Social Sciences Journal of Policy Review and Development Strategies | **SSJPRDS**
p-ISSN: 2488-9636 | e-ISSN: 2488-9628
Volume 6, Number1 August, 2024

Assessment of Equity Crowdfunding as an Alternative Source of Finance for Small and Medium Enterprises (SMEs) in Nigeria

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Article DOI: 10.48028/iiprds/ssjprds.v6.i1.18

Abstract

The development of alternative finance, notably crowdfunding, has drastically changed the fundraising landscape for small and medium-sized firms (SMEs), especially in developing economies like Nigeria. This paper explores the current situation of equity crowdfunding in Nigeria, identifying significant platforms and measuring their influence on entrepreneurial activities. Utilising a structured questionnaire, data were collected from a specific sample of respondents to evaluate their awareness and experiences with equity crowdfunding. The data suggest a low degree of awareness (24%) of crowdfunding among the respondents, underscoring the need for more education and confidence-building in Nigeria-orientated platforms. Furthermore, the report underlines the problems faced by the Nigerian crowdfunding business, including insufficient digital literacy, weak regulatory frameworks, and cultural biases favouring traditional investment techniques. By drawing parallels with successful crowdfunding models in other developing nations, this research highlights the necessity of stable regulatory systems and investor education in building a conducive atmosphere for equity crowdfunding. The findings collected from this study contribute to the broader conversation on alternative finance and provide a framework for future research and policy development aimed at boosting the entrepreneurial ecosystem in Nigeria.

Keywords: *Equity crowdfunding, Finance and Alternative source*

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Background to the Study

The term "alternative finance market" refers to capital-raising operations away from the traditional capital markets, banks, and established financial intermediaries. This industry has completely changed the landscape of conventional fundraising. Following the credit crunch over the past ten years, the alternative finance market has primarily grown through a wide range of cutting-edge products leveraging artificial intelligence technologies and online channels (Yasar, 2021). Technology in the supply of financial services is rapidly changing how credit is sourced globally in today's financial markets. The interaction of finance and information technology has given birth to new financial services and enhanced old ones while simultaneously making offering and obtaining financial services much more accessible for individuals and enterprises than previously (Oguama, 2020). To address their funding needs during the COVID-19 pandemic, SMEs extensively used online alternative finance through debt and capital-raising channels. The extensive use of these channels led to considerable variations in transaction volumes compared to the period preceding the pandemic. According to the Cambridge Centre for Alternative Finance, crowdfunding sites raised USD 51.6 billion for SMEs in 2020, up from USD 32.8 billion in 2019 (OECD, 2023). Crowdfunding is taking on a project or business that requires financing and soliciting contributions from many people (Aladejebi, 2020). Adekoya (2019) further noted that crowdfunding, with the aid of the Internet, is an emerging financing innovation available to entrepreneurs and other trustworthy entrepreneurs of creative business ideas to source cash to finance projects or ingenious ideas for negotiated rewards. Crowdfunding has gained popularity recently due to its ability to connect entrepreneurs with potential investors worldwide. This innovative financing method has opened up new opportunities for individuals who may have previously struggled to secure traditional funding from banks or venture capitalists. Additionally, crowdfunding platforms often provide a space for entrepreneurs to showcase their ideas and gain valuable feedback from the crowd, further enhancing the collaborative nature of this funding model.

Equity crowdfunding (ECF) is a method for businesses to get finance in exchange for their shares (Butticè et al., 2021). Entrepreneurs use equity crowdfunding platforms to launch an open call to sell a set amount of their equity shares through platforms where investors join to get a financial return (Butticè & Vismara, 2021). According to Coakley et al. (2021), the leading platforms of this type of crowdfunding bring together three shareholder structures: the first is that the platform's post-campaign role as an intermediary is minimal, so the startup communicates directly with its investors, who are the legal owners; the second is that the platform, as legal owner, acts on behalf of all the investors who are the beneficial owners; and the third is the co-investment or lead investor model. In entrepreneurial finance, digital platforms offer a new mechanism for entrepreneurs to access equity, debt, and non-dilutive capital through crowdfunding (Bruton et al., 2015). Equity crowdfunding has emerged as a market for entrepreneurs in which they can raise funds from their close network, which includes family, friends, customers, and present shareholders, as well as from a large number of investors in exchange for an equity stake in the business (Ralcheva and Roosenboom, 2019). Mollick (2014), in his research on reward-based crowdfunding, defines it as numerous entrepreneurial individuals and groups using the Internet to support their projects by drawing on small contributions from a large number of people. According to Block et al. (2018), crowdfunding is a new means in the global arena that assists entrepreneurs in overcoming their obstacles to raising financing. Crowdfunding platforms enable entrepreneurs and firms to engage large pools of backers and investors, connect with various people, and increase funding from the crowd rather than from (few) professional investors such as venture capitalists (VCs) and private equity (PE) investment funds (Belleflamme et al., 2014; Mollick, 2014; Vismara, 2016, 2018).

