INNOVATIVE FINANCE FOR

PRIVATE SECTOR DEVELOPMENT IN AFRICA

HIGHLIGHTS FOR MEDIA

ECONOMIC REPORT ON AFRICA 2020

United Nations
Economic Commission for Africa

CHAPTER 1: RECENT ECONOMIC AND SOCIAL DEVELOPMENTS IN AFRICA

RECENT NUMBERS:

- Africa is the second fastest growing region in the world, estimated to have grown 3.4% in 2019.
- COVID-19 pandemic will impact growth to decelerate to between 1.8% and -4.1% in 2020.
- Growth in Africa is projected to rebound to 5% in 2021, supported by the effective implementation of COVID-19 response measures and global economic recovery.
- Refer to Figure 1.1 for data on Global Economic Growth.

DECLINE ON COMMODITY PRICES: After slight increases in 2019, **commodity prices plummeted** for more than **two-thirds of African exports** in 2020, The price of **petroleum**, which accounts for 40% of African exports and 7.4% of GDP in Africa, **crashed by more than 50% per cent to its lowest level since 2003**. Metal prices fell 20%, while cotton fell 26%. The Economic Commission for Africa (ECA) projects a minimum $65 billion loss to fuel revenue for 2020. (Figure 12, p.3).

IMPACT OF COVID-19: The impact of the pandemic will push between **5 million and 29 million people below the extreme poverty** line of $1.90 per day, compared with a baseline 2020 African growth scenario, according to ECA projections (p.11).

The current health crisis has many adverse social impacts and **Africa is particularly vulnerable, given weaker health systems, difficult living conditions and sparse access to sanitation**. African health systems are weaker than those elsewhere in the world, with lower ratios of hospital beds, intensive care units and health professionals to their populations. **Africa on average has 1.8 beds per 1,000 people**, compared with 6.0 in France and 8.2 in the Russian Federation (p.11).

African governments require additional funds to deal with COVID-19. In a best-case scenario, with suppression of the coronavirus spread and intense early physical distancing measures, **$44 billion would be required across Africa for testing, personal protective equipment and treatment of COVID-19 patients** requiring hospitalization and intensive care treatment (p.20).

INFRASTRUCTURE: By recent estimates, **Africa needs $100 billion a year to close its infrastructure gap** (McKinsey & Company, 2019). That figure aligns with African Development Bank estimates of the continent's infrastructure needs amounting to $130 billion–$170 billion a year, with a financing gap of $68 billion – $ 108 billion (AfDB, 2018). **The gap is about 3–5 per cent of the continent's GDP**. **Key sectors are energy and transportation**, accounting for about 55% of the financing needs, and **water supply and sanitation**, accounting for about 40 per cent (Table 1.3), (p.20).

CHAPTER 2: THE PRIVATE SECTOR IN AFRICA

A robust and vibrant private sector is vital for inclusive and sustained economic growth. Indeed, the private sector is the engine of economic growth (p.28).

Small and medium enterprises are considered the **backbone of African economies**, since they represent about **90% of all private businesses** and account for more than **60% of employment** in most African countries. (p.29)

CHALLENGES TO PRIVATE SECTOR DEVELOPMENT: **Easy, affordable and reliable access to infrastructure** (particularly energy) and finance are **the two most cited obstacles** affecting the operation of businesses in Africa**. Access to electricity** is cited by **20.7%** of firms in Africa as the main obstacle, and **finance by 19.6%** (p.38). See figure 2.4 "Main obstacles to businesses in Africa", p.39.

TRANSPORT: Some **3.6% of firms in Africa** identified **transport as the main obstacle** to business. (p.38)

ENERGY: About **590 million people in Africa lack access to electricity**, and for those with access, the quality is generally poor and reliability unacceptably low compared with other regions of the world. (p.38)

ICT: It is estimated that **75% of the population in Africa does not have internet access**, and so does not have access to the knowledge, information and services that the internet can bring. (p.40)

WATER: The **unavailability of clean water and sanitation results in approximately a 5% loss of GDP** in Africa annually, and people spend 40 billion hours a year of otherwise productive time just collecting water. (p.40)

GOVERNANCE: Some **6.3% of firms** in Africa reported that **corruption is a major challenge** to their business operation. (p.41)

FINANCING: As reported by **19.6% of firms**, **financing is a** major **obstacle to business operations**. Almost a quarter of small firms reported it as a major obstacle, as did about 13% of large firms. (p.41)

CHAPTER 3: ACCESSING FINANCING FROM THE CORPORATE BANKING SECTOR IN AFRICA

Most financing mechanisms in Africa are bank-based, and banks are a major source of innovative financing in Africa.

