

EXPLORING CROWDFUNDING AS AN ALTERNATIVE MEANS OF FINANCING ENTREPRENEURIAL VENTURES IN NIGERIA

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Abstract

Governments all over the world have identified the importance of entrepreneurship in economic development and in the improvement of the standard of living of the people, hence the increased effort to support and encourage them by tweaking their regulatory frameworks to accommodate such financing innovations as crowdfunding. This paper examined an innovative new model of providing funding to projects and businesses. The paper adopted a conceptual view to explore the drivers and challenges of crowdfunding as an alternative means of entrepreneurial financing in Nigeria. Based on the conceptual, empirical and theoretical review, it was discovered that the major drivers of the substantial growth in the crowdfunding space worldwide is the growth and development of information and communication technology, especially the internet which has facilitated the use of social media for just anything. This is because crowdfunding uses web-based technology to drive financing of entrepreneurial ventures such that Nigeria and other African countries could leverage the power of technology especially the social media to market ideas, and raise seed and growth capital. It was also discovered that, despite the huge potential of crowdfunding as an alternative means of financing entrepreneurial ventures globally, the African continent and indeed Nigeria have not fully keyed into it due to a lack of a clear regulatory framework. Therefore, a clear legal and regulatory framework is necessary for the much-needed growth and development of crowdfunding as alternative means of financing entrepreneurial activities in Africa and in Nigeria in particular.

Keywords: Crowdfunding, Entrepreneurial Financing, Drivers, Inhibitors, Conceptual Model

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INTRODUCTION

Governments all over the world have identified the importance of entrepreneurship in economic development and in the improvement of the standard of living of the people, hence the increased effort to support and encourage them. Funding is critical to the growth and development of entrepreneurship, crowdfunding which is the use of internet platforms to pool funds from the crowd is an innovation in entrepreneurial financing. However, despite the global rising popularity of crowdfunding as an alternative means of financing for entrepreneurial businesses, its operation is being inhibited by the lack of appropriate infrastructure, legal and regulated framework in Nigeria. Entrepreneurship has been identified as the practice of starting new organization or revitalizing mature ones in response to perceived opportunities. Typically an entrepreneur spots an opportunity and takes action to make it into a commercial success (Priestley, 2013). However, financing is a major challenge that most entrepreneur experience globally. According to the African Development Bank Group (2015), the challenge of access to financing is further heightened by many deep-rooted issues some of

which have to do with the operational environment in addition to a lack of depth in the financial market. Before the advent of the modern-day system of entrepreneurial financing in Nigeria, there had been traditional or indigenous methods that dates as far back as the 16th century. Contributory thrifting saving schemes served as a voluntary association of people that come together to put their money together for the purpose of either starting new businesses, expanding existing ones, or for other economic and social purposes. (Peak2018, Oluwole2014)

The contributory thrifting savings scheme has most of the characteristics/features of modern-day crowdfunding except that it is not technologically driven. In the various ethno-cultural Nigerian setup, it goes by different names, the Yoruba ethnic group call it Ajo, Hausa, Adashi, Igbo, Isusu, Nupe, dashi and osusu in the Ogoja axis. (Oluwole2014). Peaking (2018) posited that most contributory thrifting savings schemes started as a rotating work association in which labor was aggregated and allocated to one member at a time to help in farm work but was later replaced by money. This has evolved to the different forms that we have it today in the various ethnolinguistic groups across Nigeria.

However, unlike the modern-day crowdfunding in which people donate through a platform, the ajo, esusu or issue is done among a group of people with a common goal of pooling resources together. Over the years, this has grown to become a widespread indigenous system whereby colleagues in the same office, and members of the same trade or community come together to put in an agreed amount of money each month and at the end of every month, one person in the group takes all the money put together for that month and thus it rotates until each member in the group has benefited. The arrangement is such that the group will choose one person in the group to coordinate the contributions and hand them over to the person who is next in line and thus ensuring orderliness and discipline. Otto and Upkene (2011) noted that most contributory thrift savings schemes existed to provide access to funds at critical moments by making it easier for people especially the low-income group to save and obtain credit without meeting the stiff and stringent condition of the commercial banks and other financial institutions.