Small and medium-sized enterprises (SMEs) are an essential driver of economic development and are critical to most economies worldwide, particularly in developing and emerging economies. They account for 99% of all enterprises in the European Union (EU) and have created approximately 85% of new jobs in the last five years, accounting for two-thirds of total private sector activity in the region (Gherghina et al., 2020). The relative importance of small and medium-sized enterprises in advanced and emerging countries has led to, and will continue to, a rethink of the role of SMEs in national economies. Many countries' development is frequently measured by indices such as industrialisation, modernisation, urbanisation, gainful and meaningful employment for all those who are able and willing to work, income per capita, equitable distribution of income, and citizen welfare and quality of life (Aremu & Adeyemi, 2011). Most business activities are conducted by small and medium-sized firms (SMEs), which is essential for financial growth (Kijkasiwat, 2021; Kim & Nguyen, 2021; Lin et al., 2020; Wang et al., 2020). Because of its growing importance in creating assets, facilitating employment opportunities, alleviating poverty, and adding to GDP (Bremus & Neugebauer, 2018a; Lin et al., 2020; Wang et al., 2020), the SME sector has attracted a lot of attention around the world. SMEs account for over 90% of all enterprises and more than 50% of all job possibilities worldwide. Formal SMEs account for up to 40% of GDP in emerging economies (World Bank Report, 2020). When informal SMEs are included, the figures are significantly higher. Small and medium-sized enterprises (SMEs) create the most formal jobs, accounting for seven of ten jobs in developing nations (World Bank Report, 2020). As a result, SMEs are commonly considered a critical driver of economic growth in many countries, particularly emerging ones (Wellalage & Fernandez, 2019).

Furthermore, because SMEs usually confront a shortage of operating cash flow in the marketplace, access to funding is critical for their survival and development. According to IFC research, developing nations are home to between 365 and 445 million enterprises, with over 85% of these businesses having financing constraints (Waked, 2016). As a result, governments, scholars, entrepreneurs, and other stakeholders are focusing on SMEs' access to reliable financing and a favourable environment in which to thrive and flourish (Moscalu et al., 2019). Any business requires money to get started, grow, and thrive. Financing constraints impede operational efficiency and corporate expansion (Dowling et al., 2019; Kijkasiwat, 2021; Wellalage & Fernandez, 2019). Even if SMEs have potentially lucrative investment possibilities, they may lack the finances to explore them; this is referred to as the "finance gap" (Fouejieu et al., 2020). According to a classification based on specific business characteristics and financial demands, financial constraints limit organisational productivity in various ways. For starters, financially constrained organisations forego beneficial investment opportunities, particularly continuing investment programmes that increase efficiency (Kim & Nguyen, 2021). As a company's financial situation worsens, access to external capital becomes more complex, borrowing costs rise, and the company is forced to make fixed investments with internal funds. Second, liquidity risks are heightened as a result of financial constraints. The most significant source of liquidity risk is the uncertainty of the transition from solid deposits to cash flow (Yu & Fu, 2021). The financial problem is undoubtedly significant, particularly in establishing and surviving micro, small, and medium-scale enterprises. In the wake of this crisis, the pressure developed on administrators to empower and find better access to capital for SMEs, and a large group of elective sources began to fill the void. However, as these alternative sources of finance grow, so will the competition between them to back promising ventures. Therefore, there is a need to assess the newer types of early-stage financing, such as equity crowdfunding, with the traditional SME financing methods.

