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Equity Crowdfunding Economic Growth in African Countries: A Framework

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Abstract[1]

Small and medium-sized business in Africa, which are vital to the growth of emerging African economies, have extremely limited access to the capital needed to grow, resulting in a $330 million annual funding gap in sub-Saharan Africa alone. The nascent financial technology of equity crowdfunding has shown the potential to close this funding gap by allowing international investors to invest in these African small businesses. Although equity crowdfunding holds this promise, a number of obstacles must be overcome for such a system to succeed. Investment in startup companies is a speculative proposition anywhere; in developing economies like those in Africa, the risks are amplified significantly. Less information is available to investors, political risk can threaten returns, and fraud protections must be put in place to protect the investors. Therefore, a new crowdfunding-friendly regulatory regime that borrows the successful provisions from existing systems, combined with an international intermediary to implement and enforce the regime should be created to facilitate foreign investment through equity crowdfunding. This note examines the risks associated with such an investment vehicle and proposes a framework for necessary regulation and intermediary that would allow equity crowdfunding to grow the emerging economies of Africa.

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1. This Note was written prior to the outbreak of the COVID-19 pandemic, and due to unforeseen circumstances, its publication was delayed. Therefore, the effects of the global health crisis on the viability of equity crowdfunding will not be explored.

I. Introduction

Small and medium enterprises ("SMEs") are the lifeblood of the world economy. These firms, which typically employ fewer than 500 people (this number varies),[2] comprise about 90% of businesses in the world and account for more than half of global employment, according to the World Bank.[3] In developing economies, like those in Africa, though, these businesses are even more important, contributing up to 40% gross domestic product of these countries.[4] SMEs in developing economies are responsible for seven out of every ten jobs created, and these numbers do not even consider "informal" SMEs.[5] However, these SMEs, both formal and informal, face significant obstacles in obtaining

2. *Glossary of Statistical Terms: Small and Medium-Sized Enterprises (SMES)*, Org. for Econ. Co-operation & Dev. (Dec. 2, 2005), https://stats.oecd.org/glossary/detail.asp?ID=3123 [https://perma.cc/F25L-MTRM].

3. *Small and Medium Enterprises (SMEs) Finance*, World Bank Grp., https://www.worldbank.org/en/topic/smefinance [https://perma.cc/8ZRC-NJZB].

4. *Id.*

5. *Id.*

the funding they need to grow and become profitable. The International Finance Corporation estimates that, in developing countries, there is a $5.2 trillion gap between the demand for capital and the supply of capital amongst formal SMEs and a $2.9 trillion gap for informal SMEs.[6] In sub-Saharan Africa, alone, this gap exceeds $330 billion.[7] In total, 40% of all enterprises in the developing world are credit constrained.[8]

Closing this funding gap for SMEs is vital to economic growth in the developing countries of the African continent. Though startup investment in Africa is growing rapidly,[9] the businesses that need capital the most are still largely unable to obtain it. Equity-based crowdfunding has the potential to close this gap by opening the market to investors around the globe and increasing the visibility of innovative African businesses in the global market. However, there are significant hurdles that must be overcome for this to occur. This Note will discuss a hypothetical framework that would facilitate international equity crowdfunding investment into these African SMEs. This framework, though, is equally applicable to any emerging nation.

II. CURRENT STATE OF SME INVESTMENT IN AFRICA

In a developed economy, there are a number of ways SMEs can raise capital. Depending on the company's stage of growth, it could utilize venture or angel investment,[10] private equity,[11] bank debt,[12] or mezzanine debt,[13] to name a few. In 2018, companies in the United States raised over $140 billion in venture capital alone,[14] and this

6. MIRIAM BRUHN ET AL., MSME FINANCE GAP: ASSESSMENT OF THE SHORTFALLS AND OPPORTUNITIES IN FINANCING MICRO, SMALL AND MEDIUM ENTERPRISES IN EMERGING MARKETS IX (2017).

7. *Small and Medium Enterprises (SMEs) Finance*, *supra* note 3.

8. BRUHN ET AL., *supra* note 6, at X.

9. IKBEL ACHOUR ET AL., CHI. COUNCIL ON GLOB. AFFS., AFRICA IS NOW: THE OPPORTUNITY FOR MID-SIZED US COMPANIES 1 (2015).

10. LUCIA CUSMANO, ORG. FOR ECON. CO-OPERATION & DEV., NEW APPROACHES TO SME AND ENTREPRENEURSHIP FINANCING: BROADENING THE RANGE OF INSTRUMENTS 77, 86 (2015).

11. *Id.* at 74.

12. *Id.* at 31.

13. *Id.* at 66.

14. KPMG LLP, *Venture Capital Investment in the U.S. Increases to $34.2 Billion in Q4 2019, Pushing 2019 Total to $136.5 Billion—the Second Highest Yearly VC Investment on Record: KPMG Report*, PR NEWSWIRE: CISION (Jan. 15, 2020, 12:30 PM), https://www.prnewswire.com/news-releases/venture-capital-investment-in-the-us-increases-to-34-2-billion-in-

number remained steady in 2019, with $136.5 billion in venture investment.[15] Though the venture capital market in Africa is growing rapidly, the total venture expenditure on the continent was just $725 million in 2018[16] and $1.34 billion in 2019.[17] Though impressive, this year-over-year increase was due, mainly, to an uptick in the number of "big-ticket" investments of greater than $5 million that went to larger businesses that had already raised capital in the past.[18] This still leaves SMEs seeking their first investment largely unserved, as just 6% of the companies that received investment accounted for 83% of the total invested capital.[19]

The lack of traditional banking systems also disproportionally affects SMEs in the developing economies of Africa.[20] Even where traditional banks are available, many entrepreneurs distrust banks and instead favor cash or mobile payments and transfers.[21] By choosing not to use the banking system, entrepreneurs in Africa further exacerbate their funding problems: cash transactions do not create a financial track-record for the business, thus limiting the company's ability to acquire loans or insurance.[22]

Recently, a growing number of African SMEs have begun using crowdfunding to raise money. In 2015, there were over fifty-seven active crowdfunding platforms that raised more than $126.9 million for African businesses.[23] This increasing familiarity with this type of

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q4-2019--pushing-2019-total-to-136-5-billion-the-second-highest-yearly-vc-investment-on-record-kpmg-report-300987635.html [https://perma.cc/3GHS-2QBY].

15. *Id.*

16. Yomi Kazeem, *Startup Investment in Africa Jumped to Record Levels in 2018 as Later Stage Rounds Rose*, Quartz Afr. (Jan. 11, 2019), https://qz.com/africa/1520173/african-startups-funding-in-2018-broke-records/ [https://perma.cc/29VG-HH4X].

17. Toby Shapshak, *African Startups Raised $1.34 Billion in 2019*, Forbes (Jan. 7, 2020, 8:29 AM), https://www.forbes.com/sites/tobyshapshak/2020/01/07/african-startups-raised-134bn-in-2019/#57a0c4085685 [https://perma.cc/S8YG-XTDT].

18. Kazeem, *supra* note 16.

19. Shapshak, *supra* note 17.

20. *Africa: The Unbanked Continent*, Elixirr (June 9, 2017), https://www.elixirr.com/2017/06/africa-the-unbanked-continent/ [https://perma.cc/NA32-TMLS].

21. *Id.*

22. *Id.*

23. Andrea Ayemoba, *Crowdfunding Gains Momentum in Africa*, Afr. Bus. Cmtys. (Sept. 6, 2016, 3:18 PM), https://africabusinesscommunities.com/features/crowdfunding-gains-momentum-in-africa.html [https://perma.cc/CP7N-RUY4].

funding serves as the perfect backdrop for the implementation and expansion of equity crowdfunding on a large scale.

