FUNDING FOR START-UPS IN NIGERIA: UNDERSTANDING THE CONCEPT AND LEGALITY OF CROWDFUNDING

By

Adetayo Adetuyi, LLM

Senior Consultant, Brooks & Knights Legal Consultants

And

Nnanke Williams, LLM

Senior Consultant, Brooks & Knights Legal Consultants[1]

1. Introduction

Raising the required finance for a business especially start-ups is usually somewhat of a conundrum. This is because the conventional means of raising finance are not without their own challenges – whether from family and friends which may be unpredictable, bank loans which are fraught with high interest rates, loans from cooperative societies, or personal savings. The quest for ease of access to finance by utilising the internet (and bringing the start-up owner close to the potential investor) has led to the concept of crowdfunding, which refers to a practice of raising money from a large number of people who each contribute a relatively small amount. All of this is done via the internet. Although crowdfunding is well legislated in many advanced countries of the world such as the United States, Canada and New Zealand, it remains largely unregulated in Nigeria. This article therefore intends to revisit the concept of crowdfunding and discuss its legality within the Nigerian legal system.

2. What is Crowdfunding?

Crowdfunding can be defined in several ways. Generally, it is a method by which individuals or companies raise funds online from the general public to finance a company or a particular project.[2] It may also be described as a process of raising funds in the hope of turning "promising ideals" into "business realities" by connecting investees to potential investors.[3] In the lay man's language, it can simply be explained as a situation where the crowd (many people) fund (pool resources for) a project for a return on investment.

---

[1] **Brooks & Knights Legal Consultants (BKLC)** is a law firm established in Lagos, Nigeria to provide bespoke legal advisory and policy consulting services to individuals, corporates, government agencies and NGOs.

[2] Some popular websites for crowdfunding include: Kickstarter, Indiegogo, RocketHub, GoFundMe, Crowdrise, PledgeMusic and CrowdFunder to name just a few; and there now appears to be a crowdfunding initiative for diverse areas of business.

[3] Piotr Pazowski, Economic Prospects and Conditions of Crowdfunding, Management, Knowledge and Learning, International Conference, 2014. available at https://ideas.repec.org/s/tkp/mklp14.html, accessed on 3 July 2019.

The history of crowdfunding is said to date as far back as 1700.[4] However, crowdfunding in its modern state (taking advantage of the internet) is said to date only as far back as 1997 while the term, "crowdfunding" was recorded to be first used in 2006 by Michael Sullivan.[5] In its modern form, crowdfunding usually takes place on a website platform that allows businesses or individuals to raise money, and investors to provide the money.[6]

For an investment scheme to be classified as crowdfunding, from the definition above, there are some elements that must be present:

(a) It must take place on a website platform; and

(b) It must be an offer to the general public to finance the company on a particular project, business or venture.

3. What are the various types of Crowdfunding?

Understanding the concept of crowdfunding requires a discussion of the various types of crowdfunding. Four types of crowdfunding have been identified depending on what the person making the contribution is expecting in return.[7] The types of crowdfunding are as follows:

(a) Donation based crowdfunding – This is a type of crowdfunding where people contributing persons (i.e. the crowd) give money or other resources to the person or entity running the crowdfunding campaign usually as a form of charity and with no expectation of a reward. Example of donation-based crowdfunding is contributing to a charitable cause using the GoFundMe platform.

(b) Rewards based crowdfunding – Under this type of crowdfunding, contributing persons contribute to the project with the expectation of obtaining a reward usually non-financial benefits.[8] An example of reward based crowdfunding is donating to an artist's music tour where those who contribute are guaranteed a free ticket to the event or receive the assurance of obtaining a free gift.

(c) Debt based crowdfunding – A debt-based crowdfunding is as the name suggests. Here, contributing persons usually contribute to the campaign or project with the belief that they will be paid back as their contribution is seen as some sort of loan to the project.

---

4 A Brief History of Crowdfunding. Retrieved from https://www.startups.com/library/expert-advice /history-of-crowdfunding and accessed on 09 January 2020.

5 In 2006, Micheal Sullivan coined the actual term, "crowdfunding." He was an entrepreneur looking for backers to help fund his video-blog project. Although Sullivan's project failed, the term "crowdfunding" was born.

6 Obtained from https://uk.practicallaw.thomsonreuters.com/ and accessed on 09 January 2019.

7 Anthony J. Zeoli (2014) The 4 Types of Crowdfunding. Retrieved from https://crowdfundinglegalhub.com/2014/04/27/test-3 and accessed on 09 January 2020.

8 Crowdfunding: Types of crowdfunding. Retrieved from https://www.nibusinessinfo.co.uk/content/types-crowdfunding

Thus, the person running the campaign is essentially asking to borrow money from multiple persons with the promise that they will be paid back usually at a lower interest rate than the banks provide.[9] This type of crowdfunding is popular with entrepreneurs who don't want to give up any equity in their business.[10]

(d) Equity based crowdfunding - Equity based crowdfunding is the opposite of debt-based crowdfunding. Under equity-based crowdfunding, the contributing persons are invited to contribute funds to the project for a stake in the business, usually shares. Contributors therefore become shareholders of the company and are assured of returns eventually in the form of dividend. Should the company do well, a contributor (now a shareholder) stands to make profit. Equity based crowdfunding is big in the United States which passed the Jumpstart Our Business Startups (**JOBS**) Act in April 2012.