Literature Review

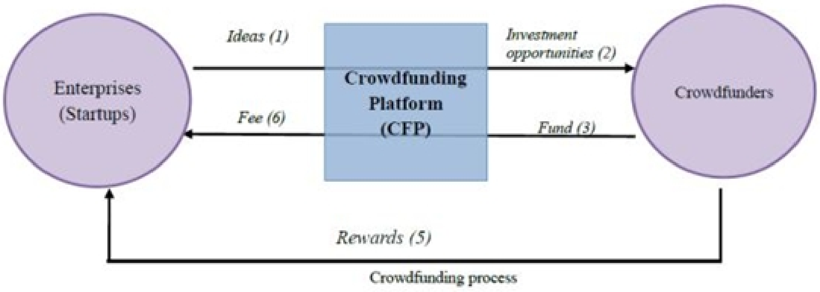
The use of the Internet and the appearance of online platforms have revolutionised communication between human beings. This revolution has allowed new financing alternatives, such as crowdfunding platforms, to be available to entrepreneurs and their innovative products. In recent years, crowdfunding platforms have gained notoriety among capital-constrained entrepreneurs and small investors (Martínez-Climent et al., 2020; Reza-Gharehbagh et al., 2021). Digital financing sources such as crowdfunding platforms reduce information access costs and facilitate communication between entrepreneurs and investors (Meoli & Vismara, 2021). Some traditional sources for financing new projects are business angels, venture capital, and private equity investors (Butticè & Vismara, 2021; Coakley et al., 2021). These traditional sources of financing often require a high level of due diligence and may be more difficult for capital-constrained entrepreneurs and small investors to access. However, crowdfunding platforms provide a more accessible and inclusive alternative, allowing more individuals to participate in the funding process.

These platforms can also offer benefits such as increased visibility and exposure for entrepreneurs seeking funding for their projects. Crowdfunding is a method of raising capital in small amounts from a large group of investors without traditional financial intermediaries, but usually with the help of a platform (Allon & Babich, 2020; Chan et al., 2020; Tiberius & Hauptmeijer, 2021). One of the characteristics of this method is the democratisation of financing, allowing all types of entrepreneurs to take advantage of opportunities to enhance their products (Gafni et al., 2021). This democratisation of funding has led to a significant increase in crowdfunding platforms catering to various industries and projects (Hornuf & Schwienbacher, 2018). These platforms provide a convenient and accessible way for entrepreneurs to showcase their ideas and attract potential investors worldwide (Belleflamme et al., 2014). It is important to emphasise that small investors can benefit from crowdfunding platforms by finding more opportunities to generate financial returns during low deposit rates (Tiberius & Hauptmeijer, 2021), helping reduce the risks associated with investment decisions. As for entrepreneurs, the advantages are multiple since the interaction on the crowdfunding platforms allows for obtaining feedback by taking advantage of the collective skills and knowledge of the investors, which can help them develop their products or services before they are launched on the market (Troise & Tani, 2020). In this financing alternative, financiers (sponsors, donors, and investors) and recipients (entrepreneurs, creators, and companies) interact with crowdfunding platforms (Allon & Babich, 2020; Ryu & Suh, 2020). In this interaction and for the campaigns to be successful, certain aspects such as quality, creativity, and even the linguistic style used can be decisive (Ryu et al., 2020; Defazio et al., 2021).

Furthermore, crowdfunding campaigns often rely on effective marketing strategies and persuasive storytelling to attract potential backers (Kuppuswamy & Bayus, 2018). Additionally, the success of a crowdfunding campaign can also depend on the trust and credibility established between the project creators and potential backers (Mollick, 2014). For Troise et al. (2020), the actors of these platforms must take into account the following: entrepreneurs must improve the quality of the campaigns and their dissemination through the different social networks; investors must analyse the previous experience of entrepreneurs in the industry and the efforts of companies in product innovation since this enhances the growth of their shares; and platform administrators must work so that entrepreneurs provide quality information to improve the experience. It is critical to stress that small investors can significantly benefit from crowdfunding platforms by discovering more options to create financial returns during low deposit rates (Tiberius & Hauptmeijer, 2021), lowering the risks connected with investment selections. Entrepreneurs benefit from the interaction on crowdfunding platforms because it allows them to obtain feedback by leveraging the collective skills and knowledge of the investors, which can help them develop their products or services before they are launched on the market (Troise & Tani, 2020). Financiers (sponsors, contributors, and investors) and recipients (entrepreneurs, creators, and companies) interact with crowdfunding platforms in this financing option (Allon & Babich, 2020; Ryu & Suh, 2020). Specific characteristics, such as quality, innovation, and even the linguistic style utilised, might be essential in this interaction and for the campaigns to be effective (Ryu et al., 2020; Defazio et al., 2021).