III. What Is Crowdfunding?

The term "crowdfunding" was first used in 2006 by Michael Sullivan, who attempted to fund his video blog using small donations from friends and acquaintances.[24] The concept, though, can be seen throughout history. In 1884, when the American Committee for the Statue of Liberty ran out of money to fund the construction of the statue's pedestal, Joseph Pulitzer launched a newspaper campaign calling on citizens to donate what they could to complete the project.[25] In six months, the campaign raised over $100,000 from more than 125,000 people.[26] As illustrated by this "capital raise," the term crowdfunding means "the use of small amounts of capital from a large number of individuals to finance a new business venture."[27] This process is facilitated by crowdfunding "platforms," which are websites that handle the logistics of the campaigns; vet the campaign proposals (with varying degrees of scrutiny); post the campaigns that pass the vetting process; and handle the transfer of money from the funders to the entity that launched the campaign.[28] The first platform appeared in 2003, when Brian Camelio launched ArtistShare[29] to help musicians raise money for production, and, since then, the number of platforms has grown to over one thousand platforms globally.[30]

24. Mark Koba, *You Hear Lots About Crowdfunding, But What Is It?*, CNBC (Oct. 23, 2013, 2:55 PM), https://www.cnbc.com/2013/10/23/crowdfunding-definition-from-cnbc.html [https://perma.cc/L55B-E9RM].

25. *Id.*

26. *Id.*

27. Tim Smith, *Crowdfunding*, Investopedia (May 15, 2021), https://www.investopedia.com/terms/c/crowdfunding.asp [https://perma.cc/4CV4-HXBK].

28. *See id.*

29. Harold Stark, *Rethink Marketing: How Crowdfunding Can Supercharge Your Campaign in 2016*, Forbes (Oct 26, 2016, 8:00 PM), https://www.forbes.com/sites/haroldstark/2016/10/26/how-crowdfunding-can-supercharge-your-campaign-in-2016/?sh=672c9da5276f [https://perma.cc/6QFD-YGDG].

30. Olga Okhrimenko, *8 Crowdfunding Trends You Need to Know in 2020*, JustCoded (Jan. 23, 2020), https://justcoded.com/blog/8-crowdfunding-trends-you-need-to-know/ [https://perma.cc/8J8E-D2U6].

A. Types of Crowdfunding

The mechanics of crowdfunding campaigns vary widely between platforms, but most can be categorized into four types: donation-based, rewards-based, lending-based, and equity-based crowdfunding.[31]

1. Donation-Based

As the name implies, donation-based crowdfunding is when a large pool of funders contribute money to a person, project, or cause with no expectation of material or financial return or reward.[32] This type of crowdfunding is typically used to fund social causes or charities,[33] but it is also often successfully used by individuals who have suffered a personal tragedy and hope to raise enough money to get through the hardship.[34]

2. Rewards-Based

Rewards-based crowdfunding has kicked off the crowdfunding "craze" of the last ten years.[35] Platforms such as Kickstarter[36] and Indiegogo[37] have popularized this form of investment in which funders contribute money to an entity so that the entity can bring some product or service to market.[38] Funders in rewards-based crowdfunding receive a reward commensurate with the amount of money they contributed (there are usually multiple "tiers" of rewards based on the contribution

31. Evan Glustrom, *Intrastate Crowdfunding in Alaska: Is There Security in Following the Crowd?*, 34 ALASKA L. REV. 293, 301 (2017).

32. Will Kenton, *Donation-Based Crowdfunding*, INVESTOPEDIA, https://www.investopedia.com/terms/d/donationbased-crowd-funding.asp [https://perma.cc/6Z5Y-8FT5].

33. Glustrom, *supra* note 31, at 301.

34. Devin Thorpe, *What Is Crowdfunding?*, FORBES (June 25, 2018, 5:07 PM), https://www.forbes.com/sites/devinthorpe/2018/06/25/what-is-crowdfunding/#54b15ad165c5 [https://perma.cc/ZU3E-55PD].

35. *See id.*

36. *Hello: Our Mission*, KICKSTARTER, https://www.kickstarter.com/about [https://perma.cc/UX5G-E6H8].

37. *About Us*, INDIEGOGO, https://www.indiegogo.com/about/our-story [https://perma.cc/SH9T-DASE].

38. Thorpe, *supra* note 34.

amount).[39] These rewards are generally the first run of whatever product or service they are trying to bring to market.[40]

In this type of crowdfunding, the fundraising business often must set a target fundraising goal.[41] If it does not raise at least that much money during its campaign, it gets nothing, but if it raises more than its goal, it gets to keep all of the money.[42] This all-or-nothing funding model is used by Kickstarter and many other platforms, but others, like Indiegogo, allow businesses to choose whether or not to make their campaigns all-or-nothing.[43] The funders are not entitled to any share of the company's profits, residual interest, or any other right given to owners of the company.[44]

Rewards-based crowdfunding is essentially a "pre-sale" of a good. It allows companies to gauge the demand for their product without expending a great deal of capital.[45] It also serves as a marketing tool for the companies who make listings.[46] There are a number of companies that achieved success based on a reward-based crowdfunding campaign. One, Pebble—creators of the smart watch the Pebble Time—set Kickstarter's record at the time for the fastest campaign to raise $1 million (the campaign reached this milestone in forty-nine minutes) and for the most money raised in a single campaign ($20,336,930).[47]

This method of capital raise, though, has its drawbacks. The vast majority of campaigns on Kickstarter and similar platforms do not raise

39. *Creator Handbook: Building Rewards*, KICKSTARTER, https://www.kickstarter.com/help/handbook/rewards [https://perma.cc/3NU8-NVMR]; *See Indiegogo Help Center: How Do I Claim a Perk?*, INDIEGOGO, https://support.indiegogo.com/hc/en-us/articles/526766-How-do-I-claim-a-Perk- [https://perma.cc/3BYT-JA5L].

40. *See* Thorpe, *supra* note 34.

41. *Creator Handbook: Funding*, KICKSTARTER, https://www.kickstarter.com/help/handbook/funding [https://perma.cc/A5CH-CKSW].

42. DAVID M. FREEDMAN & MATTHEW R. NUTTING, EQUITY CROWDFUNDING FOR INVESTORS: A GUIDE TO RISKS, RETURNS, REGULATIONS, FUNDING PORTALS, DUE DILIGENCE, AND DEAL TERMS 5–6 (2015).

43. *Id.*

44. *See What Is Crowdfunding?*, FUNDABLE, https://www.fundable.com/learn/resources/guides/crowdfunding/what-is-crowdfunding [https://perma.cc/MG8H-727P].

45. Karen Cahn, *Crowdfunding Can Help You Gauge Demand Before You Invest in Supply*, FORBES (Feb. 20, 2018, 6:20 PM), https://www.forbes.com/sites/karencahn/2018/02/20/its-all-about-demand-and-supply-kid/#7b5bbec14f74 [https://perma.cc/9CPT-PRRF].

