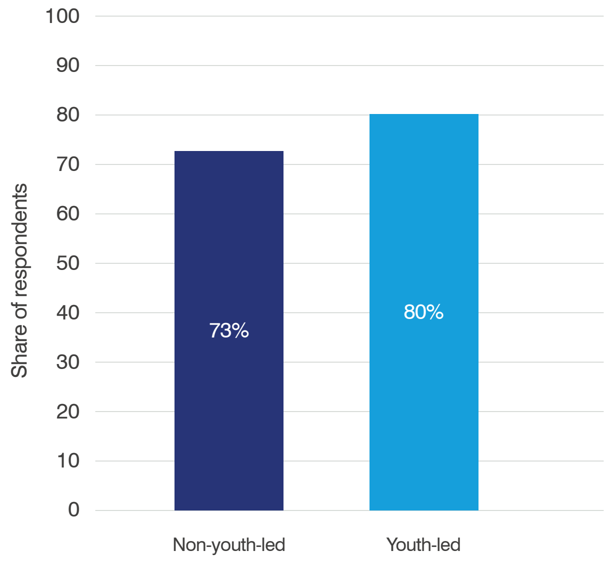
Youth-led firms are more likely to need finance, but less likely to apply

More youth-led firms need finance, compared with those led by older people. SMECS show that four-fifths (80%) of youth-led firms in Africa reported needing finance, compared with 73% of non-youth-led firms.

Although they need funds, youth-led firms are less likely to approach financial institutions. When asked if they had contacted potential investors, 45% of youth-led companies said they had, compared with 50% of non-youth-led businesses.

Youth-led firms may be less inclined to approach formal financial institutions to fulfil their financing needs, knowing that lenders are often reluctant to lend money to young people. They may also be unable to present a properly structured business plan to encourage financing. In the services sector, for example, only 49% of youth-led enterprises reported being fully capable of presenting a structured business plan to a bank for loan purposes. This compares with 57% of businesses led by older entrepreneurs, according to SMECS.[7]

Figure 3 Youth-led businesses are more likely to need finance



Note: Respondents were asked: 'Is the establishment in need of any of the following forms of financing? (i) A loan, (ii) Equity financing, (iii) Financing through the issuing of bonds, (iv) A line of credit, (v) Letters of credit.'

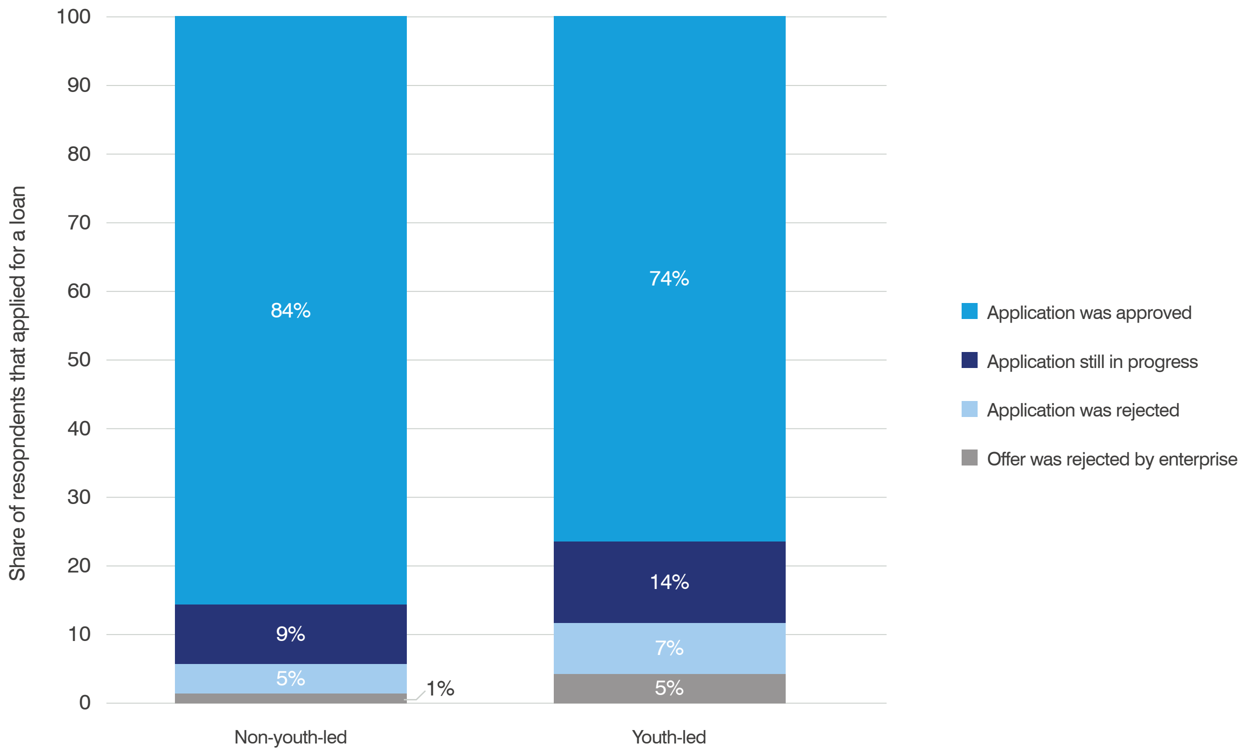
Source: ITC calculations based on SME competitiveness data collected in nine African countries between 2017 and 2022.