FINANCING: Despite an overall increase in banking activities, **bank financing to the private sector remains low and ill tailored to the needs of private firms**. (p.58). (...) **Most bank loans** to the private sector are **short- to medium-term** in tenor. However**, businesses often need financing for longer-term projects**, such as to purchase fixed assets or property to expand capacity. Common loan types are on TABLE 3.1. (p.59)

FIRM SIZE: it can have pronounced effects on access to financing, as **large companies are more likely to get loans** and favourable terms. However, small and medium enterprises can be effectively shut out of bank financing. (p.59)

INCLUSION: Although **financial inclusion is low in Africa (**3% in 2017), **the bancarization rate**, defined as the proportion of the population that uses banking services, **is projected to rise to 48% in 2022**, with more than 450 million banked Africans. See FIGURE 3.3. The expansion of traditional banks to reach more people and the entry of new banks are expected to create even more opportunities for the banking sector. (p.63)

AfCFTA: With the establishment of the African Continental Free Trade Area (AfCFTA), and liberalization of financial services as one of the priority service sectors, **African banks will have the opportunity to tap into a continental market of over 1.2 billion consumers.** (p.65)

CHAPTER 4: TAPPING INTO THE POTENTIAL OF AFRICAN MARKETS

In other parts of the world, financial markets complement bank finance as another source of financing to the private sector, but in Africa they are small and undeveloped, largely dominated by commercial banks.

IPOS: In an initial public offering (IPO), a private company offers its shares to the public and formally lists itself on a public stock market, connecting it with the wider financial system. A **functioning IPO market requires** investment banks to **help generate interest and connect companies with potential investors**. (...) South African IPOs alone represented more than 65% of the capital raised on African exchanges (p.78).

The **proceeds** raised from IPOs in Africa **between 2014 and 2019 reached $27.1 billion**, **less than 1.4% of global IPO proceeds** during that period. (p.74). With more than 1,200 public offerings completed in 2019, **the African IPO market represented 1.4% of the $1.2 trillion worldwide value** of IPOs (p.79). Refer to Figure 4.2: Initial public offerings by selected African exchanges, 2014-2019, p.78.

SOVEREIGN BONDS: In 2019, **African governments issued** over **$200 billion in sovereign bonds** (denominated in local or foreign currency), **compared with** more **than $700 billion issued by China**, the biggest bond market among emerging markets and the third biggest bond market globally. (p.81)

COMMODITY EXCHANGES: Although African countries are dominant global producers of many agricultural and natural resource goods, **the goods are traded** or have their prices quoted on exchanges **outside of the continent.** So, **opportunities** for price discovery, access to finance, hedging opportunities and market information **are limited for African farmers** and **small businesses** in those sectors. (p.85)

PRIVATE INVESTMENT MARKETS: In 2019**, $106 billion in private capital was raised worldwide**, **but only $1.1 billion in Africa**. **The number of deals in Africa increased** from 158 in 2014 to match its 2013 historic high — **186 deals in 2018** (p.86). Check out Figure 4.6 "Share of African private investment deals by region, 2013-18" on p. 87.

CHAPTER 5: LONG-TERM FINANCING FOR SUSTAINABLE DEVELOPMENT IN AFRICA

The cost to achieve the SDGs by 2030 in Africa is estimated at about $1.3 trillion a year, according to the United Nations. That could increase to $19.5 trillion as a result of population growth— projected to be 43% over 2015–2030.

INVESTMENT GAPS: A **central challenge** for Africa to meet the SDGs and achieve sustainable and inclusive development is to **mobilize the investment needed in key sectors** such as health, energy, transport, construction, agriculture, education and manufacturing (p.98). The continent's infrastructure needs amount to $130-$170 billion a year until 2025, with a yearly financing gap of $67.6-$107.5 billion. Refer to p.106 for more information.

CLIMATE CHANGE: An estimated **$18–$30 billion a year** will be needed over the **next two decades for climate action and climate change adaptation in Africa**, with nearly $1 trillion worth of investments and projects ready to be financed (p.98).