Furthermore, to attract potential backers, crowdfunding projects frequently rely on solid marketing methods and persuasive narratives (Kuppuswamy & Bayus, 2018). Moreover, the trust and credibility built between project creators and potential backers might influence the success of a crowdfunding campaign (Mollick, 2014). According to Troise et al. (2020), the actors of these platforms must consider the following: entrepreneurs must improve the quality of the campaigns and their dissemination through the various social networks; investors must analyse the previous experience of entrepreneurs in the industry and the efforts of companies in product innovation, as this increases the growth of their shares; and platform administrators must work to ensure that entrepreneurs provide quality in the campaigns.

Fig 1: A framework of the crowdfunding process (adapted from Valančienė & Jegelevičiūtė, 2014)



In Nigeria's financial landscape, equity crowdfunding is a relatively new concept. Unlike other types of crowdsourcing, such as donation-based, reward-based, and lending-based crowdfunding, equity crowdfunding includes individuals donating their money in exchange for equity or ownership holdings in a company project (Aladejebi, 2020). While equity crowdfunding still expands in Nigeria, other forms have evolved and gained support. Donation-based crowdfunding platforms like GoFundMe and Donate-ng are well-established in Nigeria. These platforms allow individuals or organisations to raise funds for specific causes, projects, or personal needs without offering equity in return. This model has gained popularity because it appeals to Nigerians' inherent generosity and community spirit and efficiently mobilises resources for charitable purposes (Akwaowo et al., 2020). Individuals can support a project or product through reward-based crowdfunding sites such as Kickstarter and Indiegogo in exchange for non-equity prizes such as early access to the product, unique experiences, or merchandise. While reward-based crowdfunding is still relatively new in Nigeria, this model has gained traction in Nigeria as it provides tangible benefits to backers, making it a more attractive option for potential supporters (Statista, 2023). Lending-based crowdfunding systems, often peer-to-peer lending, connect borrowers with lenders directly, bypassing traditional financial intermediaries such as banks. Lending-based crowdfunding is gaining traction in Nigeria, owing to websites such as Paylater, Renmoney, and QuickCheck. These platforms use technology and data analytics to give people and small businesses easy access to loans. Because of the country's massive informal sector and limited access to regular banking institutions, lending-based crowdfunding has grown in Nigeria.

Due to various factors, equity crowdfunding in Nigeria is still in its early stages. Nigeria's Securities and Exchange Commission (SEC) has only lately begun investigating rules to oversee equity crowdfunding. Because investors and entrepreneurs prefer a regulated environment that provides oversight, transparency, and investor protection, the lack of a comprehensive legal framework has hampered the growth and use of equity crowdfunding platforms (Aladejobi, 2020). Nigeria is still building an investing and risk-taking culture. Traditional money accumulation techniques, like savings accounts and real estate investments, are more familiar to many Nigerians. It will take time for people to be educated and encouraged to consider equity crowdfunding a viable investment choice (Techcabal, 2023). Building trust among potential investors is critical for equity crowdfunding success.

Many Nigerians remain suspicious of online investment platforms, and better knowledge and education on the benefits and hazards of equity crowdfunding may be required (Techcabal, 2023).

Despite these limitations, interest in equity crowdfunding is growing in Nigeria Farmcrowdy, a Nigerian agritech business that raised capital through equity crowdfunding. Monieworx, which has also raised over 100 million naira equity for SMEs, indicates the potential and appetite for crowdfunding investments. Equity crowdfunding has the potential to prosper in Nigeria as the regulatory environment improves and knowledge grows, complementing existing crowdfunding methods and giving new opportunities for both investors and businesses.

The market for equity crowdfunding in Nigeria is still very young, particularly in contrast to other African nations like South Africa and Kenya. For instance, increased levels of digital financial inclusion and more lucid regulatory standards in Kenya have benefited equity crowdfunding, allowing platforms such as M-Changa to flourish (Okoth, 2020). Similar to this, the development of equity crowdfunding platforms like Uprise.Africa has been aided by South Africa's strong fintech ecosystem and generally stable legal framework (Sibiya & Gumbo, 2019).

