



# CROWD FUNDING

-THE NIGERIAN PERSPECTIVE

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## INTRODUCTION

Disruptive technologies have continued to alter the way consumers, industries, and businesses operate globally. The internet has remained a leading source of disruptions in the 21st century. Internet-backed innovations are radically shaping the hitherto conventional and traditional ways in which activities and business relationships are being carried out and replacing them with modern, quick and smart alternatives.

Recently, there have been incursions by technology into the traditional investment and fundraising/ financing space. Prominent amongst the incursions include; cryptocurrency/virtual currency and crowdfunding. Although the financial services industry's conventional regulators are very cautious concerning embracing cryptocurrency, the digital currency appears to be gaining acceptance across the world.

In September 2017, the United Kingdom Financial Conduct Authority ("FCA") released a statement on Initial Coin Offerings ("ICO") warning that ICOs are highly risky and speculative investments. The FCA advised that persons should only invest in an ICO if they were experienced investors, confident in the ICO project's quality, and are prepared to lose their entire stake<sup>1</sup>. Also, the Central Bank of Nigeria ("CBN") in February 2018, cautioned that cryptocurrencies and digital coin exchanges are not licensed or regulated by the CBN. The CBN noted that dealers and investors in any type of cryptocurrency are not protected by law in Nigeria and that consumers may lose their money without any legal redress<sup>2</sup>. Despite the cautious approach by regulators to digital currency, its wide acceptance seems to be catching the regulators' attention. The International Money Fund in August 2020

<sup>1</sup> Consumer Warning About the Risk of Initial Coin Offering, Statement Issued by the UK Financial Conduct Authority, September 2017

<sup>2</sup> Virtual Currencies Are Not Legal Tender in Nigeria, Press Release of the Central Bank of Nigeria, February 2018

published a cryptocurrency explainer suggesting that cryptocurrency could “completely change the way we sell, buy, save, invest and pay our bills” and that it “could be the next step in the evolution of money<sup>3</sup>”. Most recently, the Nigerian Securities and Exchange Commission (“SEC” or the “Commission”), in its Statement on Digital Assets and their Classification and Treatment released on 14th September 2020, made it clear that for the sake of investor’s protection, public interest and market integrity/transparency, the SEC will begin to regulate cryptotoken or crypto-coin investments when the character of the investments qualifies as securities transactions.

On the other hand, crowdfunding has been widely embraced and regulated across the world. Crowdfunding is regulated by the FCA in the United Kingdom and the Securities and Exchange Commission in the United States and Nigeria. Crowdfunding has provided access to financing of small companies through a technology-enabled platform. In the United States, the enactment of the Jumpstart Our Business Startups Act of 2012 (JOBS Act) relaxed the regulatory burdens of smaller companies in raising capital by introducing registration exemption under the Securities Act, thereby allowing issuers sell unregistered securities to the public. The JOBS Act provided an avenue for small startup businesses that may not have access to traditional capital markets and venture capital fundraising to raise capital.

The basic underlying idea behind Crowdfunding is raising funds from many persons for the execution of a project, investment, or venture. Its exact origin cannot be identified. Early use of the crowdfunding model is traced to 18th century Poet Alexander Pope who, with a desire to fund his work of translating Greek poetry into English, asked the Greek people for assistance in return for their being acknowledged in the publication<sup>4</sup>. Mention has also been made of the New York World Newspaper’s \$101,091 fund, raised from about 160,000 persons utilised for the building of the Statue of Liberty<sup>5</sup>.

The British rock band Marillion is touted to have laid the foundation of modern crowdfunding. In 1996, Marillion was about to cancel a US tour due to lack of funds, and in response to this, fans came together through an internet-based platform to contribute \$60,000 to ensure the success of the tour<sup>6</sup>.

Despite crowdfunding’s enthusiastic reception globally, a significant challenge that has hurdled crowdfunding growth in many countries is the lack of robust regulatory support.

<sup>3</sup>Cryptocurrencies Explainer Video released via the International Monetary Fund Twitter Handle on 25th August, 2020

<sup>4</sup>“12 Key Moments in the History of Crowd Funding (so far)” - <https://medium.com/@ImpactGuru/12-key-moments-in-the-history-of-crowdfunding-so-far-3f614273d95>.