However, the success or otherwise of contributory thrift savings schemes is hinged on the trust of the individuals that make up the group. From this brief background, crowdfunding cannot be entirely said to be new to Nigeria's entrepreneurial financing space, however, the dynamism with which it has evolved is worthy of note. the only change or difference is that crowdfunding uses a more structured approach to pool or collect small amounts from the public (the crowd) to fund projects or get a business off the ground. (Gulati, 2014).

Earlier studies show that funding is critical to the growth and development of entrepreneurial ventures, crowdfunding which is the use of internet platforms to raise a small amount of money from a large number of individuals is an innovation in entrepreneurial financing (Berndt, 2017; Mollick, 2014). Mollick (2014) defined crowdfunding, "as the efforts by entrepreneurial individuals and groups-cultural, social and for-profit- to fund their ventures by drawing on a relatively large number of individuals using the internet, without standard financial intermediaries" The crowdfunding market is growing at an exponential speed. According to Research and Market (2016), the global crowdfunding market has been forecasted to grow at about 20% per year from 2016-2020. However, Africa and indeed Nigeria is yet to tap into this alternative means of financing as a result of a regulatory bottleneck

Literature Review

Concept of Crowdfunding

The concept of crowdfunding came from the broader concept of crowdsourcing, which uses the 'crowd' to obtain ideas, feedback and solutions in order to develop activities. In the case of crowdfunding, the objective is –also –to collect money from the crowd who can often participate in strategic decisions or even have voting rights in a business. The Securities and Exchange Commission Nigeria (SEC) in its recent rules defined crowdfunding as the process of raising funds to finance a project or business from the public through an online platform. There are four distinguishable models of crowdfunding that provide varied types of returns to the crowd funders – individual who invest in it. (Mollick 2014; Massolution, 2015)

Donation-based crowdfunding: is the most popular model used to raise non-equity capital rather than the sale of securities for creative projects or charity causes. Typically, the crowd funders donate funds without expecting any return. Sometimes though donations are used to support early-stage company or product innovation and in return the crowd funders get early access to the product or service. (UNDP, 2017; Berndt 2017; Worldbank 2013).

Equity crowdfunding is a new and emerging model of crowdfunding that enable crowd funders to purchase equity in a company. According to UNDP (2017), equity-based crowdfunding could reach up to US\$ 36 billion by 2020 with the potential to overtake venture capital by value. Operationally entrepreneurs desirous of using equity-based crowdfunding platforms post offerings on campaign pages and through social media to invite investors to review their offerings and indicate their willingness to invest. (Worldbank 2013; Massolution 2017)

Reward/presales-based crowdfunding is gradually evolving into a marketplace of its own. Crowd funders invest with the expectation of reward which may be in the form of a token gift of appreciation or the pre-purchase of a service or product. Mostly used by start-up companies to raise money to launch new products or services. (Berndt 2017; UNDP 2017; Worldbank 2013)

Loan or Lending – based crowdfunding otherwise known as Peer-to-Peer (P2P) or Peer to Business (P2B) is an arrangement in which multiple lenders lend small sums of money that pays a fixed rate of interest and returns principal at a stipulated time.

Operation of crowdfunding

Crowdfunding as a method of entrepreneurial financing makes it possible to get funders' knowledge, creativity, opinion, and direct participation in a project. Berndt & Mbassana (2017) noted that the entrepreneur wishing to raise financing for a particular project would first decide on the type of crowdfunding that would be suitable for the intended project as well as the applicable fees. Subsequently, a campaign would be launched on the chosen platform like Kickstarter. The campaign enables crowd funders to critically assess the project in order to take an informed decision on whether to invest in the project or not. Once the crowd funders make their decision, they put out their money and usually the campaign is open for a period of time, after which the money collected would be paid to the entrepreneur excluding operational costs. Project lenders typically appraise and choose from a variety of platforms of company and contrasting competing features and services.