Beyond Africa, developing nations like India have shown success with equity crowdfunding, partly due to increased investor interest in digital businesses and government backing (Sridhar & Bhardwaj, 2020). On the other hand, Nigeria's market has more formidable obstacles, including a lack of digital literacy, underdeveloped legal systems, and deeply ingrained cultural biases for conventional investments (Ogunbiyi, 2021). These parallels highlight how crucial robust regulatory environments and investor education are to the development of prosperous equity crowdfunding platforms. Nigeria must work to increase digital literacy, establish clear legislation, and foster confidence before it can fully reap the benefits of equity crowdfunding.

Theoretical Framework

Introducing a new financing mechanism in the entrepreneurial ecosystem presents opportunities for entrepreneurship educators in classrooms and scholarship. Discussing theories can help frame discussions and generate future research on equity crowdfunding. Trust is a necessary component of all partnerships (Art. 48). Platforms for crowdsourcing are based on the Internet. Because project initiators and funders rarely meet, trust is essential. The act of transferring trust is critical. Trust can be defined in a variety of ways. The following is one broad definition: the expectation of an interaction partner's behaviour (Gabarino & Johnson, 1999; Morgan & Hun, 1994), whereas the other general term considers the psychological condition to comprising vulnerability acceptance and exposure (Rousseau, Sitkin, Burt, & Camerer, 1998; 1995; Mayer, Davis, and Schoorman). Trust requires benevolence, integrity, and ability. Urban, Amyx, and Lorenzon (2009) provide a definition. Crowdfunding is dependent on the online trust that has been established. The report of trust offered by Mayer, Davis, and Schoorman (1995) is widely accepted, which is a party's willingness to be vulnerable to the actions of another party based on the assumption that the other will make a particular effort required by the trustor, regardless of the ability to monitor or control that other party. Many situations necessitate trust. Labour-management connections, buyer-seller partnerships, and strategic relationship alliances include crowdfunding initiators and funders.

Personal knowledge of an individual's prior behaviour is required for trust (Lionel, Robert, Alan, & Yu-Ting, 2009). Trust develops over time due to an individual's cognitive judgement of another individual's behaviour (Lionel et al., 2009). Swift trust refers to high levels of initial trust. Swift trust is formed before interaction. Swift trust is based on collaborator traits rather than team member characteristics based on their behaviour (McKnight, Cummings, & Chervany, 1998). An early, rapid trust may be viewed as fragile (Bunker, 1996). Germain & McGuire (2014) opined that initial trust is a presumed trust in which collaborators who have yet to develop trust in their colleagues' abilities and integrity must set aside ambiguity to achieve the desired results. According to Xu, Feng, Wu, and Zhao (2007) and Germain and McGuire (2014), Swift trust is not possible on a social level; it is interactive but a precognitive trust based on action.

Methodology

The research employed an ex-post facto approach, concentrating on small and medium-sized firms (SMEs) in Lagos, Nigeria, that exploited equity crowdfunding platforms. Due to the restricted number of SMEs that have utilised equity crowdfunding during the study period, a purposive sampling strategy was implemented. This method was essential to precisely identify SMEs with pertinent experience in equity crowdfunding, a task challenging to accomplish by random sample techniques. This imposes certain constraints on generalisability, although it enabled the study to investigate the experiences of a crucial but limited set of individuals. Data were gathered with a standardised questionnaire constructed from extant research on equity crowdfunding and SME success. A pilot test was executed to verify the clarity and suitability of the questions. The questionnaire's reliability was evaluated using Cronbach's alpha, with all variables exhibiting a reliability coefficient beyond the 0.70 threshold, signifying robust internal consistency.

Results and Discussion

From the table below, respondents identified equity crowdfunding platforms that they were aware of, and the results showed that 58, 52, and 44 respondents recognised gofundme, quickraiz, and naturfund, respectively. The respondents also identified other equity crowdfunding platforms and all the equity crowdfunding platforms listed for the respondents in the questionnaire. The study found that the existence of Nigeria-oriented equity crowdfunding platforms has yet to make any significant impact on the promotion of crowdfunding for entrepreneurial activities. The reason may be the platforms' inability to build the needed confidence among the population. The study also found that crowdfunding awareness is shallow in Nigeria, with only 24% of the respondents reporting awareness of crowdfunding. The study suggested that crowdfunding is possible in Nigeria if people become more positive regarding the concept and have an attitudinal change. The study's findings indicate a need to create more awareness and encourage entrepreneurs to engage in equity crowdfunding schemes in Nigeria. The study also highlights the importance of building confidence in Nigeria-oriented equity crowdfunding platforms to promote crowdfunding for entrepreneurial activities.