46. *See id.*

47. Hope King, *Pebble Time Kickstarter Project Raised $20.3 Million*, CNN: BUS. (Mar. 27, 2015, 11:16 PM), https://money.cnn.com/2015/03/27/technology/pebble-time-most-funded-kickstarter/ [https://perma.cc/8WZ9-VAHK].

nearly the amount of capital that was raised by Pebble.[48] Further, a failed crowdfunding campaign can have negative consequences for a business's prospects of obtaining venture capital funding in the future.[49]

3. Debt-Based

Debt- or lending-based crowdfunding occurs when a large pool of funders each contribute small loans to the fundraiser.[50] When making these loans, funders are offered a specific interest rate if the fundraiser reaches its funding goal, causing the loans to pay out.[51] Platforms that offer this type of crowdfunding, like Prosper,[52] for instance, set credit ratings for each listed project based on characteristics of the fundraiser.[53] This method bypasses banks and traditional measures of creditworthiness, so it can be useful for entrepreneurs who are just getting off the ground and may have poor or no credit histories.[54]

4. Equity-Based

Equity-based crowdfunding, like the previous three types of crowdfunding, involves a fundraiser raising capital from a large pool of small investors.[55] As is often the case in rewards-based crowdfunding, equity-based crowdfunding platforms often utilize the all-or-nothing model—if the funding goal is not reached, the fundraiser gets nothing.[56] In equity-based crowdfunding, unlike other crowdfunding models, the

48. *Key Crowdfunding Statistics*, STARTUPS.COM (Dec. 3, 2018), https://www.startups.com/library/expert-advice/key-crowdfunding-statistics [https://perma.cc/ZQW8-YKTR].

49. Paolo Roma et al., *Reward-Based Crowdfunding Campaigns: Informational Value and Access to Venture Capital*, 29 INFO. SYS. RES. 679, 691 (2018).

50. Paul Belleflamme et al., *The Economics of Crowdfunding Platforms*, 33 INFO. ECON. & POL'Y 11, 12–13 (2015).

51. *Id.* at 13.

52. *See Our Story*, PROSPER, https://www.prosper.com/about [https://perma.cc/68PY-FGBM].

53. Belleflamme et al., *supra* note 50, at 13–14.

54. *See id.* at 13, 18–19.

55. *See id.* at 13 (explaining the crowdfunding website Crowdcube claims to have funded over 200 campaigns for £35 million with over 146,000 investors, averaging about £240 per investor).

56. Sarah Kenshall, *Equity Crowdfunding Series #1: 5 Things You May Not Know About Equity Crowdfunding*, BURGES SALMON (Feb. 5, 2019), https://www.burges-salmon.com/news-and-insight/legal-updates/equity-crowdfunding-series-1-5-things-you-may-not-know-about-equity-crowdfunding/ [https://perma.cc/9T7W-GQHU].

funders, in exchange for their contribution, receive an equity stake in the company if the company reaches its funding goal.[57]

Because this cutting-edge type of crowdfunding involves the sale of securities, the issuing companies must comply with certain regulations. In the United States, these regulations are promulgated by the U.S. Securities and Exchange Commission ("SEC").[58] The novelty of this type of financing means that regulatory regimes governing its use are still under development around the world,[59] and some countries have had greater success than others.[60]

IV. Implementing Cross-Border Equity Crowdfunding

Securities regulators around the world have been developing regulatory regimes to govern this new type of investment vehicle.[61] However, very few, if any, of these regimes are the same, and some have led to greater success in the equity crowdfunding market than others.[62] The regulations that govern these fundraising campaigns must strike a balance between being overly liberal, which could lead to pervasive fraud and illicit use of the system, and overly protectionist, which could stifle the growth of the industry. These regimes must also be compatible with one another or, ideally, uniform in order to facilitate international crowdfunding investment.

A. The Problem

Beyond the need for regulation that supports the equity crowdfunding market, the issue of investor protection needs to be addressed for international equity crowdfunding to be a viable means of accelerating economic growth in the developing economies of Africa. This Section discusses the problems faced by investors that must be mitigated for the framework to be successful.

57. Howard Marks, *What Is Equity Crowdfunding?*, Forbes (Dec. 19, 2018, 8:00 AM), https://www.forbes.com/sites/howardmarks/2018/12/19/what-is-equity-crowdfunding/?sh=1cdaec603b5d [https://perma.cc/9XJL-K4UZ].

58. Glustrom, *supra* note 31, at 301.

59. Nathan Rose, *How the World Regulates Equity Crowdfunding*, Regul. Rev. (June 26, 2019), https://www.theregreview.org/2019/06/26/rose-how-world-regulates-equity-crowdfunding/ [https://perma.cc/ZYJ2-5X6G].

60. *See id.*

61. *Id.*

62. *See id.*

1. Information Asymmetry

The first problem that must be addressed is the risk borne by the potential investor caused by the asymmetry of information between the company to be invested in (the target SME) and the investor.[63] Without being in company meetings with the management team, there is no way for an individual investor to be certain that the information that he or she has about the SME is accurate since company insiders have a monetary incentive to exaggerate the company's current performance and future prospects.[64] To help overcome this information asymmetry, "reputational intermediaries" play an important role in vetting the target SMEs.[65] These institutions—including accounting firms that audit the financial information of the companies, investment banks that underwrite the shares, law firms that ensure compliance, and stock exchanges that list the equity shares—serve to "vouch" for companies that desire to sell equity shares. These institutions can be relied upon, as the damage to their reputation caused by allowing a firm to commit fraud would far outweigh the one-time benefit they may enjoy.[66]

Logically, if there are "bad" companies trying to fraudulently pass themselves off as "good" companies that are identified by these intermediaries, what is to prevent a "bad" intermediary? There is no one-size-fits-all solution to this problem, but the United States has seen success by using secondary intermediaries that vouch for the first-tier intermediaries in the form of mandated self-regulatory organizations, such as the requirement that investment banks be a member of the New York Stock Exchange or the National Association of Securities Dealers.[67] The United States also has a combination of regulatory bodies, enforcement agencies, and courts that police the whole ecosystem.[68] This system, though, is not easily replicated. Governments must work vigilantly to prevent bad actors from infiltrating the ranks of the intermediaries.[69]

This information asymmetry affects all investors more dramatically, however, when an individual investor in the United States is seeking to purchase equity in a target SME located in a developing country on another continent. The information that the investor needs

63. Bernard S. Black, *The Legal and Institutional Preconditions for Strong Securities Markets*, 48 UCLA L. REV. 781, 786 (2001).

64. *Id.*

65. *Id.* at 787.

66. *Id.*

67. *Id.* at 788.

68. *Id.* at 789–90. *See also* Elise Hansen, *SEC's 1st Crowdfunding Suit Targets Pair of Cannabis Cos.*, LAW 360 (Sept. 20, 2021, 11:52 AM) https://www.law360.com/articles/1423338 [https://perma.cc/DM57-FYDJ].

69. Black, *supra* note 63, at 789.

regarding the business's current state and future prospects must filter through many additional intermediaries before it reaches the investor.[70] Also, other information regarding the culture, government, and sentiment in the target SME's country is much more difficult for the investor to obtain.[71] Cultural differences can play a large part in an investor's value assessment of an investment,[72] and these differences are difficult to deduce without direct contact with the culture in question.

2. Political Risk

Political risk is a form of risk inherent in international business that is much more difficult to define. Scholars still debate how to define political risk, how to operationalize the concept, and even how to measure it.[73] Organizations that purport to measure such risk algorithmically incorporate numerous variables to arrive at a political risk "score."[74] However, most of the variables used by these companies are only tangentially related to the actual "political risk" that the score is seeking to uncover, and often it is unclear what risk the score is actually measuring.[75]

Though there is no consensus on a *precise* definition, a generally accepted definition of political risk is the risk to an investment based on war, terrorism, civil disturbance, expropriation, breach of contract by a government or government body, or currency inconvertibility.[76] Stated differently, "political risks arise from the actions of national governments which interfere with or prevent international business transactions, or change the terms of agreements, or cause the confiscation of wholly or partially foreign-owned business property."[77] The potential effects of war, terrorism, or general civil disturbance

70. *Id.* at 786, 789. *See also* Mark Cummins et al., *Addressing Information Asymmetries in Online Peer-to-Peer Lending*, *in* Disrupting Finance: FinTech and Strategy in the 21st Century 15, 26 (2018) (explaining that local forces, culture, language and other aspects of identity of borrowers and lenders impact international Peer-to-Peer lending platforms).