DEVELOPMENT BANKS: African regional and national development banks are **pivotal in supporting infrastructure finance**, including by catalysing private finance. **They should expand** in countries where they are active (adding infrastructure finance to their business if they are not already participating in that sector) and should consider going into new countries (p.110). African national development banks have considerable scope for expanding their scale, which would let them **contribute more to financing infrastructure.** Refer to the case study "Development bank of Southern Africa operations in South Africa (p.111)

PENSION FUNDS: African **pension funds have been expanding in recent years**, though from a low base, thanks to the rise of the middle class and regulatory reforms that bring more people into the social security net (ECA, 2019). **Pension funds in the six largest African markets could grow to an estimated $7.3 trillion by 2050** (from $800 billion in 2014). (p.113)

CHAPTER 6: LEVERAGING GLOBAL INNOVATIONS IN FINANCIAL TECHNOLOGY IN AFRICA

The global fintech revolution is expected to triple access to financial services in Africa, creating a new market of 350 million customers. In Africa, fintech is reducing costs and risks, as well as extending service to unbanked populations.

DIGITAL PAYMENTS: The **biggest component** of **fintech transactions** in Africa, with mobile money transactions accounting for close to **10% of GDP**, compared with 7% in Asia and less than 2% in other regions. **Africa accounts for more than 60% per cent of mobile money transactions** in the world—more than $450 billion in 2019 (p.121).

CROWDFUNDING: Africa accounts for **less than 1% of global crowdfunding** activities and reasons for that include **low internet penetration** rates, **high internet service cost** and **weak regulations** and standards (p.123).

MOBILE MONEY: Among fintech innovations, **mobile money** and **digital payments** are areas where Africa has made significant inroads. Almost **half of total global mobile money accounts are in Africa**, which had 396 million registered users and 1.4 million agents serving them in 2018. (p.125)

INCLUSION: In addition to allowing people to access financial services more easily, the **migration to mobile** and **online banking** has **expanded financial services** to people who have long been unserved by financial institutions, whether because they live in an underserved area or because they lack the documentation to open a bank account. (p.127)

MOBILE FINANCE: With the spread of **COVID-19** and its impact on economies, **the use of fintech,** including mobile money, **is expected to increase even more**. For instance, one study estimated that the spread of COVID-19 and related government lockdowns have led to a **24–32% increase** in the relative rate of daily **downloads of mobile finance applications** in 74 sampled countries around the world (p.121).

CHAPTER 7: REGULATIONS TO SUPPORT FINANCING IN AFRICA

Africa needs to rethink its financial services regulation so that innovation is fully functional, the environment enables innovation, transparency is enhanced, and financing for private sector development is delivered.

CRISIS PREVENTION: African countries need to regulate their bank sector to limit the possible harm from **banking crises** or from more general **system-wide misallocation of resources**. For the sake of private sector development, the regulation of banks and other sources of capital for funding private industry—such as equity and debt capital markets and digital platforms— needs to be strengthened. (p.136)

REGULATORY CHALLENGES: Regulations that concern the banking sector alone **may be insufficient to safeguard the financial system** against some of the **risks fintech services pose**, such as **data privacy, money laundering, mismatched risk and return**, and **systemic risk**. These new risks call for financial regulation to be reviewed to provide a flexible environment for fintech to develop that is strict enough to limit the risks. (p.143)

COVID-19 CRISIS: Some African countries have **limited fiscal space and international reserves** and thus lack the necessary resources to implement COVID-19 responses (p.149) (...) According to IMF data, African countries will record **fiscal deficits averaging 5.8% in 2020 and 4.4% in 2021**, compared with 3% in 2019. (...) However, **African policymakers' and regulators'** experience with the 2008-2009 financial crisis and use of various measures to cushion its impact give them an **advantage in rapidly responding** to the COVID-19 crisis (p.151).

CHAPTER 8: CONCLUSIONS AND POLICY RECOMMENDATIONS

This chapter summarizes the key aspects of innovative financing for the development of the private sector in Africa. Five areas are key (refer to Figure 8.1)

1 - **Financing innovations can arise from multiple sources simultaneously.** Businesses need to consider leveraging different sources according to their financing needs (banks, fintech, financial markets, capital markets, development banks)

2- **A transparent and effective regulatory institution** is mandatory to minimize risk and oversee the financial operations of firms and peer institutions.

3- The **absence of a sound eco-system can impede firms** even when financing is readily available. This affects firms of all sizes, depending on their stage in the growth cycle.

