

CROWDFUNDING: THE NEW GOLDEN FUNDRAISING TOOL FOR STARTUPS IN NIGERIA, LEGAL FRAMEWORK AND BEST GLOBAL PRACTICE.

WHAT IS CROWDFUNDING?

Nigeria is abuzz with crowdfunding. In 2021, Nigerian startups raised over \$1.6 billion in funding.¹ Out of about \$4 billion startups funding that Africa attracted in 2021, Nigeria earned the largest chunk of \$1.37 billion.² One of the major tools presently being employed to garner such humongous funding is the innovation of crowdfunding. According to Regulation 1 of the SEC Rules on Crowdfunding 2021, crowdfunding is the process of raising funds to finance a project or business from the public through an online platform. In essence, it is a method of supporting a project or endeavour by soliciting financial contributions (often modest sums) from a large number of individuals (investors), primarily over the internet.

TYPES OF CROWDFUNDING

The major types of crowdfunding include:

1. Donation Crowdfunding;
2. Reward Crowdfunding;
3. Peer-To-Peer Lending; and
4. Equity Crowdfunding.

1. DONATION CROWDFUNDING:

Donation-based crowdfunding is a method of sourcing funds for a project or endeavour by asking a pool of contributors to individually donate a small amount to it. This is a way of supporting a project by soliciting financial contributions in bits from a large number of individuals. The main idea of donation-based

crowdfunding is to voluntarily help others without compensation. Often, this method of crowdfunding is for charitable purposes.

2. REWARD CROWDFUNDING:

This is a crowdfunding method where entrepreneurs solicit financial donations from individuals or investors in return for a product or service. Here, individuals or investors donate to a project or business with the expectation of receiving a non-financial reward either in the form of goods or services.

3. PEER-TO-PEER LENDING/ CROWDLENDING/ DEBT-BASED CROWDFUNDING:

This affords a complete opposite to securing a bank loan. Companies (Borrowers) borrow directly from a pool of individuals (Crowdlenders) who are ready to lend. Borrowers accept loan offers at the lowest interest rate and after due diligence, internet-based platforms are used to match lenders with borrowers. In this method, businesses simply take loans from different investors through a crowdfunding platform, in exchange for interest and pay back the loan(s) after an agreed period of time.

4. EQUITY CROWDFUNDING:

This method of crowdfunding entails giving stakes in a company or startup to a number of investors in return for their investment. Investors are given shares in the company and therefore also owners of the company or startup.

CROWDFUNDING PLATFORMS IN NIGERIA

Globally, there are many successful crowdfunding platforms, i.e., GoFundMe, Kickstarter, and Indiegogo. Popular Nigerian crowdfunding platforms include: NaijaFund, Piggyvest, and Donate-ng.

THE LEGAL FRAMEWORK REGULATING CROWDFUNDING IN NIGERIA

Startups in Nigeria are eminently faced with lack of funds to effectively and efficiently run their businesses, no thanks to technicalities and rigors of obtaining loan from banks on high-interest rates. Coupled with the uphill task of attracting venture capitalists, many companies and startups have been happily forced to consider alternative sources of funding.

Crowdfunding, especially equity-based, is an attractive alternative source of funding. Startups are able to raise cash in a cost-effective manner, convenient and seamless way. However, this trend is not without its concerns as internet fraud, shams and schemes are possibilities; thus the need for proper compliance laws and regulatory procedures.

On 15 August 2016, the Securities and Exchange Commission (SEC) issued a statement suspending all crowdfunding activities due to a lack of rules and legal difficulties. Specifically, in Nigeria, the Investment and Securities Act, 2007 restricts private companies from engaging in equity crowdfunding. Section 67(1) of the Investment and Securities Act, 2007 states as follows:

*“(1) No person shall make any invitation to the public to acquire or dispose of any securities of a body corporate or to deposit money with anybody corporate for a fixed period or payable at call, whether bearing or not bearing interest **unless** the body corporate concerned is-*

***A public company**, whether quoted or unquoted and the provisions of Sections 73 to 87 of this act are duly complied with; or A statutory body or bank established by or pursuant to an act of the National Assembly and is empowered to accept deposits and savings from the public or issue its own securities (as defined under this Act), promissory notes, bills of exchange, and other instruments”.*

Section 22(5) of the Companies and Allied Matters Act 2020 (“CAMA 2020”) further specifies that:

“A private company shall not, unless authorized by law, invite the public to:
a. Subscribe for any share or debenture of the company; or
b. Deposit money for fixed periods payable at call, whether or not bearing interest”.