The main steps in a crowdfunding Campaign

According Onnee and Renault (2016), the following are the major steps in crowdfunding campaign

- i. An entrepreneurial venture contacts a crowdfunding platform to raise fund from the general public online to turn promising idea into business realities or for business expansion purposes.
- ii. If approved, the project campaign is launched online for crowd funders' buy-in.
- iii. Some people in the crowd pledge money to support the venture/project
- iv. Based on the platform's operating procedures; the venture campaigner may or may not attain the targeted amount as a prerequisite for collecting the money.
- v. If the campaign is successful, the pledged amounts are debited from the backers account while the platform collects its commission.

Implication for Shareholder Structures and Performance

In crowdfunding, shareholder structures may vary. One possibility is a direct shareholder structure wherein each crowd investor becomes a direct shareholder of the firm he or she funds. Another possibility is the nominee structure wherein the crowd is represented by one legal shareholder (i.e. the nominee) who holds the shares on behalf of the crowd investors. (Collings, 2015) While some equity crowdfunding platforms use a nominee structure, others use a direct shareholder structure. It is widely accepted in the corporate governance literature that concentrated ownership—associated with a nominee structure—reduces agency costs and, as such, results in improved firm performance (Cumming & Zhang, 2018)

This positive effect is mainly due to more efficient monitoring: higher ownership concentration makes it easier to act collectively because one has more incentive and power to monitor management. Moreover, as there are simply fewer owners to coordinate with, high ownership concentrations are associated with lower coordination costs (Brav, 2009). This paper believes that a similar argument holds in crowdfunding and hence that ECF firms financed through a nominee structure should outperform ECF firms financed through a direct shareholder structure.

Exploring crowdfunding for entrepreneurial financing in Nigeria

Crowdfunding is increasingly becoming a very veritable means of financing entrepreneurial ventures in most developed economies, especially after the 2008 global financial crisis (World Bank, 2013)

According to Global Entrepreneurship Research Association, (2017), entrepreneurial financing has evolved considerably in recent times – although many of the previous traditional options such as business angels, microfinance and business accelerators are still emerging. Crowdfunding has emerged as a very popular alternative for entrepreneurial financing and Nigeria cannot afford to be left out. Typically, crowdfunding enables entrepreneurs to raise or pool small amounts of money from many investors through online platforms or the Internet to support their businesses. Nigeria with its large population stands to gain from this innovative model of raising funding for innovative projects and services. (Berndt, 2016; African Development Bank Group, 2015; Worldbank 2013)

Currently, there are a number of crowdfunding platforms in Nigeria but as is the case with most other counties in Africa, they are mainly donation and reward-based platforms which typically do not come under regulatory purview. These include:

- i. Imeela– is used to raise funding for creative projects, non-profits and businesses.
- ii. Najiafund – is a platform to raise money for personal causes
- iii. Fundmie – purely charity fundraising platform

- iv. Gogetfunding – is used to raise funds for personal causes, events and projects
- v. Donate-ng Blog – for charity and social causes
- vi. Village – is an education platform for students in secondary and university
- vii. Quickraiz is used to raise funding for emergency/disaster support, medical funding, political fundraising, alumni association contribution, and religious and other funding.

A review of review of the regulatory landscape in some forward-looking countries in Africa and some developed countries.

South Africa

There is no specific regulation of crowdfunding in South Africa, typically a person desiring to offer crowdfunding services by whatever means would have to engage with the financial services board (FSB) to ensure that they are going to operate within the existing regulations. However, for equity-based crowdfunding platforms, the platforms are licensed in line with section 7 of the Financial Advisory and Intermediary Services Act No 37 of 2002.

This is because platforms are seen as offers for securities to be issued to the public in line with section 95 of South African Companies Act 2008. In this regards the platform would be required to be a public company bound by the general governance requirements of disclosure, financial reporting and auditing applicable to public companies (Cambridge Centre for Alternative Financing 2017). This notwithstanding, donation-based crowdfunding accounted for the total sum of \$10.4 raised in 2015 and \$4.1 million raised in the first quarter of 2016.

Kenya

Equally, Kenya does not have existing legislation that regulates donation, rewards and loan or equity-based crowdfunding. According to the Cambridge Centre for Alternative Finance Report, 2017 the crowdfunding space could come under existing relevant regulations in the Kenya financial system – the Communications Authority and the Central Bank of Kenya without necessarily coming under new regulations. It is interesting to note that donation crowdfunding accounted for two-thirds of part of the \$ 8.5 million raised in the first quarter of 2016, the report further asserted.

