

Policy Paper

*Alternative financing for informal businesses
to propel youth entrepreneurship
in Sub-Saharan Africa*



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Overview



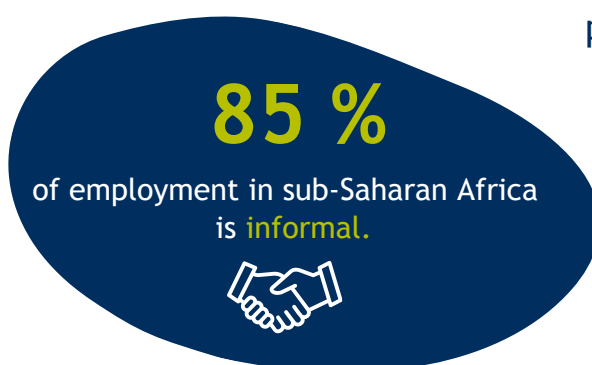
Entrepreneurship can be a transformative option for young people to gain economic independence, shape economies and create businesses that address issues in their communities. In the Global South, however, millions of young entrepreneurs, particularly women and other underserved groups, operate in the informal sector with limited access to growth opportunities and finance. This limits their ability to generate income, create jobs, and contribute to national economies and the Sustainable Development Goals. Providing better access to finance for informal youth-led businesses is crucial for inclusive economic growth and poverty reduction.

Women entrepreneurs in sub-Saharan Africa often operate in the informal sector and have no access to financial support which causes an estimated \$42 billion gender financing gap across business value chains, according to the African Development Bank. This is despite data showing that more than a quarter of all businesses in Africa were either started or are run by women and that women-led businesses have a greater positive impact on families and communities, according to Reuters. Investing in female entrepreneurs drives economic empowerment and inclusion, contributing to increased gender parity in society and business. In this paper, Youth Business International (YBI) and Somo, our member organisation in Kenya, call for alternative financing schemes for informal youth-led businesses in sub-Saharan Africa.

Introduction

The informal sector constitutes a significant part of economic activity in the Global South, including sub-Saharan Africa, South Asia, and Southeast Asia. According to the International Labour Organization (ILO), 85 per cent of employment in sub-Saharan Africa is informal. While there is no universally accepted definition of an 'informal business', common characteristics include a lack of formal registration, small-scale and localised operations, a limited formal structure, cash-based transactions, a lack of financial record-keeping and documentation, and informal employment arrangements.

In urban areas, informal businesses may be street vendors, small traders, and service providers, whereas in rural and agricultural settings, they may include small-scale farming and cottage industries.



The informal sector provides employment and income-generating opportunities to a large number of underserved groups, particularly women and youth, who are often marginalised from formal employment opportunities.

These groups often turn to informal businesses as their only option to earn an income. While this gives them the opportunity to earn a livelihood, it also exposes them to great volatility. Informal businesses operate outside of legal frameworks, meaning that wages might be low, employment may be terminated unexpectedly and at short notice, and there may be a lack of decent work standards. Owners of informal businesses are limited in their ability to grow the business as they are excluded from formal financing options.

This is due to a range of key factors, including:

Limited collateral

Informal businesses often lack formal documentation and assets that can be used as collateral for loans.

Limited financial literacy

Entrepreneurs running informal businesses may lack financial literacy, making it difficult for them to navigate formal financial processes, understand loan terms, or effectively manage their finances.

Regulatory hurdles

Many informal businesses operate in regulatory environments that do not support their integration into formal financial systems. Regulatory barriers, such as complex licensing requirements, can hinder the ability of these businesses to access financial services.

Informality and risk perception

Financial institutions may view informal businesses as high-risk due to the absence of formal records, making it challenging for entrepreneurs to establish creditworthiness. This perception further limits access to financial resources.



These barriers preventing informal businesses in the Global South from accessing financial support limit their economic growth, and thereby their ability to generate income, create jobs, contribute to national economies and the Sustainable Development Goals. It further perpetuates the economic exclusion of marginalised groups, including women and youth, and stands in the way of poverty reduction. Despite this, micro, small and medium-sized enterprises (MSMEs) make up 90% of all businesses, create 80% of all jobs and contribute to 70% of the total GDP in sub-Saharan Africa, according to the World Bank.

According to the Kenya National Bureau of Statistics' Economic Survey 2022, the informal sector accounted for over 80 per cent of Kenya's total employment outside of small-scale agriculture and pastoralist activities in 2021 - that is over 15 million people employed in the informal sector. This demonstrates that informal businesses are the engines of job creation and shows their enormous potential for growth, if they were given the right financial support.



Marion Ngoya, Founder of Lingo Styles, Kenya, supported by Somo

Accessing finance is particularly difficult for women entrepreneurs in sub-Saharan Africa, including Kenya. While the region has the largest proportion of female entrepreneurs in the world -26% according to the MasterCard Index of Women Entrepreneurs (MIWE) 2021- they receive only 7% of venture capital funding, Asoko Insights found, and earn on average 34 per cent less than their male counterparts according to the World Bank. Overall, only 16 - 20% of women in the region have access to long-term financing from formal financial institutions, FSD Africa found. This causes an estimated \$42 billion financing gap for African women across business value chains, according to the African Development Bank.



The reasons for this are multifaceted and may stem from harmful stereotypes about women's role in society and ability to do business, a lack of financial education and awareness of financial services, and legal and cultural restrictions that have historically prevented women from owning collateral and property. As a result, many women entrepreneurs are forced to operate in the informal sector with limited access to finance and growth opportunities.