The implication of the above provisions is that only public companies, statutory bodies and banks established pursuant to an act of the National Assembly, are permitted to ask the public to acquire or dispose of their securities. Private Companies are specifically prohibited from engaging in crowdfunding in Nigeria, therefore where they make invitation to the public to acquire or dispose of any of their securities; this may qualify as an infraction of the law.

However, on January 21, 2021, the SEC published new rules on crowdfunding: SEC Rules on Crowdfunding 2021, which allows private companies to engage in crowdfunding subject to the existence of required structures. The new rules however apply only to Investment-Based Crowdfunding which was described as the practice of soliciting funds from the public via an internet portal in exchange for shares, debt securities, or other SEC-approved investment instruments. This trend effectively rescinds the earlier statement suspending all crowdfunding activities in Nigeria due to lack of rules and legal difficulties.

SALIENT PROVISIONS OF THE SEC RULES ON CROWDFUNDING 2021

1. Under Rule 1,³ the following key players in a crowdfunding process are defined thus:
 - a) CROWDFUNDING INTERMEDIARY: A corporation created and registered for the purpose of facilitating transactions involving the offering of securities or investment instruments via a Crowdfunding Portal.
 - b) CROWDFUNDING PORTAL: This is the website, platform, program, or other comparable module that facilitates interactions between Fundraisers and the investing public.

- c) FUNDRAISER/ISSUER: The term “fundraiser” or “issuer” refers to the person who created and manufactured the investment instrument to be issued.
- d) INVESTOR: Any individual who wishes to make or has made an investment in an investment vehicle.
2. Rule 5(a)⁴ requires the SEC to regulate all Crowdfunding Platforms. It provides thus:
- “Every portal that facilitates, operates, provides or maintains interactions between fundraisers and investing public (crowd) in Nigeria for the purpose of an investment-based Crowdfunding shall be operated only by an entity registered as a Crowdfunding intermediary.”*
3. Furthermore, under Rule 5(a)(ii),⁵ funds may be raised only through Crowdfunding Portals that are administered by SEC-registered entities with a minimum paid-up share capital of N100 million.
4. In terms of investment limits, Rule 3 (3)(i)⁶ and (ii) prohibit retail investors who are neither High Net Worth nor Sophisticated Investors from investing more than 10% of their yearly income.
5. In the same vein, under Rule 2⁷, all Micro, Small, and Medium-Sized Enterprises (MSMEs) incorporated as a company in Nigeria with a minimum of two-years operating track record can now raise funds through a Crowdfunding Portal registered by the Commission.
6. Under Rule 3(1)(b),⁸ the aggregate amount of securities or investment instruments that can be offered in a 12-month period is pegged at N100 million for medium-sized businesses, N70 million for small businesses, and N50 million for micro businesses. These restrictions, under Rule 3(2), do not apply to Digital Commodities Investment Platforms (“DCIPs”). These are

platforms that connect investors to specific agricultural or commodities projects in exchange for returns, examples include Farmcrowdy, Thrive Agric and AgroPartnership.

7. Under Rule 42,⁹ the following entities are prohibited from raising funds through a Crowdfunding Portal: (a) complex structures; (b) public listed companies and their subsidiaries; (c) companies with no specific business plan or a blind pool; (d) companies that propose to use the funds raised to provide loans or invest in other entities; (e) such other entity as may be specified by the Commission.
8. Rule 4(a)¹⁰ of the Rules of Crowdfunding 2021 provides that, “every portal that facilitates, operates, provides or maintains interactions between fundraisers and investing public (crowd) in Nigeria for the purpose of an investment-based crowdfunding shall be operated only by an entity registered as a crowdfunding intermediary”. The Crowdfunding Intermediary is the entity that operates the Crowdfunding Portal. They are required to be registered with SEC. The Rules place further responsibility on the intermediaries, which are information disclosure, due diligence, reporting obligations, data protection and privacy, operation of a trust account, compliance and restriction on cross-ownership.
9. A number of checks and balances are also in place towards ensuring accountability, transparency and probity. On the operation of Trust Account, Rule 13,¹¹ provides that every crowdfunding portal shall appoint a custodian, who shall establish and maintain a separate trust account for each funding round on its platform with a financial institution registered by the Commission as a Custodian.
10. Rule 10¹² provides further on due diligence that crowdfunding portals shall carry out due diligence on prospective issuers intending to use the platform. It requires these portals to conduct background checks on issuers to ensure fit and properness, verify the business