71. *See* Arjun Bhardwaj et al., *Host Country Cultural Influences on Foreign Direct Investment*, 47 Mgmt. Int'l Rev. 29, 30 (2007).

72. *See id.* at 30.

73. Jason Webb Yackee, *Political Risk and International Investment Law*, 24 Duke J. Comp. & Int'l L. 477, 498 (2014).

74. *Id.* at 483–84.

75. *Id.* at 487.

76. *Political Risk Insurance*, Nat'l Ass'n Ins. Comm'rs, https://content.naic.org/cipr_topics/topic_political_risk_insurance.htm [https://perma.cc/9SSS-3H2K].

77. J. Fred Weston & Bart W. Sorge, International Managerial Finance 60 (1972).

should be relatively obvious: these scenarios can lead to destroyed assets or a total inability to conduct business.[78] Also, the negative implications for an investment if a government breaches a contract with the investor are not difficult to imagine. The other two forms of generally accepted political risk may not be as obvious.

Expropriation occurs when a foreign government appropriates the assets of the investor without proper compensation.[79] This is analogous to the concept of eminent domain in the United States.[80] However, in order for property to be justly appropriated by the United States government, fair compensation must be paid to the owner.[81] In the past, it was much more common for this form of "political risk" to be realized; however, recently, the concern has become "creeping expropriation."[82] Creeping expropriation, also called "regulatory expropriation,"[83] occurs when a government makes incremental regulatory and legal changes, such as changing the tax rate or restricting repatriation of profits, that slowly erode the value of a foreign investment.[84]

Finally, the risk of inconvertible currency is realized when the investor is unable to legally convert the local currency (whether in the form of capital repayment, interest, principal, or other forms) into U.S. dollars.[85] This issue can also occur when the investor is not legally able to extricate the U.S. dollars from the foreign country.[86] Inconvertibility can arise for a particular currency as a protection against currency devaluation when the currency is experiencing hyperinflation; however, it can also come about due to political motives of government officials.[87] The latter is the political risk that concerns foreign investors.

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78. *Id.*

79. Will Kenton, *Expropriation*, INVESTOPEDIA, https://www.investopedia.com/terms/e/expropriation.asp [https://perma.cc/4XPD-Z4R3].

80. *Id.*

81. *Id.*

82. Yackee, *supra* note 73, at 487–88.

83. *Id.* at 487–88.

84. Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639, 664 (1998).

85. James Chen, *Inconvertible Currency*, INVESTOPEDIA, https://www.investopedia.com/terms/i/inconvertible_currency.asp [https://perma.cc/GS74-9877].

86. *See id.*

87. *Id.*

There are organizations that sell "political risk insurance" to investors looking to invest in foreign companies.[88] However, for individual investors seeking a small investment in a developing country, these policies are cost-prohibitive. The insurance companies must underwrite the investment and make their own independent assessment of the political risk in the country and the viability of the project, both of which are intensive and costly processes.[89] One such political risk insurance company, the Multilateral Investment Guarantee Agency, a part of the World Bank Group, lists its underwriting fee alone at $5,000 minimum.[90]

3. Enforceability

Even if the above-mentioned issues were addressed to the furthest extent possible, there will always be wrongdoers who find ways around the safeguards in an attempt to defraud investors. In the United States, the Securities Exchange Act of 1934 created the SEC as a watchdog agency to police the sale of securities.[91] The rules promulgated by the SEC create standards for companies that wish to raise capital through the sale of equity on a public stock exchange.[92] Among other things, these standards require disclosures of all information relevant to the performance and prospects of the company (including audited financial information), mandate the underwriting of the company's shares by an investment bank, and require periodic reporting on the standing of the firm.[93] These requirements were implemented to ensure full information is given to potential investors.[94]

The SEC also established the liability for those who commit securities fraud.[95] These penalties may not be restricted to the issuer of the securities alone; some state laws impose liability on the accountants, lawyers, bankers, and others involved in the transaction for failing to

88. Bethan Moorcraft, *What is Political Risk Insurance?*, Ins. Bus. Am. (Mar. 18, 2019), https://www.insurancebusinessmag.com/us/guides/what-is-political-risk-insurance-162502.aspx [https://perma.cc/W3HP-DJYB].

89. *See What We Do: Our Process*, Multilateral Inv. Guarantee Agency, https://www.miga.org/our-process [https://perma.cc/BA5Q-G5HR].

90. *Id.*

91. Securities Exchange Act of 1934, 15 U.S.C. § 78 (1934).

92. Scott Bauguess et al., U.S. Sec. & Exch. Comm'n, Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009–2017, at 1, 3 (2018).

93. *See Registration Under the Securities Act of 1933*, Investor.gov: U.S. Sec. & Exch. Comm'n, https://www.sec.gov/fast-answers/answersregis33htm.html (last updated Sept. 2, 2011).

94. *See id.*

95. 17 C.F.R. § 240.10b–5 (2010).

serve as effective gatekeepers.[96] These penalties generally serve as an effective deterrent of fraud.[97]

Further, the rules created by the SEC also allow for investors to seek damages in court.[98] In the United States, securities fraud cases often proceed as class action suits and often result in multi-million-dollar settlements.[99] These cases are very enticing to plaintiffs' attorneys due to the potential size of the awarded damages.[100]

Until recently, American investors could seek damages for securities fraud from foreign companies pursuant to Section 10b–5 of the Securities Exchange Act, which provides that:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.[101]

The case law, coming disproportionately from the U.S. Court of Appeals for the Second Circuit, had created two different tests to determine if a court had jurisdiction to hear a case of extraterritorial securities fraud: the effects test and the conduct test.[102] The effects test required that the fraudulent activity must have had sufficient effects

96. Jennifer J. Johnson, *Secondary Liability for Securities Fraud: Gatekeepers in State Court*, DEL. J. CORP. L. 463, 475–76 (2011).

97. *Id.* at 507.

98. *Id.* at 470.

99. *See, e.g.*, Alison Frankel, *Securities Fraud Defendant Agrees to Pay $217.5 Million to Opt-Outs. A Portent?*, REUTERS (Oct. 29, 2018), https://www.reuters.com/article/lega-us-otc-securities/securities-fraud-defendant-agrees-to-pay-217-5-million-to-opt-outs-a-portent-idUSKCN1N32JI [https://perma.cc/F86B-P8RK].

100. *See id.*

101. 17 C.F.R. § 240.10b–5 (2010).

102. Joshua L. Boehm, *Private Securities Fraud Litigation After* Morrison v. National Australia Bank: *Reconsidering a Reliance-Based Approach to Extraterritoriality*, 53 HARV. INT'L L.J. 249, 253–54 (2012).

on an American investor.[103] The court described the test in *Bersch v. Drexel Firestone*,[104] explaining that the court had subject matter jurisdiction over fraud committed abroad if the acts "result in injury to purchasers or sellers of those securities in whom the United States has an interest, not where acts simply have an adverse effect on the American economy or American investors generally."[105] Under this interpretation of the statute, American investors who are defrauded by foreign companies in the purchase and sale of securities would likely have had a cause of action that could be heard by the federal courts of the United States.[106]

The other construct the Second Circuit employed centered on the conduct involved in the underlying activity that led to the fraud occurring. The court explained that the critical factor was that "significant conduct" in furtherance of the fraud was performed in the United States, regardless of whether American shareholders ultimately bore the loss.[107] Opining on Congress's lack of clarity with regard to the scope of extraterritorial jurisdiction, Judge Friendly reasoned that Congress must not have wanted the United States "to be used as a base for manufacturing fraudulent security devices for export, even when these are peddled only to foreigners."[108] Complicating matters, other Federal Circuits could not agree on the breadth of the conduct test, and thus, it was applied differently depending on the court.[109] This interpretation is much more fact-dependent than the effects test, but in many cases, American investors would likely be able to bring claims in U.S. courts under this regime.