Table 1: Analysis of Equity Crowdfunding Platform.

Equity Crowdfunding Platforms	Frequency	Percentage
Gofundme	58	20.8
Quickraiz	52	18.6
Naturfund	44	15.8
Fund an Enterprise	42	15.1
Monieworx	36	12.9
Farmcrowdy	29	10.4
Farmfunded	18	6.5

Source: Field Survey, 2023

Relationship between equity crowdfunding and the performance of SMEs in Nigeria

Multiple regression analysis was utilised to examine the relationship between equity crowdfunding and the performance of SMEs in Lagos. The results of the multiple regression analysis ($\beta = 0.453$; $R^2 = 0.432$; Adjusted $R^2 = 0.423$; t-value = 11.414; $p < 0.05$; $F = 22.278$) indicate that while equity crowdfunding has a positive impact on the sales turnover and profitability of SMEs, the Adjusted R^2 value suggests that other factors not included in this model explain 57% of the variance in SME performance. These findings highlight that equity crowdfunding is one of several mechanisms affecting the success of SMEs. Other variables, such as access to traditional financing, the regulatory environment, economic conditions, and financial literacy, are likely to play significant roles in shaping SME outcomes. Future research should consider incorporating these variables to provide a more comprehensive understanding of the factors influencing SME performance. The study also found that equity crowdfunding has a positive and significant relationship with the profitability of SMEs. The study's findings suggest that equity crowdfunding can be an effective source of financing for SMEs in Nigeria and can positively impact their performance. The study's findings also highlight the importance of promoting equity crowdfunding as a viable funding source for SMEs in Nigeria to enhance their growth and development.

Table 2: Regression Analysis of Hypothesis One

Hypothesis	Beta	Std. Dev.	Std. Error	R^2	Adjusted R^2	T	p-value	F
EC→Performance	0.453	0.58	0.513	0.432	0.423	11.414	.000	22.278

Source: Field Survey, 2023

Relationship Between Equity Crowdfunding and the Efficiency of SMEs in Nigeria

The study identified a positive but relatively weak correlation ($r = 0.492$) between equity crowdfunding and the efficiency of SMEs. While this suggests a relationship between the two variables, it is important to note that correlation does not imply causation. It is possible that more efficient SMEs are better positioned to access equity crowdfunding platforms, rather than equity crowdfunding directly causing improved efficiency. Additionally, other unmeasured factors, such as the size of the SME, industry sector, or the economic environment, may also contribute to this relationship. Future research could address these limitations by employing longitudinal data to track the impact of equity crowdfunding over time or by using quasi-experimental designs to better establish causal relationships.

Table 3: Pearson Correlation Coefficient***

		Equity Crowdfunding	Efficiency
Equity Crowdfunding	Pearson Correlation	1	.792**
	Sig. (2 tailed)		.000
	N	75	75
Efficiency	Pearson Correlation	.792**	1
	Sig. (2 tailed)	.000	
	N	75	75

Source: Field Survey, 2023

Conclusion

The study aimed to assess the impact of equity crowdfunding on the performance of SMEs in Nigeria. Given the limitations of the current study, future research should aim to include a broader range of variables that impact SME performance. Macroeconomic factors, regulatory policies, and internal SME dynamics such as management quality and financial literacy should be considered. To establish a more definitive causal link between equity crowdfunding and SME performance, future studies could employ longitudinal data to track SMEs over time, or use econometric techniques like instrumental variable regression to account for potential reverse causality and omitted variable bias. This would provide a clearer picture of how equity crowdfunding interacts with other factors to influence the performance of SMEs in Nigeria. The study recommends that SMEs in Nigeria consider equity crowdfunding a viable source of financing and utilise social network platforms to publicise their campaigns. The study also suggests that future research should explore other factors impacting SME efficiency and the potential benefits of equity crowdfunding in Nigeria.

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