proposition of the issuer and comply with all relevant KYC and Anti Money Laundering/Combating Financing of Terrorism (AML/CFT) regulations as stipulated by SEC. Also Rule 11 empowers SEC to monitor the conduct of issuers and take action against the misconduct of issuers.

11. Rule 12 makes sufficient provisions on data protection and privacy: The Rules provide that crowdfunding portals shall establish appropriate safeguards to ensure information privacy, ensure confidentiality, maintain reliable and secure operating systems, develop systems to avoid operational disruptions, have backup facilities and insurance, keep copies of all relevant documents for a period of at least seven years as well as provide investors with copies of documents relevant to the investor within a ten-day period from the date of the request

GLOBAL BEST PRACTICE

It is interesting to note that the wildfire of crowdfunding is sweeping through the world, and at a fast pace too. According to Statista Research Department, in 2021, the global crowdfunding market was valued at \$12.7 billion and was forecast to double by 2027, growing at the compound annual growth rate (CAGR) of 11 percent, amounting to more than \$25.8 billion.¹³ There are more than 10,000 crowdfunding portals worldwide supporting multi-billion industries. As of 2014, crowdfunding hit \$16.2 billion in the United States of America.

In Nigeria, on May 26, 2021, the SEC released a notice directing all investment crowdfunding platforms in Nigeria to comply with the new crowdfunding rules or cease operations by June 30, 2021. The crowdfunding rule thus came into effect on January 21, 2021. Interestingly, the SEC of the United States of America released amendments to its crowdfunding regulations which took effect from March 15, 2021 thereby affording a side-by-side comparative analysis.

Following the March 2021 amendment to Regulation CF in the United State regulations, the offering limit in regulation crowdfunding has been raised from a total of \$1.07M to \$5M within a 12-month period.¹⁴ In 2016, France also increased its limits to €2.5 million, and presently, while in 2018, both the United Kingdom and Germany upped to €8 million.¹⁵

This is however not the case in Nigeria, even with our more recent rules, the maximum amount that can be raised depends on whether the company is classified as Micro (N50 Million), Small (N70 Million), or Medium Enterprise (N100 Million). Even though these limits do not apply to commodities investment platforms (CIPs), the limits are quite low and likely to discourage intending companies with a global and international outlook, hoping to raise funds via crowdfunding.

CONCLUSION

The provisions of the Investment and Securities Act need to be amended to make provisions to allow the crowdfunding of private companies. The CAMA 2020 makes allowance for the implementation of the extant law on equity crowdfunding. Also, the Rules on Crowdfunding 2021 is a welcome development in the regulation of crowdfunding in Nigeria. It encourages more startups to spring up as well as support small and medium-scale businesses.

END NOTES

¹ <https://nairametrics.com/2022/02/07/nigerian-startups-raise-over-1-2-billion-fundings-in-2021/>

² <https://guardian.ng/technology/nigerian-startups-retain-1-37bn-of-africas-4b-funding-in-2021/>

³ SEC Rules on Crowdfunding 2021

⁴ Ibid

⁵ Ibid

⁶ SEC Rules on Crowdfunding 2021

⁷ Ibid

⁸ Ibid

⁹ Ibid

¹⁰ Ibid

¹¹ Ibid

¹² SEC Rules on Crowdfunding 2021

¹³ <https://www.statista.com/statistics/1078273/global-crowdfunding-market-size/>

¹⁴ <https://www.sec.gov/smallbusiness/exemptofferings/regc-rowdfunding>

¹⁵ <https://www.crowdfundinghub.eu/france-current-state-of-crowdfunding-2022/>



Hassan Sherif

Associate

sherif@j-kgadzamallp.com

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