In June 2010, both tests were explicitly overruled by the Supreme Court of the United States. The case of *Morrison v. National Australia Bank*[110] is an "f-cubed" case, which means it was a claim brought by a foreign investor in a foreign company whose shares are traded on a foreign exchange.[111] The claim was brought by Australian investors in

103. *Id.* at 254.

104. Bersch v. Drexel Firestone, Inc., 519 F.2d 974 (2d Cir. 1975).

105. *Id.* at 989.

106. *Id.* at 992–93.

107. Boehm, *supra* note 102, at 255.

108. IIT v. Vencap, Ltd., 519 F.2d 1001, 1004 (2d Cir. 1975) (holding that the conduct test was passed and the Court had subject matter jurisdiction because the fraudulent activity of the Bahama-based company occurred almost entirely in the United States).

109. Boehm, *supra* note 102, at 256–57.

110. Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247 (2010).

111. Simon Goldring, *The End of "F-Cubed" Claims*, LEXOLOGY (July 5, 2010), https://www.lexology.com/library/detail.aspx?g=cf032c65-95a8-404c-8a98-2c30810db574 [https://perma.cc/B5EJ-4TH4].

National Australia Bank ("NAB"), which had acquired a Florida-based mortgage servicer called HomeSide.[112] The management of HomeSide manipulated the financials of the company to make profitability and prospects look very good, but three years after the acquisition, NAB wrote down nearly $2 billion in relation to HomeSide, and thus, the investors brought suit.[113] The Supreme Court first clarified that the extraterritorial reach of the Court was a merits question, not a question of subject matter jurisdiction.[114] The Court then went on to state that Section 10(b) does not give a cause of action to foreign plaintiffs suing American or foreign investors for alleged fraud relating to securities traded on a foreign stock exchange,[115] and that it only applies to "transactions in securities listed on domestic exchanges, and domestic transactions in other securities."[116] The Court reasoned that, because Congress was silent on the extraterritorial application of the statute, none should exist.[117] This holding effectively ended "f-cubed" claims and raised many questions about the protection of American investors.

In July 2010, Congress passed the Dodd-Frank Act, which attempted to establish a version of the conduct test as the guiding metric.[118] However, since the provision was stated in terms of whether or not the court had jurisdiction instead of in terms of the merits of the claim, it had little effect on the precedent set by the Court in *Morrison*.[119]

The path to redress for a fraud committed by a foreign company that is not listed on an American exchange could now be arduous or even impossible. The SEC does cooperate with foreign securities regulators in order to prosecute international securities fraud,[120] and in some cases, there may be a bilateral treaty in place between the United States and the host country which more clearly explains the

112. Boehm, *supra* note 102, at 257.

113. *Id.*

114. *Id.* at 258.

115. *Id.*

116. Morrison v. Nat'l Austl. Bank Ltd., 561 U.S. 247, 267 (2010).

117. *Id.* at 265.

118. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (2010).

119. Boehm, *supra* note 102, at 261.

120. *International Enforcement Assistance*, U.S. Sec. & Exch. Comm'n, https://www.sec.gov/about/offices/oia/oia_crossborder.shtml [https://perma.cc/93RB-7YYB].

enforcement of anti-fraud measures.[121] This can sometimes be helpful, but litigating the case is not always possible.

Even if an investor is able to ascertain the correct forum for his or her claim, there still exist other barriers to redress. Individual investors purchasing equity in highly speculative businesses in developing nations are not likely investing a large sum of money, and, therefore, absent a large class of claimants, the amount in controversy will likely not rise to the level of jurisdiction for certain courts, like the federal courts of the United States.[122] If this requirement does not bar the investors claim, though, the prospect of relatively insignificant damage awards do little to entice plaintiffs' attorneys who have the resources to argue such complex cases. The damage awards ignore the exorbitant costs of litigating internationally that the plaintiff would be forced to pay, and which would likely far outweigh any potential award.

In order to overcome this issue and give international equity crowdfunding investors the certainty that they will have recourse in the case of securities fraud, the nations involved will need to create multilateral treaties that unify the definition of fraud and the violations that result in fraud liability. The treaties must clearly describe the mechanisms that will be used to enforce these laws.

4. Incentives

An investor, who can invest his or her money in United States Treasury bills and realize a "risk-free" return of about 1.5%,[123] must be properly compensated for the greatly magnified risk of their investment in order to be incentivized to invest in developing African countries. This additional compensation is known as the "risk premium," and the risk premium expected by investors increases as the likelihood of losing their invested capital increases.[124] In startup financing, the rule of thumb is that one third of target companies fail and return nothing, one third return the original investment, and one third generate

121. Mark Kantor, *Little Has Changed in the New U.S. Model Bilateral Investment Treaty*, 27 INT'L CTR. SETTLEMENT INV. DISPS. REV. 335, 366 (2012).

122. 28 U.S.C. § 1332(a) (federal jurisdiction when the matter in controversy exceeds $75,000).

123. Prior to the outbreak of the COVID-19 pandemic, the rate was estimated at 1.5%. *See 3-Month Treasury Bill: Secondary Market Rate*, FED. RSRV. ECON. DATA, https://fred.stlouisfed.org/series/TB3MS [https://perma.cc/W3KH-MNCB]. By year two of the pandemic, as this Note goes to print, it has dropped to .04%. *See* Eric Milstein & David Wessel, *What Did the Fed Do in Response to the COVID-19 Crisis?*, BROOKINGS, https://www.brookings.edu/research/fed-response-to-covid19/ [https://perma.cc/MH5W-RGVX].

124. Adam Hayes, *Risk Premium*, INVESTOPEDIA, https://www.investopedia.com/terms/r/riskpremium.asp [https://perma.cc/85AQ-YDL3].

significant returns.[125] Therefore, in order for equity crowdfunding in Africa to generate returns large enough to keep foreign investors interested, about one third of the campaigns that are successfully funded must succeed.[126] Eventually, as the ecosystem develops and venture capital firms target African SMEs with greater amounts of capital, the very remote chance of a "unicorn"[127] in Africa could become a reality. Until then, though, there must be incentives to invest in African SMEs that make the small likelihood of choosing a target company that results in significant positive returns more palatable to potential investors.

One such incentive is the prospect of greater portfolio diversification, as small firms in developing countries are far removed from the economic pressures impacting American companies, and thus, will not be highly correlated with fluctuations impacting the American market.[128] However, efficient diversification can be achieved through participation in only developed markets with lower risk, and further diversification can very easily suffer from diminishing returns.[129] Therefore, diversification is more often an incentive for corporations, rather than individual investors, to make foreign investments.[130]

The host country can make a serious impact when it comes to such incentives. If the government of the country is "bought-in" on the importance of small business growth for the growth of the economy as a whole, that government's motivations will be aligned with foreign investors—they both have an interest in the success and profitability of the target SME. To leverage this motivational alignment, host governments could offer fund matching programs, in which a government agency pledges to match money contributed by a foreign investor to an SME in the country. In this way, the company has a "double" influx of capital, hopefully allowing it to grow even more quickly, thus achieving the goals of the country and the investor.

125. Manoj Ranaweera, *The 10x Return Model of VC Funding*, TECHCELERATE VENTURES (May 5, 2021), https://www.techcelerate.ventures/2018/12/the-10x-return-model-of-vc-funding/ [https://perma.cc/K3KB-2JVN].