<sup>5</sup>The Statue of Liberty and America’s Crowdfunding Pioneer - <https://www.bbc.com/news/magazine-21932675>

<sup>6</sup>Rich Wilson, Pledge Pioneers: How Marillion invented crowdfunding

In some countries, setting-up a crowdfunding platform or raising funds for business via crowdfunding unavoidably breaches specific laws (especially investment and securities laws), thereby limiting its exploitation.

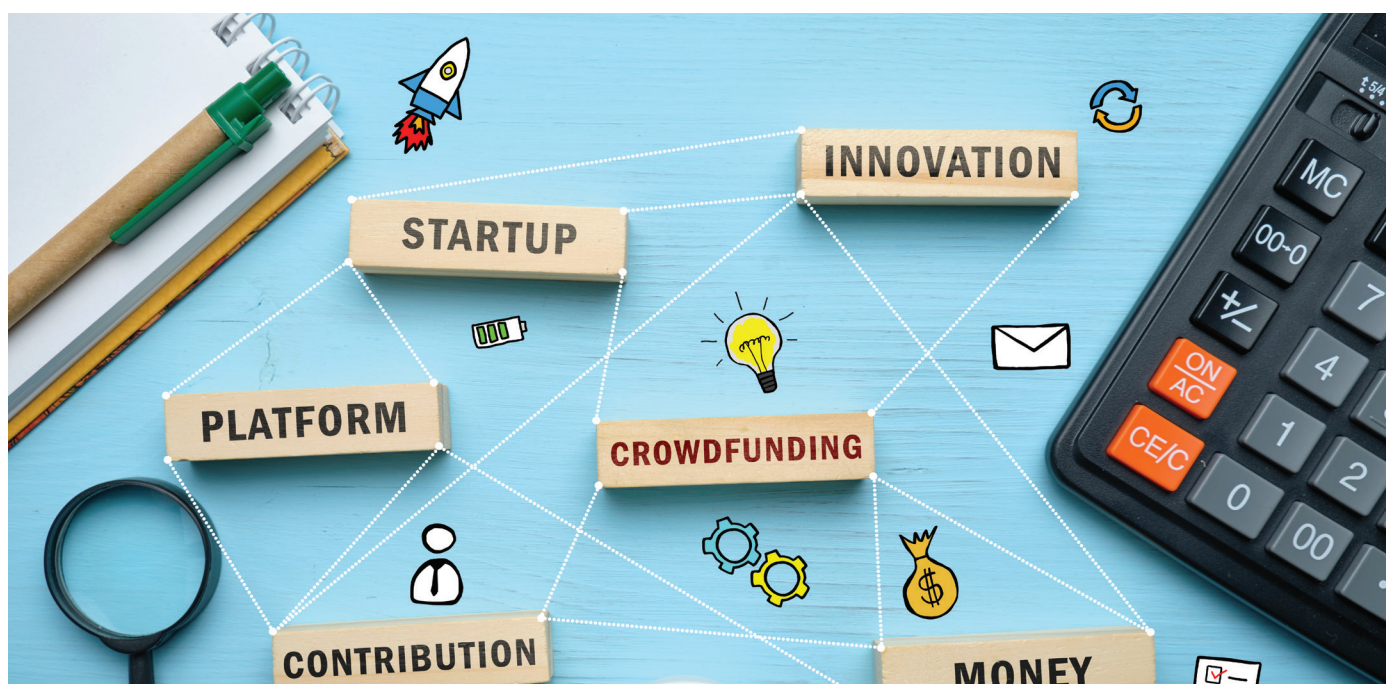
This work's focal point is to examine the concept of crowdfunding, understand the approach adopted in certain jurisdictions towards domesticating its operation and review the Nigerian position on Crowdfunding.

## WHAT IS CROWDFUNDING?

Crowdfunding is an innovative means of sourcing funds for organizations. It involves raising funds from a large number of persons, usually referred to as the "crowd". The distinctive feature of crowdfunding is that the funds are raised through an internet-based portal (Crowdfunding Portal).

