

Cambridge Centre for Social Innovation

Research Report Summary

TRUST AS CAPITAL: GROWING INVESTMENT-BASED CROWDFUNDING IN KENYA

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MSt Social Innovation, 2020

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Social
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Key findings

Crowdfunding models from Western contexts have been adopted in Kenya to meet the need for sustained investment in small and medium-sized enterprises. Growing this emerging crowdfunding market required trust. This research highlighted the importance of relationships at many levels. It showed how institutional actors built trust, to institutionalise investment-based crowdfunding in a context where individuals are more trusted than institutions.

Background

Crowdfunding is one of the most rapidly growing alternative finance instruments. It began as a means of raising donations from individuals, but now has distinct variants, including donation-based, reward-based, debt-based (peer-to-peer lending), and equity-based (Kuti and Madarász, 2014). An enabling regulatory and policy environment in Western Europe and the United States has contributed to the growth of crowdfunding. Across Africa, the uptake of crowdfunding has been slower, but this is changing. In 2015, the continent received over eighty million dollars in crowdfunding (Cambridge Centre for Alternative Finance, 2017). This doubled in 2016 to \$181.56 million (Cambridge Centre for Alternative Finance, 2018).

Kenya has a tradition of community self-help through fundraising: harambee, which loosely translates to 'let us pull together' (Merriam-Webster, 2019). Despite this tradition, and many financial technology innovations such as mobile money (MPesa), the slow growth of crowdfunding has mirrored the rest of Africa. However, this is changing due to increasing need for alternative sources of finance, particularly for small and medium-sized enterprises (SMEs), who are becoming more important employers but have limited access to credit. SMEs often rely on their founders and informal networks for seed-stage capital (Gichuki et al., 2014; Clawson, 2014). Beyond these resources, entrepreneurs often find funding inaccessible (Sankara, 2017; Cheney, 2018). Investment-based crowdfunding presents a potential solution to this.

Trust is imperative in crowdfunding because financial relationships are mediated through a digital interface. In mature economies, trust is mediated through 'institutions, law enforcement and intermediaries' while, in developing economies, personalised trust plays a more significant role in mediating economic and social relationships (Nooteboom, 2007). While researchers have sought to understand the role of institutions in enabling or facilitating trust (Greenwood, et al., 2017), questions remain regarding how trust is enhanced in contexts, such as Kenya, in which financial relationships are based on personal relationships (Johnson, 2016) and trust in institutions is low.

In order to understand how investment-based crowdfunding has been adapted in Kenya, this research sought the personal accounts of multiple stakeholders. 16 participants were interviewed. They were drawn from across the ecosystem, including ventures, crowdfunding platforms, intermediaries, an industry association and the relevant regulatory authority. The researcher was able to draw on her own lived experience of Kenya to interpret participants' accounts.

Emerging themes

The Kenyan context is distinct. There is a tradition of collective fundraising, but there are also low levels of trust. 'Trust is not the default'. Trust is extended to individuals raising funds more than to institutions. Trust, therefore, emerged as the main theme of the research. We saw that at the individual micro-level,

existing networks were activated to lengthen 'chains of trust'. This entailed challenges of translation from the western context. At the organisational meso-level, 'trust capital' was built by extending these networks further, relying heavily on the social capital of those with contacts from further afield. At the macro level, institutions acted as 'trust-brokers', influencing this emerging field.



Figure 1. Building trust in Kenyan crowdfunding across levels.

Micro level – lengthening chains of trust

Kenyans are familiar with the tradition of Harambee, but this involves donations, rather than investment, and giving would be towards social needs or emergencies. Aligned with this familiar institution of communal giving, there is potential for investment-based crowdfunding to grow, but supporters would need to understand and buy-in to the concept. In this effort, personal trust was more important than the technology or the platform, which were unfamiliar.

"For a harambee you give because you hope that the day when your own trouble comes people will contribute."

Ventures that successfully crowdfunded built their networks by using a personal touch, targeting their communications to individuals. Existing personal networks were activated by identifying individuals with strong social capital – large social networks who believed in the cause – who were key in the early stages of a campaign. Second and third-degree networks were therefore engaged through trusted intermediaries, who were interested in social impact. In this way, chains of trust were built, enabling the crowdfunding campaigns to reach a larger 'crowd'.

"Very few people are going to just see you on social media or hear from friends then put money on you. They want to hear from you..."

"There is trust, but in a market where resources are limited everyone is fighting for it."

Meso level – building trust capital

Historical data indicated potential for continued growth of crowdfunding in Kenya. However, crowdfunding based on personal networks alone is limited. Some campaigns were seen as contrived, 'matchmaking' pre-selected investors with ventures. Participants believed crowdfunding needed to be demand-side driven if it were to continue growing. Many participants believed there was a 'latent demand', beyond the personal networks of existing supporters. However, due to low trust in institutions, particularly emerging ones, Kenya would need a different approach.

