



Crowdfunding

Summary of Preliminary findings of Feasibility study on crowdfunding opportunities in Zambia
Report prepared by Kukula Capital Ltd on behalf the UK aid funded Private Enterprise Programme Zambia (PEPZ)



Introduction

Rational for feasibility study

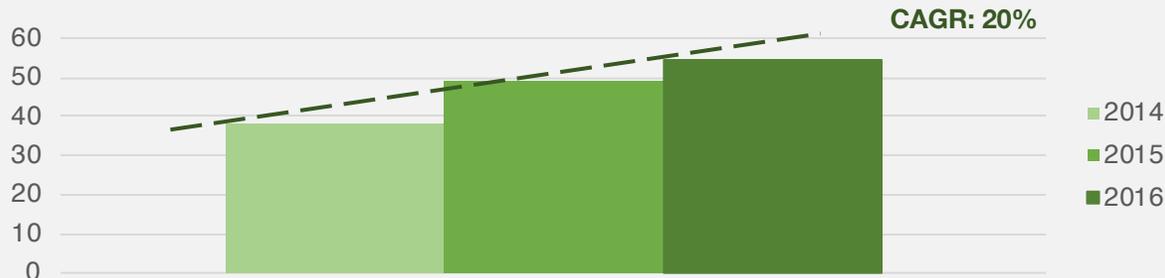
In the recent years, Micro finance institutions(MFIs) have played a critical role in increasing the access to finance for Zambian SMEs. However, the MFI model has its own disadvantages such as high financing costs and strict collateral requirements. Crowdfunding is developing gradually as a new financing model for African SMEs. Crowdfunding through lending has experienced high growth over the past decade in developed economies, and has more recently picked up in Africa. Crowdfunding is the mobilisation of funding for projects or businesses from a large number of investors 'crowd' using internet based platforms and online processes.

Purpose of the study

The purpose of the feasibility study is to assess the willingness of Zambian investors to provide growth capital to local businesses through a local crowdfunding platform.

Unrealized opportunity

SME and P2P-lending in Africa, USD

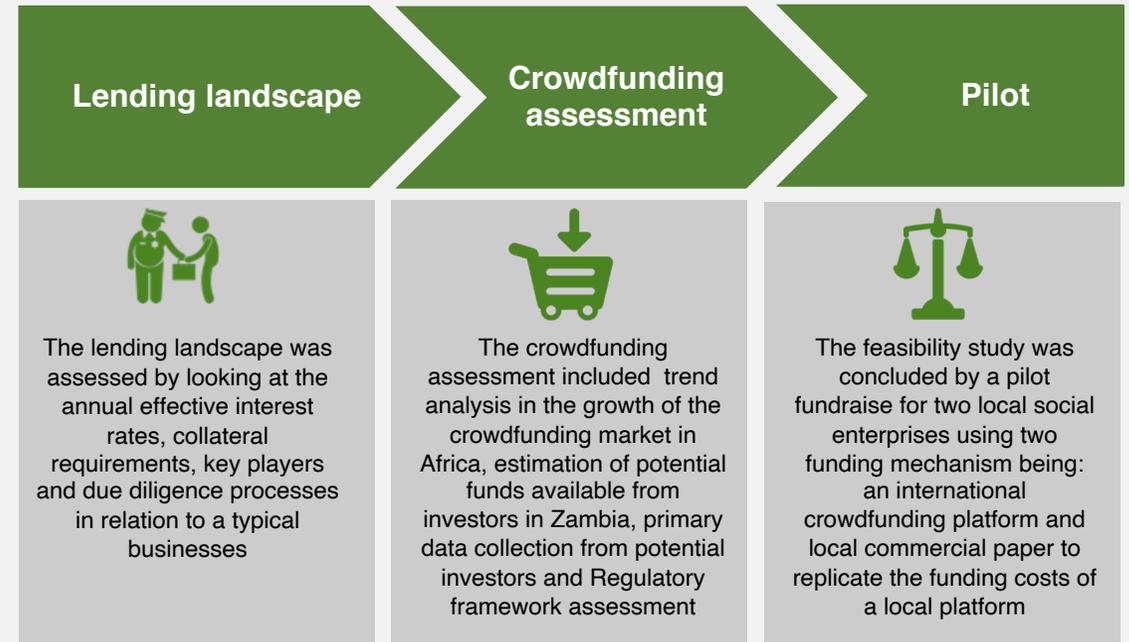


The crowdlending model has experienced a double-digit growth rate in Africa, while catering to both local and international investors.