This article will examine below, the legality of equity and debt-based crowdfunding as an alternative to traditional funding by investors as both donations and rewards-based crowdfunding are less about investment. Thus, the term "crowdfunding", shall for the later part of this article, refer to both equity and debt-based crowdfunding.

4. Is it lawful to carry on the business of crowdfunding in Nigeria?

Even though crowdfunding is gaining traction in other jurisdictions outside Nigeria, the case appears to be different in Nigeria. Section 67 of the Investment and Securities Act provides as follows:

"67 (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) a public company, whether quoted or unquoted, and the provisions of sections 73 to 87 of this Act are duly complied with; or

(b) 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:

Provided that nothing in this subsection shall render unlawful the sale of any shares by or under the supervision of any court or tribunal as may be authorised by law.

(2) If an invitation to the public is made in breach of subsection (1) of this section, all persons making the invitation and every officer who is in default or anybody corporate making the invitation shall each be separately liable to a penalty of ₦500,000 in the case of a body

9 Anthony J. Zeoli (2014) The 4 Types of Crowdfunding. Retrieved from https://crowdfundinglegalhub.com/2014/04/27/test-3 and accessed on 09 January 2020.

10 *id*.

corporate and ₦100,000 in the case of an individual."

From the above, it can be deduced that it is only a company registered as a public company or a statutory body empowered to accept savings and deposits that can invite the public to deposit money with it. Thus, where a company is not a public company and is not a statutory body or bank empowered to accept deposits and savings, such entity is prohibited from engaging in the business of crowdfunding.

On the other hand, it is interesting to note the definition of collective investment scheme by the Investment and Securities Act (**ISA**). The ISA defines collective investment scheme as "*a scheme in whatever form, including an open-ended investment company, in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which- (a) two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; (b) the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis determined in the deed, but not a collective investment scheme authorised by any other Act."*[11]

It can be argued that crowdfunding investment is a scheme in pursuance of which the members of the public are invited or permitted to invest money and in terms of which two or more investors contribute money or other assets to and hold a participatory interest. However, section 159 of the ISA goes on to define who can engage in the business of collective investment scheme. Section 159 of the ISA provides that:

"159 (1) <u>No person may, unless registered as a manager under this Act, include in or have as part of the name of its business or in any description of his business any reference to a collective investment scheme, open ended investment company, unit trust or real estate investment and no person who is not registered as a manager or trustee or custodian under this Act may perform any act calculated to lead the public to believe that any business carried on by such person consists of or is connected with the administration of a collective investment scheme</u>."

In fact, section 159(2) goes ahead to stipulate that acting in contravention of section 159(1) above is an offence and anyone in breach of that subsection is liable to a fine. This means that where an entity is not registered as a manager or a trustee or a custodian, such entity cannot engage in the business of collective investment neither can the crowdfunding business be classified as a collective investment scheme unless it is registered by the Securities and Exchange Commission (**SEC**) as a collective investment scheme.

The provisions of the Companies and Allied Matters Act (**CAMA**) appear to be more direct in prohibiting the business of crowdfunding as it is stated in section 22 (5)(b) of the CAMA that "*a private company shall not, unless authorised by law, invite the public to (a) subscribe for any shares or debentures of the company; or (b) deposit money for fixed periods or payable at call, whether or not bearing interest."*

[11] Section 315 of the Investment and Securities Act, 2007.

From the reading of the provisions of CAMA and the ISA, it appears that a private company can only be authorised by law to invite the public to deposit money for fixed periods or payable at call, when such private company had converted to a public company and therefore able to issue prospectus in accordance with the provisions of the ISA.

5. Can an advertisement via a website be an invitation to the public?

The Investment and Securities Act explains what an invitation to the public means. Section 69 of the ISA states as follows:

69 (1) For the purposes of this Act, an invitation shall be deemed to be an invitation to the public if it is an offer or invitation to make an offer which is:

(a) published, advertised or disseminated by newspaper, broadcasting, cinematograph or any other means whatsoever;
(b) made to or circulated among any persons whether selected as members or as debenture holders of the company concerned or as clients of the persons making or circulating the invitation or in any other manner;
(c) made to anyone or more persons upon the terms that the person or persons to whom it is made may renounce or assign the benefit of the offer or invitation or any of the securities to be obtained under it in favour of any other person or persons; (d) made to any one or more persons to acquire any securities dealt in by a securities exchange or capital trade point or in respect of which the invitation states that an application has been or shall be made for permission to deal in those securities on a securities exchange or capital trade point.

(2) Nothing contained in this section shall be taken as requiring any invitation to be treated as an invitation to the public if it can properly be regarded in all circumstances as not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation, or otherwise as being a domestic concern of the persons making and receiving it.

(3) For the purpose of this section, the issuance of any form of application for securities or of any form whatsoever to be completed on the deposit of money with a company shall be deemed to be an invitation to acquire those shares or to deposit money. (Emphasis ours).

A number of things can be deduced from the provision of the ISA above:

(a) Advertisement via a website is an invitation to the public; and

(b) The issuance of an application form for deposit of money is deemed to be an invitation to deposit money.

6. Conclusion

Equity and debt-based crowdfunding have been seen as an alternative to the traditional ways of raising funds. In order for Nigeria to continue to fulfil the mandate of its Ease of Doing Business campaign, it is important for regulators to take an urgent look at enacting regulations and guidelines that will govern and provide adequately for the crowdfunding space in order to enable private companies have easier access to finance than they currently have.