Kenyan investors prefer to have short-term returns on their investments, perhaps in part due to limited means. When giving, they expect reciprocity. This is not consistent with the principles that have made crowdfunding successful elsewhere. We saw that platforms who successfully grew their reach, did so by bringing in investors from further afield. The newness of investment-based crowdfunding made it interesting to potential investors outside Kenya: as an emerging field, it is open to innovation. To a degree, this growth still relied on existing networks. Those who had lived abroad, or were non-Kenyan and had international networks, were more successful.

People without these advantages had to be more creative. For example, Kenyan diaspora could be called on to extend networks, as they would understand the context and the concept of Harambee. Chamas (savings clubs) were another pathway. Many chamas have become investment clubs, members of which are actively looking for opportunities to invest. They are able to build 'trust capital' in investment-based crowdfunding by their endorsement. Neither diaspora nor chamas have a collective platform, so there is still potential for new coalitions to be developed.

"A lot of trust capital exists within communities which are already funding projects [among] themselves. That capital needs to be leveraged towards crowdfunding as much as possible."

Macro level – institutions as trust brokers

In Europe and the USA, legislation enables crowdfunding. In Kenya, institutions needed to play a more active role in brokering trust. This involves reputational risk. However, institutions also recognise that the market requires their signals of trust for crowdfunding to become institutionalised, especially at this early stage.

Some institutions shaped the crowdfunding market and brokered trust by offering matching funds to ventures. Entrepreneurs saw this mechanism as a means of affirming the validity of the campaign. Local donation-based crowdfunding platforms, such as M-Changa, are widely recognised and seen in a positive light. A notable example of trust brokering is the Kenyan Capital Markets Authority (CMA) regulatory sandbox which is mechanism that suspends some regulatory requirements for fintech innovations to allow them to test feasibility while the regulator designs appropriate regulation.

Partnerships between institutions played an important role in increasing trust in crowdfunding by addressing regulatory barriers impeding the growth of crowdfunding. Notably, the engagement between the industry association, the Africa Crowdfunding Association (ACFA), and African regulators including the Kenyan Capital Markets Authority (CMA). This partnership has led to the development of an industry set of standards: the ACFA label; an interim license that participating regulators can opt to recognise if they want to start crowdfunding in their jurisdiction. The Kenyan CMA has adopted the label, and other African regulators are now also taking it on. It is unusual for industry standards to be developed by the industry itself. Standards would normally be devised and imposed by regulators but for crowdfunding, the regulations adopted from other contexts were found to be too expensive or

onerous for pioneering African platforms to fulfil. Therefore, the strong alliance between the regulator and the industry association enabled this development to be bottom-up.

Implications and future research

It is important to understand different perspectives of innovation from diverse cultural contexts. This work adds practitioner perspectives, demonstrating how trust was built, at different levels, in the process of establishing a new alternative financial instrument.

It was interesting to observe how the cultural context influenced the development of this emerging field. At the scale of the campaign, the need for trusted individuals and personalised communication were clear. And, at the organisational level, relationships through trusted networks were still crucial to growing the market. At the national level, institutions acted as the trust-brokers. This was essential for the scaling and sustainability of investment-based crowdfunding, if it was to address the financial needs of Kenyan SMEs in a meaningful way. It may seem counter-intuitive that, in a context where trust in institutions is lacking, institutions are the trust-brokers for an emerging field. But we saw how, in this context, the role of trusted institutions was especially important. In particular, it was essential to have strong alliances between institutions, such as between the industry association and the regulatory body.

As alternative financial instruments are gaining hold globally, further research into how they are becoming institutionalised in non-Western contexts would be useful. While this research offers a small qualitative snapshot of one context, it represents an interesting example of a culture that has a distinct heritage, in which trust cannot be taken for granted. Indeed, any research seeking to understand the adoption of Western models in non-western contexts would do well to understand the historical reasons for intuitional mistrust.

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About the project

This research is based on an analysis of literature and qualitative data from key informant interviews. It was carried out with the support of the Cambridge Centre for Social Innovation.

This research is carried out by the Cambridge Centre for Social Innovation. It was designed and conducted by graduates of the MSt Social Innovation, with the support of faculty and fellows of the programme. The Centre is committed to ensuring wide access to our research findings. We welcome your feedback and ongoing support. The views of the authors do not represent those of their employers or CJBS. If you wish to discuss this research or access the full report, please contact the Centre at: socialinnovation@jbs.cam.ac.uk.

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