126. *Id.*

127. James Chen, *Unicorn*, INVESTOPEDIA (Mar. 29, 2021), https://www.investopedia.com/terms/u/unicorn.asp [https://perma.cc/TYQ3-3YK5] (defining a "unicorn," in venture capital parlance, as a "privately held startup company with a value of over $1 billion").

128. Joost Driessen & Luc Laeven, *International Portfolio Diversification Benefits: Cross-Country Evidence from a Local Perspective*, 31 J. BANKING & FIN. 1693, 1704–05 (2007).

129. Silvio J. Camilleri & Gabriella Galea, *The Diversification Potential Offered by Emerging Markets in Recent Years*, 1 FAC. ECON., MGMT. & ACCT. RSCH. BULL., no. 3, 2009, at 21, 31.

130. Jeff Madura & Ann M. Whyte, *Diversification Benefits of Direct Foreign Investment*, 30 MGMT. INT'L REV. 73, 73 (1990).

The host countries that have realized the importance of small business growth to overall economic prosperity have also begun to implement other programs to encourage and support entrepreneurship.[131] These programs include government-backed funds that give grants and other forms of capital to startup companies.[132] Also, some governments have started incubator programs in which entrepreneurs spend a period of time with a group of experienced investors and business owners who help them develop their business plan and prepare their business for growth.[133] Tax breaks on investment in SMEs from the host country are also becoming a popular form of incentive enacted by African governments.[134] All of these programs contribute to an environment that is receptive to the needs of entrepreneurs, making investment in these African nations much more enticing. Investors can see that the government of the host country is also working toward the success of the target SME.

B. Where Is African Equity Crowdfunding Today?

Today, there are hundreds of crowdfunding platforms providing financing all over the world. In Africa, the number of such platforms is growing rapidly; however, there are still few success stories from equity crowdfunding platforms on the continent. For example, South Africa has the equity crowdfunding platform Uprise.[135] Africa has completed a couple successful campaigns: Drifter Brewing Company completed a campaign raising approximately $200,000 in 2018[136] and, in 2019, Intergreatme, a regtech startup, successfully raised over $2 million.[137]

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131. *E.g.*, Aubrey Hruby, *Entrepreneurship Funds in Africa: Distinguishing the Good from the Bad*, CONVERSATION (Apr. 29, 2019, 6:37 AM), http://theconversation.com/entrepreneurship-funds-in-africa-distinguishin g-the-good-from-the-bad-115927 [https://perma.cc/8KCD-FJ4E].

132. *Id.*

133. *Id.*

134. *See, e.g.*, Meghan McCormick, *Africa Needs More Angel Investors*, FORBES (June 16, 2019, 7:21 AM), https://www.forbes.com/sites/meghanmccormi ck/2019/06/16/africa-needs-more-angel-investors/#4b89d3922d24 [https://perma.cc/RH9B-FZF2] (describing the South African law that makes all funds invested in small business 100% tax deductible).

135. *About Us*, UPRISE.AFRICA, https://uprise.africa/about-us [https://perma.cc/ GT9V-ATXZ].

136. Lebohang Thulo, *Drifter Brewing Co. Reaches R3 Million Crowdfunding Goal*, SME SOUTH AFR. (May 3, 2018), https://smesouthafrica.co.za/cra ft-beer-startup-drifter-brewing-co-reaches-r3-million-equity-crowdfunding -goal/ (last visited Feb. 2, 2022).

137. Tom Jackson, *SA Regtech Startup Intergreatme Ends Crowdfunding Campaign After Securing $2.19m*, DISRUPT AFR. (May 30, 2019), https://disrupt-africa.com/2019/05/sa-regtech-startup-intergreatme-ends-

As this Note goes to print, the platform has two campaigns currently seeking funding.[138]

C. The Solution?

Equity crowdfunding, given the correct regulatory framework and system of self-governance, seems to be a viable option for capital formation in developing countries.[139] This Section will explore the different facets of a regulatory framework to show how problems associated with individual investors contributing capital to SMEs in African nations can be alleviated.

1. The International Crowdfunding Intermediary

In order for international equity crowdfunding to succeed, there must be some form of oversight. This oversight, I propose, should be achieved by forming a "hub-and-spoke"[140] network of crowdfunding platforms that are linked by one central intermediary. This intermediary would be responsible for standardization of crowdfunding campaigns; the curation of investable campaigns that are available to international investors; the navigation of the regulatory environment in all countries that participate; the lobbying of host governments to enact compatible, if not uniform, crowdfunding-friendly legislation; and the resolution of disputes between investors and the target SMEs. The intermediary must help to ensure investor protection as well as foster trust in crowdfunding as an investment vehicle.

The need for this intermediary in cross-border equity crowdfunding on the African continent is already evident. The African Crowdfunding Association ("ACfA") was founded in 2015 by several African crowdfunding platforms who saw the need to develop and harmonize crowdfunding regulations on the continent.[141] In 2019, the organization, which describes itself as self-regulating,[142] released the ACfA Label Framework, which outlines the organization's proposition for the

crowdfunding-campaign-after-securing-2-19m/ [https://perma.cc/C6RZ-5TZ5].

138. *Browse Investment Opportunities*, UPRISE.AFRICA, https://uprise.africa/discover/ [https://perma.cc/LQ8B-2LWH].

139. Jonathan Moed, *Equity Crowdfunding: A New Model for Investing in Africa*, FORBES (Aug. 2, 2018, 5:04 AM), https://www.forbes.com/sites/jonathanmoed/2018/08/02/a-new-model-for-investing-in-africa/#2aa038c83a45 [https://perma.cc/77CH-N8YC].

140. Adam Hayes, *Hub and Spoke Structure*, INVESTOPEDIA (Aug. 20, 2021), https://www.investopedia.com/terms/h/hub_and_spoke_structure.asp [https://perma.cc/TVM7-WW6P].

141. *What We Do*, AFRICAN CROWDFUNDING ASS'N, https://africancrowd.org/about/what-we-do/ [https://perma.cc/Z3T5-RB3E].

142. *Id.*

implementation of pan-African crowdfunding.[143] In this framework, the ACfA plays the role of intermediary, and all participating nations cede oversight responsibilities with regard to equity crowdfunding to the intermediary.[144] It is unclear whether this framework has garnered support from African nations at this point. The framework described in this Note will borrow from the ACfA Label Framework where applicable.

2. Who Is the Intermediary?

The international equity crowdfunding intermediary ("Intermediary") could either take the form of a private, for-profit enterprise or some form of intergovernmental agency. The uncertainty regarding the adoption of this framework, however, would limit the feasibility of a private organization filling this role in the beginning. This could change as the equity crowdfunding market matures and the private company acting as Intermediary could be sure that there would be enough participation to make a profit. If the ACfA has the required capacity, it would be a good candidate to fill the Intermediary role (assuming the goal is to implement international equity crowdfunding for developing countries in Africa). This organization is well equipped to navigate the legal regimes that exist in the African countries, as it was formed by active crowdfunding platforms in these countries.[145] Further, it is ACfA's goal to close the funding gap for African SMEs, which is precisely the outcome this framework seeks to reach.[146]

Alternatively, an international organization or agency that already exists could spearhead this endeavor. The World Bank Group is the best suited to take this on. Specifically, the International Finance Corporation ("IFC"), part of the World Bank Group, would be uniquely suited to run the Intermediary. This organization is the "largest global development institution focused on the private sector in developing countries,"[147] and asserts that "[it] works with the private sector in developing countries to create markets that open up opportunities for all."[148] This seems to align perfectly with the purpose sought to be achieved by the Intermediary.