There is an estimated **30,000 people in the formal sector in Zambia earning over USD1,000 per month** who form the core target investor group for a Zambian platform.

Assessment model and study assumptions

Assessment model – Phase I



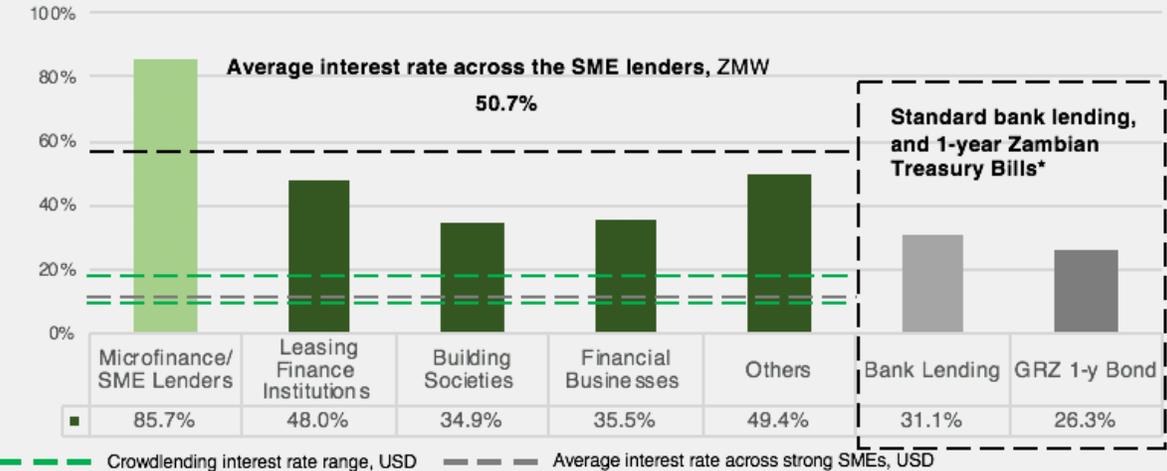
Phase II – Assessment of pilot and final recommendation



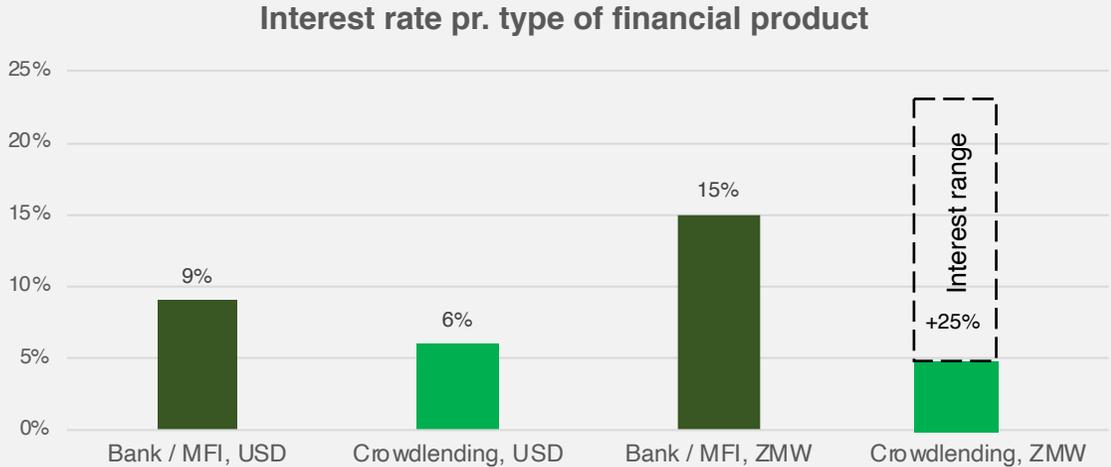
Market potential for crowdfunding using the current lending landscape