Rwanda

Interestingly, Rwanda has been tipped as one of the African countries that have implemented the highest number of business reforms in the past 15 years, with a whopping number of fifty –two (52) reforms, Rwanda ranked forty-one (41) in the global ease of doing business. (CNBC Africa 2017). The sum of \$ 3.5 million was raised in 2015 from donation crowdfunding and other non-financial return-based models but equity and reward-based crowdfunding are yet to emerge. (CCAF2017).

Uganda

Like most other countries in Africa, Uganda has no specific provision for the regulation of crowdfunding especially equity and loan-based crowdfunding. In any case, donation and reward crowdfunding which often come outside most financial regulation was used to raise a whopping sum of \$7.5 million in 2015 and an additional \$ 4.5 million in the 1st quarter of 2015. (CCAF 2017).

Malaysia

In 2014, Malaysia became the first ASEAN country (Association of Southeast Asian Nations) to provide a regulatory framework for the regulation of equity-based crowdfunding in that region. The

Malaysian Securities Commission started with a stakeholder dialogue which culminated in the passing of the capital markets and securities bill 2015.

The regulatory framework, made a far-reaching provision for the authorization of equity –based platforms as well as some restrictions. There were also various requirements for loan –based crowdfunding that seek to outline the duties and responsibilities of the platforms, types of issuance as well as the classes of investors that could participate. As of 2016 a total of six equity platforms have been licensed but donation crowdfunding still accounts for the majority of the market activity, (CCAF 2017)

United States of America

The United States of America (USA) used the Jumpstart our business startups (JOBS) Act of 2012 to open up a new pool of investment capital through equity crowdfunding. What the JOBS Act 2012 seek to do was to create exemptions that allow issuing businesses to raise funds online by selling securities, but with an ongoing reporting requirement that both issuers and platforms must comply with to maintain good standing with the regulators. Donation and reward crowdfunding is unregulated except for the prohibition on fraud and false advertising that is applicable to all commercial transactions. In addition, a fundraising company cannot raise more than \$1.07 Million through a crowdfunding platform within a 12-month period likewise an investor cannot invest more than \$107,000 in crowdfunding within the same 12 months period. Furthermore, fundraisers are not permitted to issue prospectus and the investors are at liberty to withdraw from the investment. (US SEC 2016)

United Kingdom

The Financial Conduct Authority (FCA) amended the Financial Services Market Act 2000 to permit investments to be made directly or indirectly into new or established businesses by buying shares or debt securities on crowdfunding platforms. However, crowdfunding platforms must be authorized and businesses desiring to use the platforms to raise funds must issue a prospectus while firms issuing securities must provide clear and fair information as the FCA considers investments in unlisted securities to be high-risk. Donation and reward-based crowdfunding are exempted from this regulatory regime. (FCA2015)

Drivers of crowdfunding

Crowdfunding has been identified as a multi-billion-dollar global industry. What started first in Australia as a crowdfunding movement has now spread across the globe, especially in more developed countries like the United Kingdom, the United States of America, Europe and Asia. (Worldbank 2013). Wisse-Huiskes, (2017) noted that with a fast-growing population of 170 million, great social media usage and a great network of family and friends the future of crowdfunding in Nigeria seems promising.

Also, the entrepreneurial scene is expanding; with about 84% of the population being active on the Internet and the banking system is seen to be moving ahead of its counterparts in other emerging markets she further asserted. Furthermore, crowdfunding is tipped to be a good alternative for small projects and entrepreneurs that are scattered across the length and breadth of Nigeria. This is because it helps to eliminate the human factor in the assessment of loans generally.

It has also been discovered that the major drivers of the substantial growth in the crowdfunding space

worldwide are the growth and development of information and communication technology, especially the internet which has facilitated the use of social media for just anything. This is because crowdfunding uses web-based technology to drive financing of entrepreneurial ventures such that Nigeria and other African countries could leverage the power of technology especially social media to market ideas, and raise seed and growth capital. (World Bank 2013).