Younger entrepreneurs are less successful in securing funds

Raising bank finance is more challenging for youth-led businesses. Young people are unlikely to have an established credit history, limiting their ability to secure finance through conventional channels.[8] SMECS show that 14% of the African firms whose loan applications were rejected were youth-led, compared with 9% for non-youth-led firms.

The younger the business owner, the harder it is to secure funding. Among youth-led firms, those owned and managed by people below 24 years of age have the lowest success rate in fundraising, according to the Access to Finance Needs of Youth in Africa survey. While nearly 40% of enterprises owned by people aged 25–35 reported successfully raising funds in the past, only 22% of those managed by individuals aged 18–24 said the same.

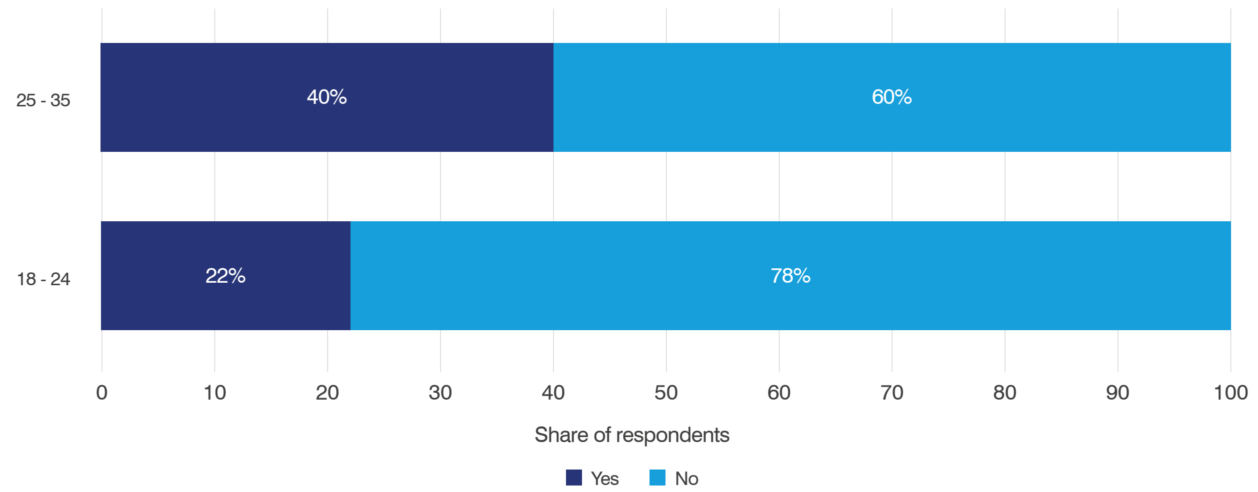
Figure 4 More loan requests by youth-led companies are rejected



Note: Respondents were asked: 'What was the outcome of that application (in the case of multiple applications, please select the highest by value of the loans)? (i) Application was approved, (ii) Application was rejected by bank, (iii) Offer was rejected by enterprise, (iv) Application still in progress, (v) Do not know.'

Source: ITC calculations based on SME competitiveness data collected in four African countries between 2017 and 2022.

Figure 5 Younger entrepreneurs are less likely to secure funding



Note: Respondents were asked: 'Have you successfully raised funds before?'

Source: ITC calculations based on the Access to Finance Needs of Youth in Africa survey.