Gap Analysis of lending landscape

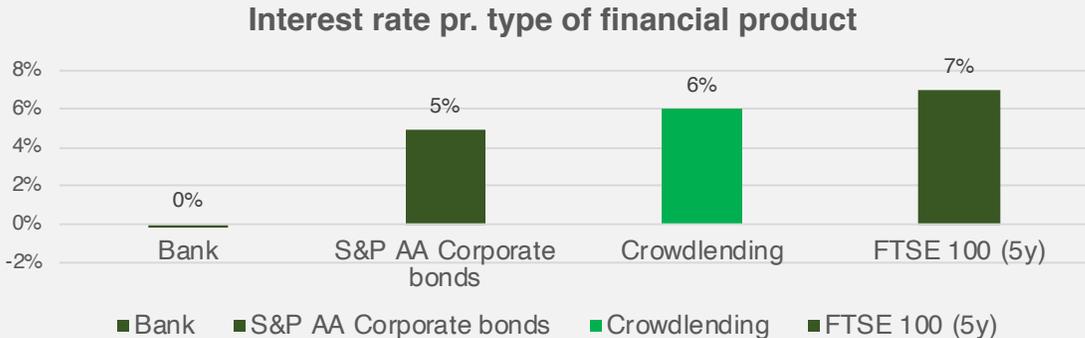
Effective Annual interest rate pr.type of of SME lender , March 2019



Zambian Lending landscape , June 2019



UK Lending landscape , June 2019



- **Crowdfunding presents a cheaper debt alternative to SMEs**, while allowing for greater flexibility towards collateral and screening processes
- The opportunity cost for investing in crowdfunding is **low-moderate for UK investors**, as they receive low-to-none interest in the bank
- In the Zambian case, international crowdfunding offers a lower USD return when compared to placing hard currency in the bank, or with an MFI. Therefore, crowdfunding has to cater to a different investor segment with preference for social impact and SME growth. According to the interviews, investors preferred interest rate is above 25% pa. in ZMW. No investors would invest at less than 6% pa. The opportunity cost for crowdfunding is **high for Zambian investors**, as they receive higher net returns in the bank for USD (ZMW may differ).
- **Particular opportunity** for ZMW denominated crowdfunding in Zambia

No regulation on crowdfunding exists in Zambia, which increases the uncertainty for investors in setting up a Zambian platform

The Securities and Exchange Commission Zambia

The SEC is deemed to be the most important stakeholder, as crowdfunding falls under their regulatory mandate

Highlights from meetings

- There is currently no regulatory framework for crowdfunding in Zambia
- SEC is currently not pursuing it, but is interested in establishing a regulatory framework and follows the development in other countries in the region.
- If you market financial products (such as a crowdfunding campaign) to investors, you fall under SEC registration where you have to comply with established legislation
- It is possible to market a financial product to 14 investors before a securities registration or waiver is required, and this process typically takes 3-6 months



DFID has previously supported the drafting of a regulatory framework on crowdfunding in Kenya



Public and private sector mix:

In Kenya, DFID supported the drafting of a regulatory framework on crowdfunding through external consultants and private sector stakeholders working side-by-side with the SEC. These initiatives open up for larger cross-sector interaction, which results in more practical regulation that addresses the needs of the actual market participants. Participating in drafting the regulatory framework also ensures a larger buy-in from the people subsequently adhering to the regulation



Lendahand operates under a European brokerage license (MiFID), which allows them to broker promissory notes that are issued by the Investees to the crowd. Their license does per se not allow them to market the crowdfunding campaigns globally, since local regulation always prevails over their international marketing rights.