Crowdfunding envisages that if a large number of persons each provide little monetary contributions for a particular venture or project, then the aggregate of such sums will result in a substantial amount of money, capable of meeting the funding need of the Crowdfunder. It also serves as a viable alternative to traditional fundraising options.

The Global Crowdfunding Market was Valued at 10.2 Billion US\$ in 2018 and is forecasted to hit a \$96 billion by 2025. However, Crowdfunding for Nigerian entrepreneurs is still at its nascent stage, and its slow growth is attributed mainly to the initial lack of regulation.



<sup>7</sup> Global Crowdfunding Market Size, Status and Forecast 2019-2025 by QYresearch

<sup>8</sup> A 2013 World Bank report on Crowdfunding Potential for the Developing World



## TYPES OF CROWDFUNDING

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### Reward driven crowdfunding

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Under reward-driven crowdfunding, contributors identify a particular project or venture in which they intend to contribute token amounts of money (via an online platform) for its actualization, in exchange for a reward. This reward may be a direct product/result of the target project or any other stated reward. This type of crowdfunding is mostly used for non-financial benefits<sup>9</sup>.

An excellent example of reward-driven crowdfunding portals is Kickstarter and Indiegogo.

### Charity driven crowdfunding

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For charity-driven crowdfunding, contributors donate varying amounts of money to execute a charitable or not-for-profit objective or project. There is no expectation of a reward or any repayment in the form of dividend or interest, save for the beneficiaries, organisers, and other well-wishers' gratitude. Just like its name, Charity driven crowdfunding, is simply for charity.

The GoFundMe and Crowdrise platforms are good examples of charity-driven crowdfunding platforms. Charity driven crowdfunding can be utilised for causes such as; medical bills, school/tuition fees, sponsorship of athletes and sportspeople, and charitable visits. In 2017, the Nigerian women bobsled team raised \$75,000 (Seventy-Five Thousand Dollars) on the Gofundme crowdfunding portal to enable them to attend the 2018 Winter Olympics Games in PyeongChang, South Korea.

### Equity crowdfunding

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Equity Crowdfunding is a popular type of crowdfunding option amongst entrepreneurs and startups. Under equity-crowdfunding, contributors are regarded as investors who contribute varying amounts of money each to form a pool of capital, to be invested in the Crowdfunder's business, not for a reward or charity, but in expectation of obtaining equity stake (shares or stocks) in the organisation or a good return for investment<sup>10</sup>.

<sup>9</sup> Different types of crowdfunding and how they work? <https://fundcrowder.com/different-types-of-crowdfunding-and-how-they-work/>

<sup>10</sup> The Four types of crowdfunding? <https://crowdfundinglegalhub.com/2014/04/27/test-3/>

## Debt crowdfunding

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A company may desire to raise money from the crowd in the form of a debt to be repaid in agreed instalments during a moratorium of years, without offering ownership stakes in the company to the investors. This is debt crowdfunding. This form of crowdfunding is specially useful where the cost of borrowing from commercial banks and the attendant interest rates are not business-friendly<sup>11</sup>.

To put it simply, in debt crowdfunding, investors do not get any reward or equity stake in the company for their investment; instead, they make a loan with the expectation that the principal sum will be repaid with agreed interest. Debt crowdfunding can raise money for many reasons, such as raising capital for business, purchasing assets, refinancing loans, and financing personal needs.

## CROWDFUNDING IN NIGERIA

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With a population of over 180 million people, Nigeria, a major developing country in Africa, is numerically advantaged to make the most of crowdfunding, as Nigerian crowd-funders have a large pool of people to reach out to for their fundraising campaigns.

Data from the National Bureau of Statistics (NBS) states that Nigeria has an estimated number of 37,067,416 MSMEs, 99.8% of which constitute micro-enterprises. Unfortunately, the MSMEs in Nigeria have grappled perennially with the challenges of funding, amongst other business constraints. There is no doubt that "access to fund" is of critical importance to entrepreneurs' entrepreneurs.