Similarly, young women are disadvantaged when it comes to securing funding for their businesses. Women-owned firms tend to be underserved by the traditional financial sector compared to businesses led by young men.[9] The Access to Finance Needs of Youth in Africa survey illustrates this reality: almost 5% of young women who own businesses reported successfully raising funds from microfinance institutions and from banks, compared with 10% of young men securing microfinance and 18% funding from banks.

Both supply and demand factors hinder women's access to finance. On the supply side, firms led by young women are perceived as riskier, as they are typically smaller and have limited or no collateral. On the demand side, differences in education and life experiences – often born out of male-dominant cultures – imply that women have limited awareness and understanding of the products and services of the formal financial sector, especially when they are young. Similarly, biased norms, such as inability to hold property or land title to serve as collateral, may also constrain women's capacity to obtain finance from traditional sources.[10]

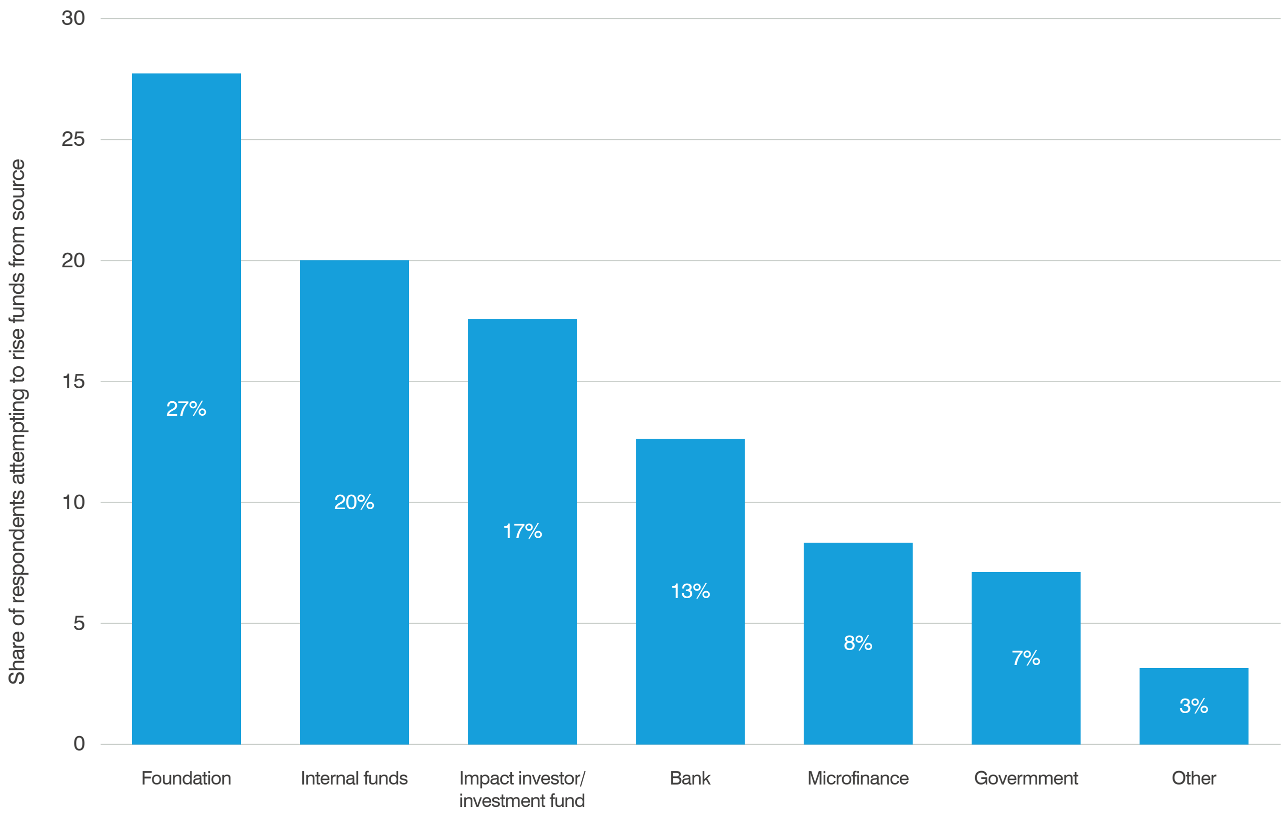
Youth-led firms turn to alternative funding sources

African youth-led MSMEs have turned to alternative financing instruments, in part because they struggle to access traditional sources of finance, the Access to Finance Needs of Youth in Africa survey shows. The main sources of finance for youth-led businesses today are alternative financing instruments such as foundations (27%) and venture capital and impact investors (17%).

