

INSIGHT

Private Debt in Africa: Unlocking Growth for SMEs and the Broader Economy

Africa's economic landscape is dominated by small and medium-sized enterprises (SMEs), which constitute 75% to 90% of businesses, depending on the sector according to the World Economic Forum. These enterprises are critical engines of growth, innovation, and employment. Yet, despite this, access to financing remains a persistent challenge that significantly constrains their ability to scale and contribute fully to the economic development of the continent. Against this backdrop, underutilised private debt emerges as a promising financing avenue that could bridge the continent's massive financing gap.

The Financing Challenge for SMEs in Africa

SMEs in Africa face a daunting financing environment. Traditional financing from banks and other financial institutions often come with exorbitant interest, stringent collateral requirements, short tenors, and risk-averse lending policies that exclude many SMEs. Banks tend to focus on safer large corporations or government-backed projects, leaving SMEs underserved. According to the World Bank, credit formation relative to GDP in Sub-Saharan Africa remains low compared to high-income countries, highlighting a structural financing deficit. According to the Africa Development Bank, many SMEs rely on retained earnings or informal sources due to limited access to formal credit, which restricts their growth potential and innovation capacity.

The Affirmative Finance Action for Women Entrepreneurs estimates women-owned SMEs face even greater hurdles, with a financing gap estimated at USD 42 billion, reflecting systemic inequalities in access to capital across the SME sector). The result is a continent-wide financing gap estimated at hundreds of billions of dollars which underscores the urgent need for alternative financing solutions tailored to the SME sector.

Why Private Debt Could Be the Answer

Private debt, particularly in the form of mezzanine financing and senior direct lending, offers a flexible alternative to traditional financing options, as well as to equity-based financing such as venture capital, and private equity. Unlike equity financing, private debt does not dilute ownership, allowing business owners to retain control which is a key incentive for many SMEs. In comparison to venture capital, which often targets high-growth startups with higher risk profiles and longer investment horizons, private debt generally offers more predictable returns and greater flexibility in structuring repayment schedules.

Globally, private credit markets have surged to more than USD 1.5 trillion according to Moody's, yet Africa captures only about 0.3 percent of this market, indicating a significant untapped opportunity. This accounts for a mere 7 percent of total funding raised in Africa, lagging behind equity-based financing such as venture capital and private equity. This underutilisation is despite private debt's potential to fund SMEs and sectors crucial for development, such as health, education, and nutrition.



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Advantages of Private Debt for Lenders and Businesses

For lenders, private debt offers several benefits including predictable cash flow through regular interest and principal repayments, lower risk compared to equity since debt holders have priority in case of default, and portfolio diversification opportunities beyond traditional equities and bonds, appealing especially to institutional investors like pension funds.

For businesses, private debt preserves ownership and management control, unlike equity financing. It also provides flexible financing options, such as mezzanine finance, that combine debt, and equity features often tailored to the specific circumstances of the borrower. This flexibility, along with longer tenors and tailored repayment schedules aligned with business cash flows, supports sustainable growth without immediate liquidity pressure.



Successful Models and Regional Initiatives

Several initiatives demonstrate the potential of private debt to unlock SME growth in Africa. The Africa Private Equity and Debt Programme (PEDP), supported by FSD Africa and implemented across multiple countries, aims specifically to improve long-term financing options for SMEs by creating enabling environments and innovative funding structures that attract institutional investors like pension funds. The programme targets key sectors such as healthcare, agriculture, and climate, which are critical to Africa's economic development. Through grants, technical assistance, advocacy, and investment capital, it supports the growth of private capital markets tailored to local contexts. This initiative has already helped channel more local capital into SMEs, preserving jobs and enabling business expansion despite economic challenges exacerbated by COVID-19.

South Africa has one of the most developed private debt markets in Africa, with a private debt-to-GDP ratio close to 0.42 percent, comparable to developed economies. This market has provided South African mid-sized businesses with flexible financing options like mezzanine and senior lending, helping them grow and create jobs. For example, Kholo Capital's Mezzanine Debt Fund I, which closed at more than USD 76 million in 2025, offers tailored mezzanine financing to SMEs across Southern Africa, targeting sectors such as social housing, healthcare, renewable energy, and ICT. Strong regulatory support, including revised pension fund investment limits and enhanced governance standards, has enabled institutional investors such as pension funds and asset managers to allocate more capital to private debt funds.

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Conclusion

Africa's SME sector is at a critical juncture. Traditional financing mechanisms have failed to meet the scale and diversity of their needs, while venture capital and private equity, though growing, do not fully address the demand for flexible, non-dilutive financing. Private debt offers a compelling alternative, balancing risk and return for lenders and providing SMEs with growth capital that preserves ownership and aligns with cash flow realities.

However, to realise the potential of private debt in Africa, policymakers, regulators, and financial institutions must address challenges like limited investor confidence and regulatory uncertainty by fostering enabling environments

through targeted reforms. These reforms include establishing clear legal frameworks that protect creditor rights and enforce contracts efficiently. Institutional investors should be encouraged to participate in private debt markets, supported by risk mitigation tools from development finance institutions. Such reforms remove barriers to private debt growth, making the market more transparent and attractive, which is vital for mobilising capital to finance SMEs and boost economic development.

Ultimately, unlocking private debt markets in Africa could catalyse SME growth, drive job creation, and accelerate inclusive economic development across the continent.

Should you have any questions regarding the information in this legal alert, please do not hesitate to contact, Dominic Robelo and Edwin Odundo.



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