143. ELIZABETH HOWARD & MOUHAMADOU MBENGUE, AFRICAN CROWDFUNDING ASSOCIATION LABEL FRAMEWORK 5 (2020).

144. *Id.*

145. *Id.* at 11–12.

146. *Id.* at 8.

147. *About IFC: Overview*, INT'L FIN. CORP., https://www.ifc.org/wps/wcm/connect/corp_ext_content/ifc_external_corporate_site/about+ifc_new [https://perma.cc/5G9S-92PQ].

148. *Partners*, STARTUPLIST AFR., https://startuplist.africa/company/partners [https://perma.cc/N87X-MB5H].

The Intermediary would create an international platform ("Master Platform"), which would host campaigns from its member platforms that qualify for international investment. In this way, investors would have a "one-stop-shop" to contribute capital to SMEs in Africa, which would help alleviate investor concerns that there may be a "better deal" elsewhere.

To avoid disincentivizing investor or target SME participation in the system, the Intermediary should not charge fees to either party for using the system. Instead, member platforms should be required to pay an annual membership fee that is used to cover the overhead of the Intermediary.

The Intermediary will also be responsible for working toward the harmonization of crowdfunding laws in the countries that it operates. While it may be possible to conduct international equity crowdfunding between certain countries with existing laws, many of the regulatory regimes create legal barriers to such campaigns.[149] Lobbying for new legislation in each African country that would allow such crowdfunding campaigns would be extremely time consuming. Therefore, I argue that the most efficient means of unifying crowdfunding laws would be for the Intermediary to lobby the governments of African nations to cede oversight of crowdfunding to the Intermediary, which would then become responsible for rule-making, fraud detection, enforcement, and dispute resolution regarding equity crowdfunding in these countries. The ACfA's Label Framework envisions such an arrangement.[150]

3. Members

The capital required for the Intermediary to create offices around the world would be far too great to justify given the uncertain climate surrounding crowdfunding in many African host countries.[151] Therefore, the Intermediary will create a crowdfunding association ("Association") and existing and future crowdfunding platforms in Africa will apply to become members of the Association ("Members"), creating a "hub-and-spoke" system. These platforms would have a significant incentive to join the Association, as it would open up a much larger capital market to their platform users, allowing for larger capital raises, which would result in larger fees paid to the platform. (In the United States, equity

149. Covington & Burling LLP, *Crowdfunding in Africa: Opportunities and Challenges*, Nat'l L. Rev. (Feb. 7, 2017), https://www.natlawreview.com/article/crowdfunding-africa-opportunities-and-challenges [https://perma.cc/HCH5-7BUL].

150. Howard & Mbengue, *supra* note 143, at 11–12.

151. *See id.* at 9.

crowdfunding portals charge anywhere from 5% to 12% of the amount of capital raised.)[152]

The vetting process undertaken by the Intermediary begins by setting requirements for the Members. The Intermediary must foster trust in the campaigns available to investors, so it is important that Members have a clean track record in uncovering and avoiding potential fraud. Members must also have a robust user base (both investors and issuers) and must be active for at least two years to help prevent the failure of Members from tarnishing the reputation of the Association. The Intermediary should also include non-equity-based crowdfunding platforms (like Kickstarter and Indiegogo) in its membership. Including these platforms would allow for a much larger network of Members, thus increasing the institutional knowledge of the Association and giving entrepreneurs who utilize the Master Platform a much larger support network.

4. Standardization

Investing in equity crowdfunding domestically poses a number of risks for investors, as discussed above. When investing in companies in developing countries, these risks are greatly magnified. The main reason for this is the inability for investors to perform their own due diligence on target SMEs. Most SMEs seeking funding in developing nations will not have a website that discloses their Generally Accepted Accounting Principles ("GAAP") compliant financial statements. Instead, investors who wish to invest in these foreign companies must rely on the due diligence of the Members and the Intermediary.[153]

To facilitate this due diligence, campaigns in the framework I propose must be posted to the Member platforms in a standardized format with a minimum set of disclosure documents. These documents should include (but not be limited to): information about the officers, directors, and owners of the issuer's business; a description of the issuer's business and the intended use of the proceeds from the campaign; a valuation of the company and supporting data; the target fundraising amount; and a discussion of the issuer's financial condition and statements. These disclosures are required by the SEC for U.S. firms seeking to take advantage of Regulation Crowdfunding ("Reg CF") by raising capital through equity crowdfunding.[154] Members must

152. Brian Belley, Top Equity Crowdfunding Sites—Comparison for Startup Founders (Q4-2019), CROWDWISE (Oct. 23, 2019), https://crowdwise.org/for-founders/comparison-of-the-top-8-reg-cf-intermediaries-for-startups-q4-2019/ [https://perma.cc/L6T7-ARQT].

153. *See Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers*, U.S. SEC. EXCH. COMM'N (Apr. 5, 2017), https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm [https://perma.cc/E984-6BFX] (explanation of required disclosures).

154. *Id.*

ensure that the data posted to their platforms is accurate. These requirements will help establish trust among investors and facilitate an efficient vetting process for the Intermediary when it judges campaigns for inclusion on the Master Platform.

5. Curation

Not all crowdfunding offerings that are presented to the Intermediary will meet the standards required to conduct an international crowdfunding campaign. The first thing that potential issuers must do is complete a successful crowdfunding campaign locally. This campaign can be rewards-based, lending-based, or equity-based campaign; however, the target SME must have successfully met its funding goal. In the case of rewards-based and lending-based campaigns, all rewards must have been delivered and all loans repaid, respectively. This local campaign requirement will ensure that, at the very least, there is a local market for the goods or services provided by the target SMEs. It will also serve as a trial-run for the businesses, hopefully making the large-scale, international campaign run more smoothly.

In addition to completing a successful campaign, the Intermediary will also go through its own due diligence process using what has been called "social underwriting."[155] To do this, the business seeking equity crowdfunding would be required to obtain investment from a minimum number of family and friends; in effect, these investors would be vouching for the trustworthiness of the issuer.

If these two requirements are fulfilled—barring other problems that may limit a business's chances for a successful international campaign—the business will post its new campaign to its local Member platform, and the Intermediary will move the campaign from the Member platform to the Master Platform.

6. Dispute Resolution

In the United States, equity crowdfunding faces a significant issue when it comes to dispute resolution. If a target SME commits securities fraud, the remedies typically available to the investor are often ineffective.[156] The amount in controversy for an individual crowdfunding investor would be relatively insignificant, and, thus would not demand the limited resources of the SEC.[157] Further, private actions also fail to achieve a satisfactory remedy, as the amount

155. Emily Fockler, *What Is "Social Underwriting"?*, Kiva (Feb. 27, 2018), https://www.kiva.org/businesscenter/what-is-social-underwriting [https://perma.cc/66W7-UCTW] (describing how Kiva, a non-profit lending-based crowdfunding platform, uses social underwriting to "vet" loan requests).

156. C. Steven Bradford, *Online Arbitration as a Remedy for Crowdfunding Fraud*, 45 Fla. St. U. L. Rev. 1165, 1168 (2018).