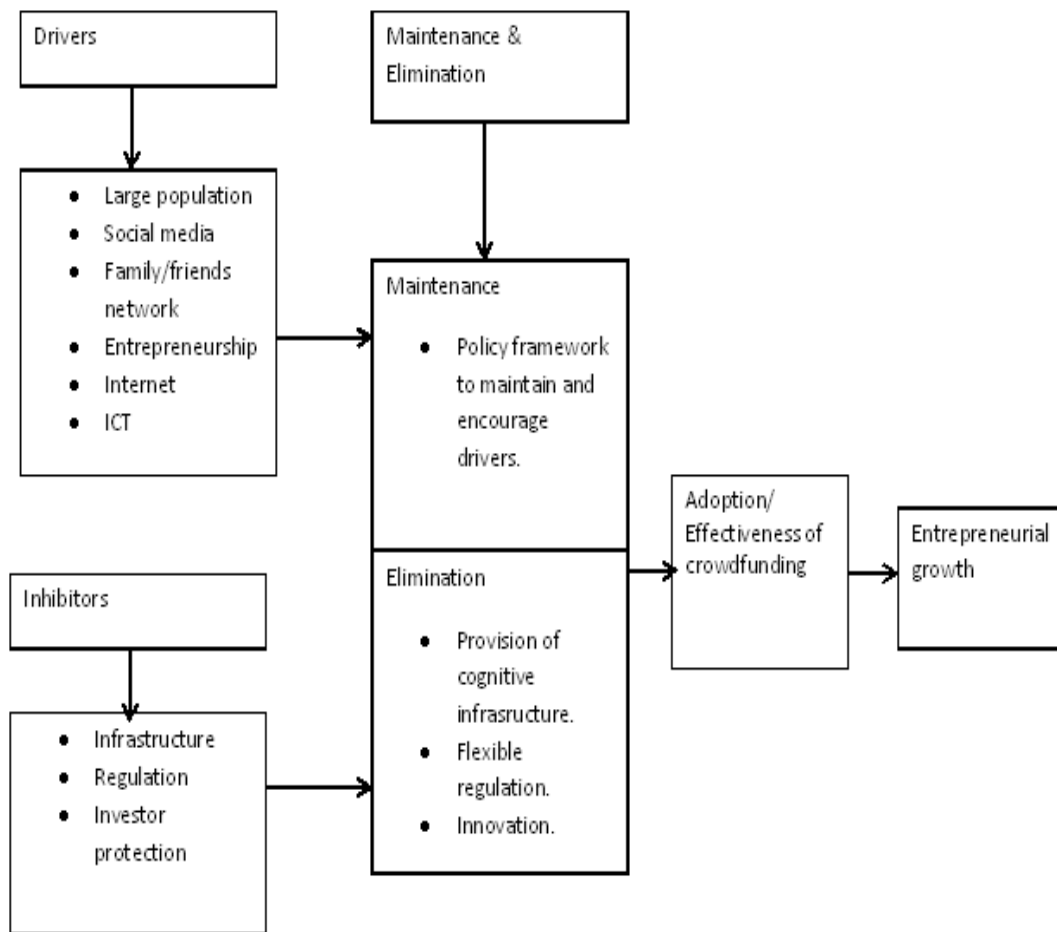
Crowdfunding in Nigeria.

However, despite the huge potential of crowdfunding as an alternative means of financing entrepreneurial ventures globally, the African continent and indeed Nigeria have not fully keyed into it (African Development Bank 2015). In other more forward-looking economies, entrepreneurs and cash-strapped startups are increasingly turning to crowdfunding for the financing needed for their businesses.