Commercial products, including government-backed and bank loans and microfinance instruments, are the least used sources of funds among youth-led firms.

In addition, youth-led companies rely heavily on internal funding, with 20% saying they collect funds from friends, family, or personal savings, compared with 11% for businesses not led by youth. While these aforementioned funding sources may be easier to access than traditional products, some (such as informal lending) may come at greater cost and risk to young entrepreneurs. Informal lending arrangements often lack the legal protections provided by formal loan contracts and are more susceptible to misunderstandings and disputes. In addition, informal finance is typically limited and is not able to fully cater for the finance needs of a company as it grows. Because informal lending does not contribute to building a borrower's credit history, relying on it also makes it challenging for borrowers to access formal financing options in the future.

Figure 6 Youth-led firms combine financial instruments



Note: Respondents were asked: "Have you ever attempted to raise funds before?' and 'From whom/which organization did you raise the money (select the most appropriate option): (i) Banks, (ii) Foundation, (iii) Impact investors, (iv) Government, (v) Investment funds/venture Capital, (vi) UN, (vii) Other.'

Source: ITC calculations based on the Access to Finance Needs of Youth in Africa survey.

CHAPTER 2 Recommendations

Based on the findings discussed in Chapter 1, policymakers and development partners aiming to help young entrepreneurs access finance should focus on the following:

Build skills and confidence to apply for bank loans

Young entrepreneurs are less likely to apply for funding and secure it. They must be equipped with the knowledge, skills and tools to feel confident about approaching banks and submitting applications.

Training programmes and mentorship can play a pivotal role in developing the required competencies, such as budgeting, financial planning and forecasting, and investment strategies. Young entrepreneurs also must be able to access information about available funding (for example, special funds or grants, subsidized loans, relevant investors) and related requirements.

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Work with financial services providers to de-risk young entrepreneurs

Traditional financial service providers (FSPs) perceive young entrepreneurs as high risk. FSPs consider certain criteria when assessing loan applications, such as credit history and business track record, which tend to be poorer for youth. This leads to tougher requirements (e.g. collateral and interest rates) with which youth-led MSMEs struggle to comply. Young people may also face additional barriers due to FSPs' own biases about young entrepreneurs and scepticism about their capacity and ability to repay loans.[11]

- By lowering the risk perception of FSPs about young entrepreneurs, the conditions under which funding is offered should improve. For instance, by setting up funds that mix grant and loan financing, or providing loan guarantees to youth-led MSMEs, governments and development partners can provide a safety net that allows FSPs to reduce interest rates and collateral requirements. Products that accept alternative sources of collateral, for example equipment leasing or lead-firm finance, can also be more youth-friendly.
- FSPs might consider restructuring their disbursement process to include specific business and repayment milestones. This means the business performance and re-payment behaviour can be monitored, lowering the risk of default.
- These alternatives can support youth in building a financial track record and learning about bank requirements, eventually ensuring they are ready to access commercial products.

Promote alternative finance sources that cater to youth-led businesses

- The alternative financing instruments, such as philanthropic and venture capital, on which many youth-led African MSMEs rely are of special value because they often provide more than just financial capital. Such investors may also bring additional resources, such as their network and knowledge, which benefit young business owners.
- Increasing the availability of such types of finance would have a positive effect in the ability of young entrepreneurs to fundraise. For instance, the provision of incentives for investors, such as co-investment matching grants or tax exemptions, when investing in youth-led MSMEs could help move the needle towards more funding to this target group.

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Endnotes

1 (Guerrero, Amorós and Urbano, 2019).

2 (Strategy Consulting, 2022).

3 ITC defines MSMEs as companies with one to 99 employees, and large businesses with 100 or more.

4 ITC defines youth-led firms as those owned by a person under 35 years of age.

5 ITC survey conducted in Argentina, Gambia, Hungary, Kenya and Morocco in 2017 and 2018 with a total of 1,308 firms (Organisation for Economic Co-operation and Development and World Trade Organization, 2019), Aid for Trade at a Glance 2019: Economic Diversification and Empowerment, OECD Publishing, Paris, https://doi.org/10.1787/18ea27d8-en..

6 More information on ITC SME Competitiveness Surveys (SMECS) can be found at https://intracen.org/resources/data-and-analysis/research-and-data.

7 (ITC, 2022).

8 (Schøtt, Kew and Cheraghi, 2015).

9 (ITC, 2019).

10 (Alliance for Financial Inclusion, 2022).

11 (Organisation for Economic Co-operation and Development and European Commission, 2012).

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