Bank of Zambia



Bank of Zambia is the largest influencer on new legislation for a Zambian platform due to its experience in lending regulation

Highlights from meetings

- BoZ has no regulatory framework for crowdlending
- BoZ agrees that SEC is the relevant authority to develop the regulatory framework for crowdfunding, as there is no deposit mobilization in crowdfunding, and funds would not sit on the platform owner's books

Bank of Zambia carries a positive sentiment towards Crowdlending

"Well-regulated and transparent peer-to-peer platforms offer great opportunities as an alternative investment for loan providers as well as for borrowers – both in retail and small businesses."
– Bank of Zambia, June 2018

Case studies:

- The bank highlights in the publication that crowdfunding is effectively regulated by the SEC in Canada and Malaysia to spur growth and protect investors

Zambia: In a publication from June 2018, Bank of Zambia stated that crowdfunding and peer-to-peer lending is a keystone of serving the capital-demand of Zambian SMEs.



The SEC and Bank of Zambia are both interested in building an accommodating regulatory framework to support crowd-lending between local investors and Zambian SMEs.

Investor insights: Demographics and conclusions from identified segments

Categories of respondents

Young Professional

Senior Zambian Professions

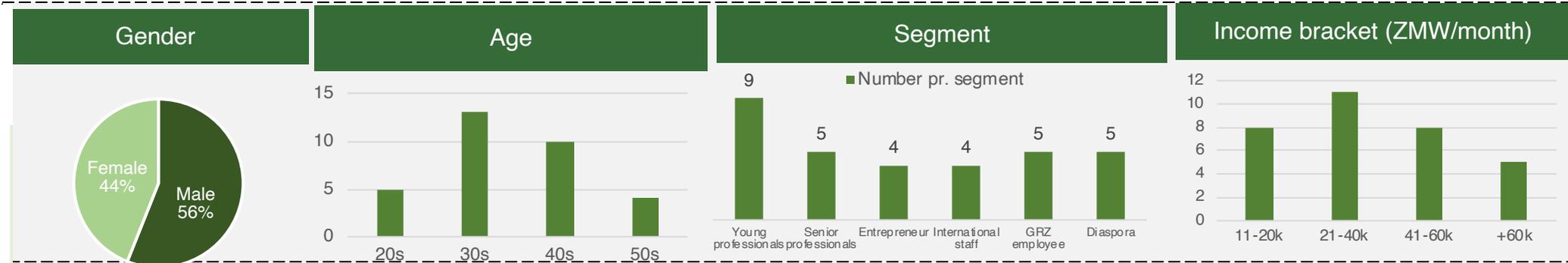
Business Owners & Entrepreneurs

International Organization Staff

Senior GRZ Employees

Zambian Diaspora

Interviewee demographics



Conclusions and highlighted insights

- | | |
|---|---|
| 96% would lend money to SMEs through a platform | 85% prefer 6 or 12 months maturities |
| 55% requires a yearly ZMW-return of +20% | All relevant payment options should be included |
| 33% requires a return that matches or exceeds fixed deposits in the bank | 98% require reporting on their loans that follow the interest payments |
| 2/3 will invest in the range of ZMW 5-50,000 pr. SME | 2/3 puts great value on social impact when crowdlending to a SME |
| 59% has a clear idea about what industry/SME they want to support | 75% wants to support the Zambian SME landscape, while 25% only look for return |

In general, the Zambian investors support crowdlending with short maturity loans and a social impact profile while expecting returns that match the bank deposit rate

A Zambian crowdlending platform will lower the financing costs for SMEs and increase the ease for investors to sign-up and deploy capital locally