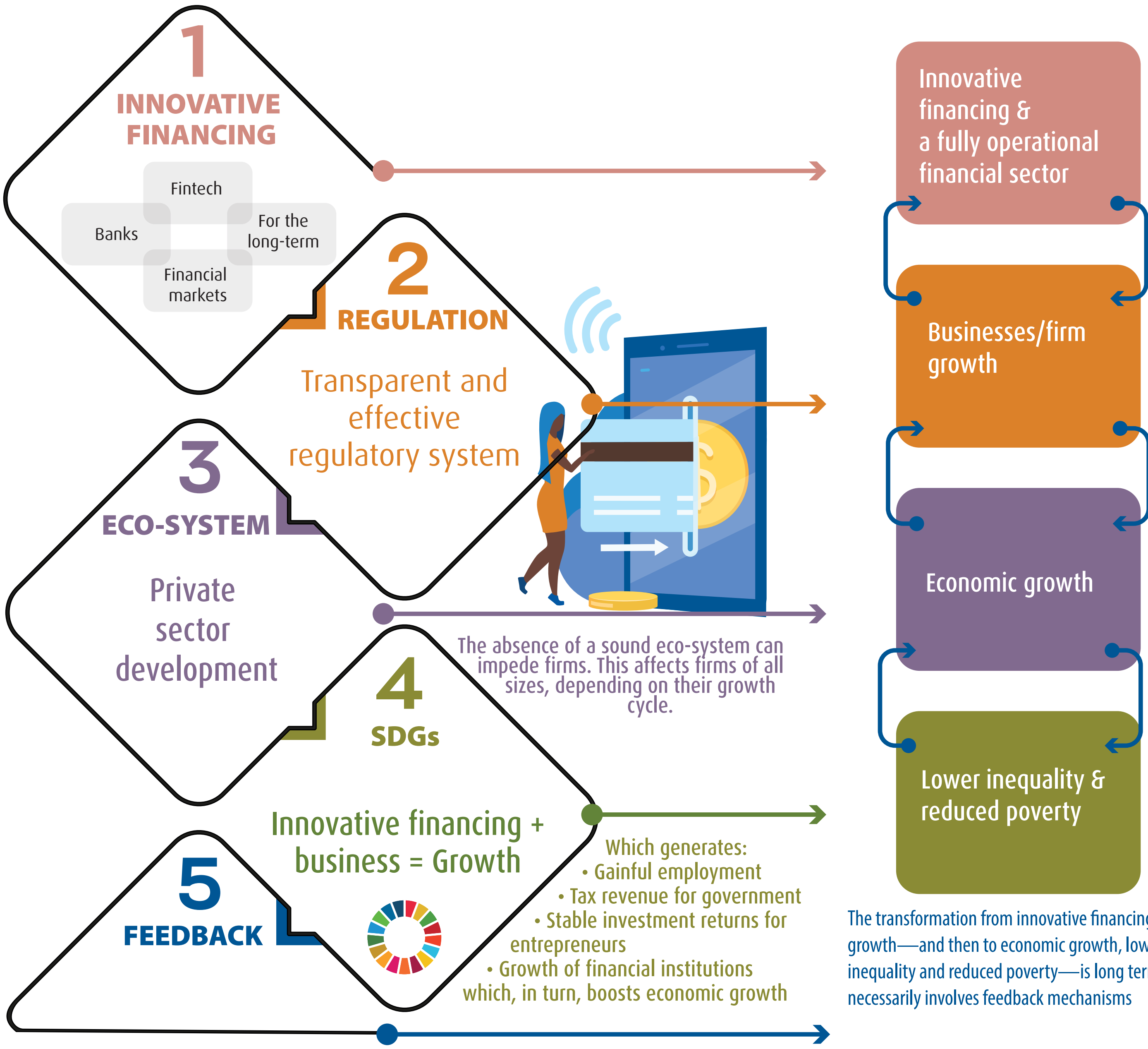
4- **Innovative financing** of the private sector and business growth **generates**: firm value added, gainful employment, tax revenue for government, stable investment returns for entrepreneurs, growth of financial institutions.

5- The **transformation** from innovative financing and from a fully operational financial sector to economic growth, lower inequality and reduced poverty is long term and **necessarily involves feedback mechanisms**.

COVID-19 CRISIS: To enable economic recovery and reasonable SDG progress, **African economies should fully explore innovative financing** for the private sector and enhance the eco-system for private sector development. Efforts should include **raising investment to 35–40% of GDP**, enhancing competitiveness and supporting regional integration. A **key strategy** is the **African Continental Free Trade Area (AfCFTA),** signed by 54 African countries - see Figure 8.2 on p.157 and read more on p.158.

FINANCIAL MARKETS: Africa can **deepen and broaden financial markets** by supporting the digital payment systems and platforms that underlie electronic payments and transfers through two important continental integration initiatives: the **Digital Transformation Strategy and the AfCFTA**.

PRIVATE SECTOR DEVELOPMENT AND SDGS



The transformation from innovative financing to firm growth—and then to economic growth, lower inequality and reduced poverty—is long term and necessarily involves feedback mechanisms

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