157. *Id.*

recovered would be less than the cost of the litigation in most cases.[158] Due to restrictions on the amount individual investors can contribute, even the wealthiest crowdfunding investors may only invest $107,000 and the average investment in the early offerings under Reg CF was just $800.[159] Class-action suits would be similarly futile since the maximum offering amount of $1.07 million is unlikely to entice class-action attorneys to take the case.[160] Among early offerings, the median target funding was just $53,000 and the mean was $110,000.[161] To overcome this issue, many crowdfunding platforms have implemented arbitration requirements in their terms of service.[162]

In the case of international equity crowdfunding, though, in-person arbitration will likely never be financially justified given the amount of recovery possible.[163] Therefore, the international crowdfunding intermediary should implement a uniform, online arbitration system for all Member platforms as well as investors and target SMEs. The structure of this regime will be adapted from the system formulated by Professor C. Steven Bradford.[164]

The goal of the arbitration system is to augment investors' ability to seek a remedy when fraud is committed,[165] and therefore, the structure of the system should be reflective of that end. First, the required arbitration agreement between investors and issuers should be unilateral.[166] This means that the issuer should be required to arbitrate any claims brought by its investors, but investors should not be required to bring claims.[167] Further, the agreement should not limit investors from taking the claim to court, in the rare instance that the recovery would make such litigation worth it.[168]

Second, the arbitration process should be handled completely online. The distance between parties in international crowdfunding could be thousands of miles, which would make in-person arbitration cost-prohibitive in all but the most extreme cases of fraud. Handling

158. *Id.*

159. *Id.* at 1184–85.

160. *Id.* at 1201–02.

161. *Id.* at 1185.

162. Huu Nguyen et al., *The Future of Dispute Resolution for Crowdfunding Websites*, 18 FINTECH L. REP. 3 (2015).

163. *See* Bradford, *supra* note 156, at 1185.

164. *See id.*

165. *Id.* at 1168.

166. *Id.* at 1191–92 (stating that unconscionability should not be a bar to unilateral arbitration as it gives the advantage to the weaker party).

167. *Id.* at 1188.

168. *Id.* at 1191–92.

the process online significantly reduces such costs and also increases the speed of resolution.[169] The fact that fraudulent transactions occur online further bolsters the logic behind this forum.[170] The ability for investors to easily pursue a claim for fraud as easily as they invest—from home—would also strengthen investor trust in the system.

This online arbitration process should be handled completely in writing.[171] Again, as a function of the distance between parties, scheduling a time to teleconference between two parties on different continents, in order to provide oral testimony, would not only be inconvenient but also unnecessary.[172] Further, though the target SMEs in African countries will have access to the internet, they may not have adequate bandwidth to conduct a live interaction online. Records of wrongdoing should not be difficult to obtain, given that all communication regarding the questioned transaction occurred online, so digital records of every aspect of the transaction should be available to the arbitrator.[173] The parties will submit their statements in writing, at which point the arbitrator can issue an award at his or her convenience, without the need for live communication with the parties.[174]

The arbitrators in the system should be experts in the laws governing securities and crowdfunding.[175] Each case should be assigned to two arbitrators—one from the country of residence of each of the parties—in order to ensure the proper application of the proper laws. The arbitrators must also make efforts to guide the process so that all necessary information and evidence is properly presented.[176] This is a greater issue in crowdfunding due to the general lack of sophistication of either party (an unaccredited investor and an SME with likely no previous experience in the sales of securities). Though the arbitrators will already have all documents involved in the transaction, any additional evidence required by the proceedings will likely be in the possession of the issuer, thus disadvantaging the investor, who has the burden of proof, unless the arbitrator actively and skillfully participates in the process in order to ensure all relevant evidence has been produced.[177]

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169. *Id.* at 1192.

170. *Id.* at 1194.

171. *Id.*

172. *See id.*

173. *Id.* at 1194–95.

174. *Id.* at 1194.

175. *Id.* at 1195.

176. *Id.* at 1196.

177. *Id.* at 1196–97.

Investor trust in the Intermediary can be further strengthened by the arbitration process by ensuring that it is transparent—the proceedings and an explanation of the outcome should be publicly available. This serves a number of purposes: it aids in future fraud prevention, alerts other investors of potential claims, and allows for easier monitoring by regulatory bodies.[178]

Finally, aggrieved investors should have the option to consolidate their claims with those of other investors to form what would essentially be an "arbitration 'class action.'"[179]

D. An Example

The implementation of this framework would allow SMEs in Africa to raise capital from a vast pool of international investors. This Section will give an overview of the path that a fictitious African SME, Company X, would take to avail itself of the Master Platform. Company X has self-funded to this point, and is seeking additional investment.

1. Local Campaign

The first step for Company X is to submit a campaign proposal to its local Member platform. This proposal would include information about the officers, directors, and owners of the issuer's business; a description of the issuer's business and the intended use of the proceeds from the campaign; a valuation of the company and supporting data, the target fundraising amount; and a discussion of the issuer's financial condition and statements. If the Member determines that Company X is a viable candidate for crowdfunding, the campaign will be posted to the Member platform.

During this campaign, the Member will support and educate Company X by connecting the company to other entrepreneurs who have experience in Company X's industry as well as in crowdfunding campaigns. At the end of the campaign, if Company X reaches its target raise, it will receive the funds and begin to execute the plan detailed in its campaign proposal. Company X will pay a percentage of the raised capital to the Member as a commission for its services.

2. Submission to the Intermediary and the Vetting Process

When Company X determines that there might be global demand for its product, it decides it is ready to raise more money and apply to the Intermediary to launch an international crowdfunding campaign. This application should contain the same information that was submitted as part of its local campaign proposal.

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178. *Id.* at 1197–98.

179. *Id.* at 1199.

The Intermediary would then communicate with the local Member through which Company X had already completed a crowdfunding campaign. The Member would recount its experience working with Company X, such as whether Company X was a diligent and upstanding business. If the Intermediary is satisfied and determines that Company X would be a good candidate to raise money internationally, based on the documentation provided by Company X, then the Intermediary would begin the process of "social underwriting."

The social underwriting process begins with a request by the Intermediary for Company X to provide proof of investment by the minimum number of family members and friends. When this proof is provided, the Intermediary will vet the family members and friends to assure legitimacy and to uncover any misgivings that these individuals might have.

When this process is complete to the satisfaction of the Intermediary, Company X and the local Member Platform will be notified of Company X's acceptance to the Master Platform. At this time, Company X will submit a new campaign proposal to the Member containing the documents that were approved by the Intermediary. The Member will then produce the campaign page and send it to the Intermediary to be posted on the Master Platform.

3. International Campaign

The international campaign will proceed in the same manner as the local campaign. The Intermediary will work to market the campaign to investors on a global scale, these investors will contribute capital through the Intermediary, and if the campaign reaches its target raise, the Intermediary will transmit the money to Company X.

4. Dispute Resolution

If an investor in the international campaign feels that he or she has been defrauded by Company X, then the investor will submit his claim to the Intermediary with all supporting documents necessary to make his or her argument. The Intermediary will then inform Company X of the allegation. Company X will then be required to submit a written copy of its testimony to the Intermediary. When all documents are received, the Intermediary will task the appropriate arbitrators to the case and provide all the documentation.

The arbitrators will then determine if they have the appropriate information to rule and issue an award, contacting the relevant party directly if more information is required. The arbitrators will perform a full analysis of the claim, asking, in writing, any questions they may have of the parties.

When the decision is reached, the arbitrators will inform the Intermediary, and the Intermediary will inform the parties of the decision and enforce any remedy that the arbitrators deemed appropriate. The ruling and award will be posted on the Intermediary's website. If the arbitrators return a ruling against Company X, the Intermediary will determine if additional penalties may be necessary.

V. Conclusion

SMEs in Africa are being constrained by a lack of capital that is stifling the growth of African economies. This funding gap must be closed so these SMEs can help African economies to keep up with the skyrocketing working-age population, which is expected to require 450 million new jobs by 2035.[180]

International equity crowdfunding has the potential to solve this crisis if it is properly implemented. The cooperation of all African nations is required for this to happen, though. The implementation of this framework, I believe, would unlock the true growth potential in the African market and help bring economic stability to the continent.

180. World Econ. F., The Africa Competitiveness Report 2017, at xiv (2017).