According to Afrikstart, 2016, Africa has less than 1% of total crowdsourcing platforms with about only 0.5% of total crowdsourcing campaigns in the world. Statista Market Forecast, 2018 shows that the total value of the global transaction in crowdfunding in 2018 amounted to US\$9.370m with China having the highest transaction value of US\$7,477m. Followed by the United States US\$1.041.3m, the United Kingdom US\$156.3m, Japan US\$94.0m and France US\$93.2m and no mention was made of the African continent. The major impediment to crowdfunding in Africa is regulation. A clear legal and regulatory framework is necessary for the much-needed growth and development of crowdfunding as alternative means of financing entrepreneurial activities in Africa, especially Nigeria. Nigeria has been battling recession for the past few years and what other way to stimulate the economy for productivity than to encourage the development of enterprise activities through modern innovative alternative financing such as crowdfunding? This will pool the idle funds in the system as well as attract funds from citizens in the diaspora to productive sectors of the economy. (African Development Bank Group 2017, World Bank 2013). Quartz Africa, 2016 stated in its recent report on the situation of crowdfunding in Africa that crowdfunding in Africa raised \$32.5m for different projects in 2015. However, despite the global rising popularity of crowdfunding as an alternative financing for entrepreneurial businesses, its operation is being inhibited by lack of appropriate infrastructure, legal and regulating framework, the report further asserted.

World Bank (2013) suggested that some of the major challenges to the use of crowdfunding to finance entrepreneurial projects in most developing countries could be attributable to overburdened investor regulation/protection, focus on saving face and overly burdensome hiring and firing mechanisms. Moving forward, the Securities and Exchange Commission Nigeria recently released rules for the registration and operation of crowdfunding platforms in Nigeria. The following instruments were approved for issuance through crowdfunding portals; shares, plain vanilla bonds or debentures, and simple contract. All Micro, Small and Medium Enterprises with a minimum of two years track record would be eligible to raise funds through a crowdfunding portal registered by the commission (SEC 2020)

Conceptual Model of Drivers and Inhibitors of Crowdfunding for entrepreneurial funding in Nigeria



Methodology

The study used an exploratory research design, according to which the related literature in the area of business administration, accounting, finance and relating to the subject matter has been reviewed, conclusion Drawn and made a suggestion

Discussion

Financing is a major challenge that most entrepreneur experience and in most developed countries the emergence of alternative innovative means of financing have helped to alleviate the problem. However, emerging countries like Nigeria are still struggling with adopting appropriate regulatory framework that would aid its operation. From the review of literature, on crowdfunding as an alternative financing for entrepreneurs, it is imperative to note that Nigeria is yet to put together policy and regulatory framework that would aid its operation. The worldbank (2013) noted that for crowdfunding to be effectively and successfully used in countries like Nigeria:

- i. There is need for a regulatory environment which facilitates the development of technological innovations.
- ii. Online market place that not only makes investment possible, but also educates those interested to invest.
- iii. The use of social media to foster investment.

- iv. Collaboration with those involved in building entrepreneurship such as training and development agencies.

Conclusion.

The potential for using crowdfunding for entrepreneurial financing is still limited in Nigeria, Funding is critical to the growth and development of entrepreneurship, and crowdfunding which is the use of internet platforms to pool available funds is an innovation in entrepreneurial financing. Crowdfunding help to launch new products, and grow and scale existing businesses by pooling small contributions from small groups of people who share common interests making it possible for everyone to achieve financial goals.

However, despite the global rising popularity of crowdfunding as alternative financing for entrepreneurial businesses, its operation is being inhibited by a lack of appropriate infrastructure, and legal and regulated framework in Nigeria.

Recommendation

- i. The global financial landscape is continually evolving and countries need to catch up to reap the benefits from new innovative funding sources for rapid economic development. Nigeria is Africa's largest economy and home to millions of young entrepreneurs desirous of doing things to improve their standard of living, therefore the need for an enabling environment that encourages enterprising spirit.
- ii. The US SEC through the JOB Act 2012 revisited and reviewed the general prohibition Act against "General Solicitation and General advertising" in their rule 506 and 144A offering to make it possible for crowdfunding to come on board. The Nigerian regulatory authorities should borrow a leaf from other counties that have crafted rules to accommodate crowdfunding as an alternative means of entrepreneurial financing.
- iii. The regulatory landscape in Nigeria should seek to embrace currents trends. In as much as regulation is for investor protection and to prevent exploitation, there should be flexibility and innovation in the laws as the Holy book says "Law is made for men and not men for law"

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