Zambian platform

Advantages*

Challenges



Access/sign-up	Access criteria can be freely defined (e.g. bank or mobile money account based for repayments)
Uploading funds	Can be done by bank transfer, credit card or mobile money
Currency	Since loans are given and repaid in local Zambian Kwacha there is no foreign currency exposure
Money transfers	Lower cost of local transfers within Zambia with possibly no cost if using mobile money
Lenders	Focus on Zambian lenders with possibility to open for lenders from other countries
Processing time	Short time required for national bank or mobile money transfers
Intermediaries	Intermediaries not required if platform does the vetting itself, and thus no risk of fraud at partner level with the possibility to work with local feeder partner who do not handle money
Cost of loans	Potentially lower interest rates/cost of loans through own, local, simple and efficient loan screening structure
Borrowers	Free to determine the recipient groups/beneficiaries according to need or mission
Guarantees	Possibility to enter into risk underwriting agreements with public or private guarantors (SIDA, USAID, DFID etc.)
Local lender support	Can capitalize on national, Zambian investors looking to invest locally and support Zambian SME's, and may also open the possibility for overseas/international lenders
Mobile app	Possibility to develop an online app where loans can be granted and followed via the mobile phone
Diaspora	Easy and central platform for Zambian diaspora to find Zambian SMEs to invest in
Fraud	As all funds are controlled by the local platform, the risk of fraud can be considerably reduced by introducing strong Internal Control Systems
Regulation	If a license to operate is granted by the Zambian authorities, the platform is likely to have a broad range of marketing methods and products at its disposal.

Regulation	As no existing legislation is in place in Zambia it may take considerable time and effort to obtain permission to operate
Availability	Does not exist today and will need time and money to develop
Reliability	As a Zambian platform does not yet exist there is a risk of initial, operational challenges
Withholding tax	Obligation for the platform to deduct 20% withholding tax on interest payments for foreign investors and 15% for local. This makes it uncompetitive to bank savings products which are exempt from WHT.
Timing	It is estimated that developing a Zambian platform may take approximately 6 months for a white label version and 12 months if developed from scratch
Investment capital required	Establishing a Zambian platform based on an existing white label is estimated to require an initial investment of \$95,000 and developing a platform from scratch a substantially higher amount
Operating capital required	Running a Zambian platform is likely to involve an operating loss for the first few years and a risk of never reaching breakeven in case the Zambian market turns out not to deliver critical mass



The investor journey from project interest to actual capital deployment eases significantly with a local platform

It takes time and resources to launch a Zambian platform with more analysis required on the business case to present a solid 'go/no-go-recommendation'

The report concludes that crowdlending has a potential in Zambia while the success of a potential platform rests on good execution and DFID-support

Zambian investor appetite



- 1. Market segments:** 6 market segments were identified based on income level, tech savviness and previous investing exposure. Young professionals, Senior professionals, Entrepreneurs, International staff, GRZ employees and the Zambian diaspora constitute the majority of the Zambian crowdlending market.
- 2. Market size:** Based on several comparables, market research and other proxies, **we defined the total market size from the supply-side, i.e. the investors, and found the range of USD 4-6m/year.** Hence Zambian SMEs would benefit from ZMW 50-70m at a lower financing cost each year, if a local crowdlending platform was to emerge.
- 3. Investor appetite:** Yes, Zambian investors are interested in crowdlending! Yet the majority invest with a return/risk consideration in mind, and thus expect an interest rate beyond the bank deposit rate. Projects with a social impact profile rank high, while the majority prefer projects with a shorter maturity time and frequent reporting on the fund's usage and progress.

Regulatory landscape



- 1. There is currently no regulation on crowdfunding/lending in Zambia,** and thus the relevant stakeholders have to be engaged to draft a legislative framework that can accommodate both investor and SME protection. A Zambian platform will most likely register with SEC while this depends on the future legislation. Other African and Western countries have leaped forward on this matter, and hence several relevant case studies exist for Zambian lawmakers to assess.
- 2. The SEC is very supportive to wards developing new regulation for crowdfunding as part of their mandate to develop capital markets.** Best practice from around the world as well as regionally can be used as inspiration to create a new regulatory framework.
- 3. Bank of Zambia carries a positive sentiment** on establishment of crowdfunding platforms in Zambia and will coordinate and support in case SEC initiates the process of setting up a legal framework

There is documented investor appetite for Zambian crowdlending, while several factors have to be kept in mind when structuring the crowdlending offerings. Regulation is currently absent, and thus a framework has to be developed across the key stakeholders. The upside for local SMEs is significant as financing costs are expected to drop

Phase II of this study will run an evaluate a pilot crowdlending campaign for two Zambian SMEs and make final recommendations