Prior to crowdfunding regulation in Nigeria, there were some legal and regulatory hurdles to raise capital through crowdfunding in Nigeria successfully. During this period, capital raising was governed mainly by the Companies and Allied Matters Act (CAMA) and the Investment and Securities Act (ISA). The CAMA and ISA limited the rights to raise capital from the public to only public companies<sup>12</sup>. The ISA further provides that securities offered by a company must be registered with the SEC, and any portal where such securities are to be traded by the public shall also be registered as a Capital Trade Point.

The requirement of CAMA and the ISA appeared to be cumbersome for small businesses

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<sup>11</sup> *ibid*

<sup>12</sup> Section 22 (5) of CAMA and Section 67 (1) of the ISA.

seeking to raise capital for their respective businesses. They were either running their business under a business name or as private companies. Despite this, several entrepreneurs successfully utilised the crowdfunding model to raise capital for their businesses, while a couple of crowdfunding portals also began operations in Nigeria.



## SECURITIES AND EXCHANGE COMMISSION PROPOSED RULES ON CROWDFUNDING

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On 28th March 2020, the SEC published the exposure draft of the Proposed Crowdfunding Rules and Regulations for the comments and input of the public and later re-exposed the same in September 2020 (the "Proposed Rules"). A study of the Proposed Rules reveals the intention of the Commission to regulate investment-based crowdfunding in Nigeria.

The Proposed Rules defines crowdfunding as the process of raising funds to finance a project or a business through an online electronic platform. An entity raising funds through a crowdfunding portal is referred to as a Fundraiser, while those contributing via the funds via the portal are referred to as Investors.

Who Can Raise Funds Through Crowdfunding?

All Micro, Small, and Medium Scale Enterprises (MSMEs) incorporated in Nigeria with a minimum of two (2) years' operating track record are eligible to raise funds through a crowdfunding portal. According to the Proposed Rules, Micro, Small and Medium enterprises shall be as prescribed by the Small and Medium Enterprises Development Agency of Nigeria (SMEDAN) in relation to total asset and annual turnover or number of Employees.

SMEDAN, in its National Policy on Micro, Small, and Medium Scale Enterprises, defines MSMEs with the following criteria.

S/N	Size Category	Employment	Assets (N Million) excluding land and buildings)
1	Micro enterprises	Less than 10	(Less than 5
2	Small enterprises	10 – 49	5 – less than 50
3	Medium enterprises	50 – 199	50 – less than 500

From the above definition of MSMEs by SMEDAN, only companies with assets and turnover below N500 million and less than 199 employees can raise capital via crowdfunding and vice versa.

### ***Duties of Fundraisers***

1. Fundraisers are required to file standardized offering documents for any fundraising round with the intermediary and make the same available to investors through the portal before entering into an investment agreement.
2. The offering document shall not be posted on any other website apart from the crowdfunding portal.
3. The offering document shall state all risks associated with the investment without mitigants.
4. Investors shall have the right to withdraw any offer or agreement to purchase the securities or investment instruments up to 48 hours before the close of the offer.
5. Fundraisers shall continue to make ongoing disclosures during the lifetime of the investors' investments.

### ***What can be offered in exchange for the funds?***

Under the proposed rules, Fundraisers will be able to raise funds from the public in exchange for investment instruments approved by the Commission. Investment Instruments that can be issued through a crowdfunding portal include ordinary shares, plain vanilla bonds or debentures, and simple investment contracts approved by the Commission from time to time. A Simple Investment Contract is defined under the Proposed Rules as a contract or scheme for placing capital or in a way intended to secure income or profit from its employment. It includes participation in any profit-sharing agreement under which:



- The investors provide the capital;
- The promoters manage, control and/or operate the enterprise; and
- The investors share in the earnings and profits.

### ***Where can crowdfunding be carried out?***

Under the proposed rules, crowdfunding can only be carried out on an online portal registered with the Commission as a crowdfunding portal. An entity will be considered to be facilitating, operating, maintaining, or providing a crowdfunding portal in Nigeria if: (i) the portal is operated, provided, or maintained in Nigeria; or (ii) the portal is located outside Nigeria but actively targets investors in Nigeria; or (iii) the component parts of the platform when taken together are physically located in Nigeria even if any of its component parts, in isolation, is located outside Nigeria.