Investing in these female entrepreneurs will drive the economic empowerment and inclusion of women in the region, contributing to increased gender parity in society and business. Research by the McKinsey Global Institute suggests that progress towards gender parity in Africa could add \$316 billion or 10 percent to the continent's GDP by 2025. Furthermore, women typically invest a higher proportion of their income back into their families and communities, often investing in better nutrition, healthcare and education, contributing to a general reduction in poverty.



YBI and Somo Revolving Loan Fund



To address the challenges faced by women entrepreneurs operating in the informal sector in Kenya, Somo and YBI launched a Revolving Loan Fund in 2023 as part of the Futuremakers global youth economic empowerment initiative, funded by Standard Chartered Foundation. The Fund supports low-income female entrepreneurs aged 18 to 35 to access the financial support they need to sustain and grow their businesses.

They are provided with loans between US\$1,000 and US\$25,000 at a five per cent interest rate per annum. Repaid capital is released in subsequent rounds as a revolving fund, which will be used to support additional young female entrepreneurs. Somo has also developed an alternative credit scoring system, the Somo Scorecard, that utilises data and social relationships to allocate financing. Combining programme participation, relationships, business insights, and social impact, the Somo Scorecard collects advisory and peer data and financial and impact data from DigiKua, Somo's reporting tool available through USSD, WhatsApp and web. This automatically generates a weighted score that serves as a filtering system for financing decisions.

Entrepreneurs and the Somo team access scores in real time, utilising them as an alert for problems entrepreneurs are facing and a way to better understand operating results, both for the business owner and Somo. For businesses built in marginalised communities, collateral and previous credit histories are often non-existent. This tool cultivates a more equitable and accessible form of financing, enabling more transparent risk assessment for financing partners.

This model allows young entrepreneurs who are operating in the informal sector and are excluded from the financial landscape to access capital and grow their businesses into commercially viable and investable models, whilst replenishing the loan fund through repayments for investment in further informal businesses.

Participants are provided with a holistic package of financial literacy support, including coaching and advisory support on financial management, legalisation and standardisation, and access to markets. They are also trained on how to use digital reporting tools for financial record keeping such as Somo's innovative USSD- and WhatsApp-based reporting system DigiKua, and set up a business profile on Somo Invest, an online platform that tracks business performance and manages the loan portfolio.

This holistic support package and the loans empower young female entrepreneurs in the informal sector to keep records of their finances and assets, build up a positive credit history, establish creditworthiness, and legally register their business, thereby opening the door to more traditional financial support from formal financial institutions.



In its first year, The Revolving Loan Fund supported 77 women-led businesses with loans aggregating \$177,154. Since receiving the loans, these businesses have achieved 28 per cent monthly revenue growth and created 326 new direct jobs. Four of the loans have been fully repaid, with another 78 current. No loans are late or defaulted. These outcomes from the first year of the programme powerfully demonstrate the power of financial support and financial management training to enable women-led informal businesses to grow and thrive.

Case study: Moureen Odera



An example of a business supported by Somo and YBI through the Revolving Loan Fund is Modesh Bakers, founded by Moureen Odera in the informal settlement of Manyatta, Kisumu, Kenya. Modesh produces cakes and cookies made from cassava and crickets, and trains young women in baking skills. Utilizing the non-commercial debt financing from the Revolving Loan Fund, Moureen constructed a shop extension for walk-in clients, set up a cafe, and purchased essential equipment.

Through this investment she has significantly grown her operations, now generating a monthly turnover of KES 1.5 million, versus a baseline of KES 57,000 in 2022.

Moureen is committed to empowering other women and has trained 80 women in bakery skills. 35 of them have secured employment, and 20 have started their own bakery shops, while three have been retained by Modesh. By supporting and empowering young women entrepreneurs in the informal sector like Moureen, we create a multiplier effect for them to make positive contributions in their communities.

”
With access to a low-interest debt loan, I pursued **growth opportunities** with confidence, scaling up operations and boosting revenue.

Moureen Odera

Propelling youth entrepreneurship by investing in alternative financing models

Youth entrepreneurship can be a driving force for decent work, economic development and green and social jobs if all young entrepreneurs have access to the opportunities and resources they need to scale their businesses. Informal youth-led businesses in sub-Saharan Africa provide employment, products and services that cater to the needs of their communities.

Access to alternative financing empowers them to scale their operations to make more impact and supports the economic inclusion of underserved groups, such as women, who are more likely to work in the informal sector. Our experience of implementing our Revolving Loan Fund in Kenya has shown that providing young entrepreneurs who operate informally with loans and financial literacy training empowers them to invest in their businesses and take control of their finances, which leads to revenue growth and the creation of new jobs.



To increase access to finance for informal businesses in sub-Saharan Africa, Youth Business International (YBI) and Somo call for governments, financial institutions, and development agencies to:

1 Offer alternative financing models and partner with community-based organisations specifically targeted at informal businesses and provide microloans, alternative credit scores and guarantor arrangements, complemented by a holistic package of financial literacy support.

2 Partner with local organisations to provide financial literacy initiatives tailored and accessible to marginalised groups who are more likely to operate in the informal sector

3 Support marginalised groups, including young people, women, people with disabilities, refugees and migrants, and ethnic or religious minority groups, to navigate regulations and harmful stereotypes that prevent them from building an enterprise.

4 Tailor all support services and financing models to the marginalised groups mentioned above, addressing their specific needs and challenges.

5 Simplify policy frameworks for formal business registration and access to finance.

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