Furthermore, a Crowdfunding Portal located outside Nigeria will be considered as actively targeting Investors in Nigeria if the operator, or the operator's representative, promotes the portal in Nigeria directly or indirectly.

### ***Who can register and operate a crowdfunding portal?***

A Crowdfunding Portal can only be registered or operated by an entity registered with the Commission to facilitate transactions involving the offer or sale of securities or investment through an online electronic platform (Crowdfunding Intermediary).

As part of the requirement of registering as a Crowdfunding Intermediary, an applicant is required to provide evidence of having a minimum paid-up capital of N100,000,000 (One Hundred Million Naira), a current Fidelity Insurance Bond valued at a minimum of 20% of the paid-up capital and a The cash assets ratio shall be a minimum of 30% liquid assets and 70% fixed and other assets amongst other requirements.





**General Duties of a Crowdfunding Intermediary:**

1. Duty to make relevant Disclosures to the Commission.
2. Duty to conduct necessary Due Diligence on prospective Fundraisers.
3. Duty to Monitor and Report (Monthly and quarterly reports) its activities and that of the Fundraisers to the Commission.
4. Duty to observe the Data Protection and Privacy matrix contained in the Proposed Rules.
5. Duty to set up and operate of a Trust Account for holding funds raised in an issue, before transfer.
6. Duty to publish Warning Statements to investors.
7. Duty to keep Records.
8. Where the minimum threshold is not reached at the end of an offer, the Crowdfunding Intermediary shall effect a refund to all investors within 48 hours.

**Aggregate Limit of Fundraising**

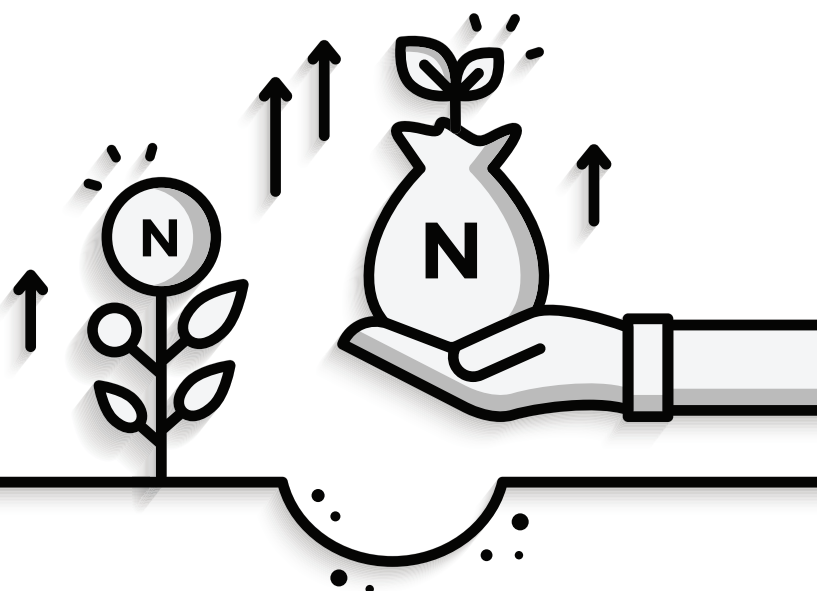
Crowdfunding is chiefly structured to assist MSMEs (as Fundraisers) seeking to raise financing from the public, with instruments that can be offered and sold by the Fundraiser through an online electronic platform.

The Proposed Rules has set out the following '12-months period' fundraising limits for Fundraisers seeking to raise funds through crowdfunding in Nigeria:

- N100 Million for Medium Enterprises;
- N70 Million for Small Enterprises; and
- N50 Million for Micro Enterprises.

These restrictions, however, do not apply to commodities investment platforms.

The Proposed Rules also places limits on the amount of money an investor can invest in investment-based crowdfunding within a 12-month period, based on the category of investors the investor belongs to. The Proposed Rule provides that:



- Retail investors (i.e. any investor other than a High Net worth, Sophisticated Investor, or Qualified Institutional Investor) may not invest more than 10% of their annual income in a calendar year.
- Sophisticated, High Net worth and Qualified Institutional Investors are not subject to the limits set forth above.

Furthermore, after a careful study of the Proposed Rules, it is advisable for SEC to consider the following modifications to the Proposed Rules to capture the interest of all existing and interested players better:

- a. As practiced in the United States of America, investor's investment limits and disclosure requirements should be determined by the Fundraisers category. Retail Investors should be allowed to invest a higher percentage of their annual income in medium enterprises than are allowed to invest in small and micro-enterprises. Similarly, the medium enterprises' disclosure requirements should be higher than that of the small and micro-enterprises.
- b. The financial and operational requirements for owning and operating a crowdfunding portal under the Proposed Rules appears to be quite excessive and should be reviewed downwards to accommodate more participants, especially existing portal operators who currently run crowdfunding portals as MSMEs.
- c. The mandatory requirement for trustees and/or custodians as additional operators in the crowdfunding market will increase crowdfunding costs in Nigeria. The Fundraisers/crowdfunding portals can have the funds raised, paid into a separate account held in a Bank, with a standing order that the funds are not to be released to the Fundraisers until all the stated and agreed conditions are met.

## CROWDFUNDING IN OTHER JURISDICTIONS

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The world's reaction to crowdfunding has been diverse, with each jurisdiction responding to its development in different ways. Faced with the expanding frontiers of crowdfunding, the United States of America in 2012 enacted the Jumpstart Our Business Start-ups Act to support startups ("JOBS Act"). The JOBS Act's combination with the final rules on equity crowdfunding under Title II and Title III provided a legislative permit for the operation of equity crowdfunding in the country, albeit adequately regulated.

### ***Features of the JOBS Act and the crowdfunding regulations:***

- The legal reforms require all transactions under the crowdfunding regulation to take place online through a SEC-registered intermediary, either a broker-dealer or a funding portal;
- It permits a company to raise a maximum aggregate amount of \$1,070,000 through crowdfunding offerings within a 12-month period;
- limits the amount individual investors can invest across all crowdfunding offerings in a 12-month period; and
- Fundraising companies are exempted from preparing prospectus document, but they need to file with SEC and disclose to investors the business information in the form of an offering statement, including capital structure, directors and officers, business plan and risks, intended fund usage, and financial statements
- The final rules also require a Crowdfunding portal to be registered with the Commission and become a member of a national securities association (currently FINRA)

In the UK, The Financial Conduct Authority (FCA) describes the Loan Based Crowdfunding and Investment Based crowdfunding as regulated transactions requiring the FCA's authorization for its operationalization. In regulating their activities, the FCA did not enact a new Act, instead, the FCA fine-tuned its existing investment and securities framework to accommodate crowdfunding. The amended rules were effective from 1st April 2014. Italy was one of the first European countries to issue a bespoke crowdfunding regulation in 2012.

The Corporations Amendment (Crowd-sourced Funding) Act, 2017, was enacted to amend the Corporations Act 2001 in Australia. The Crowd-Sourced Funding Act also amends certain parts of the Australian Securities and Investments Commission Act 2001 to provide crowdfunding regulation in Australia. The entire amendments intend to secure the reduction of the regulatory requirements for raising funds from the public in equity while ensuring appropriate investor protection measures.

In several developing countries, such as Rwanda, Ghana, Kenya, etc., there are no regulations for equity crowdfunding, and activities in that spaces are quite suboptimal.



In India, the Securities and Exchange Board has declared equity crowdfunding illegal in the country.

## CONCLUSION

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Having recognised the enormous potential embedded in crowdfunding, we believe the Nigerian Government is now moving in the right direction by taking this fundraising model more seriously.

With a fast-growing technology, Nigeria's financial services and entertainment sector is in dire need of capital for growth, and crowdfunding will undoubtedly assist in plugging the staggering capital deficit. Several individuals and entities in these sectors can utilise their personal and team reputation to raise funds from the Nigerian public to fund their new Apps developments, music/movie productions, and innovative technology solutions.

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