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REGULATING STARTUPS TO DEATH: THE CURIOUS CASE OF THE NIGERIAN REGULATORS

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INTRODUCTION

8 April 2021: The Securities and Exchange Commission ("SEC") released a circular titled "*Proliferation of Unregistered Online Investment and Trading Platforms Facilitating Access to Trading in Securities Listed in Foreign Markets*", wherein SEC criticized the rise in providers of online investment and trading platforms which facilitate direct access to securities of foreign companies listed on exchange platforms in other jurisdictions. SEC advised against such activities as only foreign securities listed on any Exchange registered in Nigeria may be issued, sold or offered for sale or subscription to the Nigerian public.

SEC's position could be due to the rise in Apps which enable individuals to easily buy stocks of foreign companies from their mobile phones. Trading in foreign securities has been made possible by a surge in popularity of investing apps like Bamboo, Trove and Risevest etc., who have been front and centre in disrupting the traditional capital market investment. These tech Startup companies ("the Startups") enable Nigerians with smartphones and capital as minimal as N380 (US$1), to access Stocks, Exchange Traded Funds, Real Estate Investment Trusts and Bonds trading on the US and Nigerian Stock Exchanges.

Following SEC's circular, the Startups emailed customers to assure them of the safety of their investments and full compliance with the law as the directive created unrest among customers using these apps. This will not be the first time that by the wave of the regulator's wand, Startups have had the carpet pulled from under them.

This article examines how negative/overregulation and regulatory uncertainty continues to cripple Startup development in Nigeria and advises how Startups can be better regulated to boost the Nigerian economy and aid Startup survival.

EFFECT OF NEGATIVE/OVER REGULATION AND REGULATORY UNCERTAINTY ON STARTUP DEVELOPMENT

Generally, poor or oppressive regulation can ruin the commercial potential of businesses thus leading to failure of Startups, loss of investments, job losses and general economic decline. We outline below some of the effects of negative regulations, over regulation and/or regulatory uncertainty on Startups:

Failure of Startups

Startup failure is a common occurrence in the tech ecosystem as research shows that 9 out of 10 Startups will fail.[1] However, Nigerian Startups have had peculiar complaints of failure due to political instability, lack of access to finance, lack of power supply and regulatory clampdown. Examples of notable failed Nigerian Startups include: **Efritin.com** (2015 – 2017) which cited poor internet penetration, huge data costs and challenging economic conditions as the major reasons for its failure;[2] **DealDey** (2011 – 2018), one of Nigeria's biggest daily deals eCommerce platform nosedived in 2015 WHEN the company laid off 60% of its workforce and was acquired for US$5MILLION in 2016 before finally calling it quits in 2018; **OLX.com.ng** (2012 – 2018), the virtual eCommerce site experienced a sporadic rise in frauds perpetrated on its platform, which among other issues led to the deals site closing its operations in Nigeria.

Regulation plays a significant part in Startup failure in Nigeria: According to a survey conducted by Ernst & Young, 24% of the Fintech Startups interviewed quoted regulatory outlook/landscape and the unfavorable regulatory environment to be amongst the top challenges they face as a business. Compliance with regulation was identified as the most challenging policy area in the current business environment (at 18%)[3].

Migration of Startups

Nigeria's "ease of doing business" reputation is not enviable and Startups looking to take advantage of the African market are gradually moving base to tech friendly ecosystems like Ghana, South Africa and Kenya and even Startups in Nigeria have relocated between states due to regulatory concerns.

In 2020, SafeBoda, an east- African motorbike hailing startup announced its expansion to Nigeria with plans to launch in Lagos, however, following the 2020 Lagos State Government's ban on motorbike operations on major roads in the state[4], it switched to Ibadan, Oyo State. [5]

Shortly after its US$120M Series B funding, OPay a Nigerian motorbike hailing Startup was forced to stop its core business of bike hailing following the 2020 ban on motorbike operations on major roads across Lagos State. It is reported that GoKada, a Nigerian motorbike hailing Startup, sacked almost 70% of its staff to accommodate the loss of revenue caused by the Lagos motorbike ban[6].

On 12 April 2021, Twitter announced the opening of its operations in Africa with the active building of a team in Ghana. When answering the question "Why Ghana?", Twitter's official statement read, "As a champion for democracy, Ghana is a supporter of free speech, online freedom, and the Open Internet, of which Twitter is also an advocate. Furthermore, Ghana's recent appointment to host the Secretariat of the African Continental Free Trade Area aligns with our overarching goal to establish a presence in the region that will support our efforts… " Twitter's decision to set up shop in Ghana caused a furor among Nigerians.

One week after the Twitter announcement, it is reported that Amazon will locate its African Headquarters in Cape Town, South Africa, further to which it will invest up to US$280 million and create over 5,000 direct jobs and 19,000 indirect jobs. The question must be asked: ***Is regulatory uncertainty and/or over regulation driving these tech giants to other countries?***

[1] https://www.forbes.com/sites/neilpatel/2015/01/16/90-of-startups-will-fail-heres-what-you-need-to-know-about-the-10/?sh=577445266679
[2] https://digestafrica.com/africa-most-high-profile-startup-failures
[3] https://assets.ey.com/content/dam/ey-sites/ey-com/en_ng/ey-fintech-nigeria-census-final.pdf
[4] https://www.economist.com/middle-east-and-africa/2020/03/12/a-ban-on-motorcycle-taxis-is-causing-chaos-in-lagos
[5] https://techcabal.com/2020/03/04/safeboda-launches-in-nigeria/

Innovating around Harmful Regulation

Startups have had to adapt to the realities of the Nigerian ecosystem and innovate their businesses to stay within the regulator's good books while remaining profitable or alive. Following the ban on motorbike hailing in Lagos, Gokada switched its core business model of bike hailing and human transportation to logistics and delivery services around Lagos. Opay runs a mobile money business alongside logistics and delivery services. Piggyvest, a virtual savings and investment platform was forced to migrate its virtual accounts from Providus Bank to Wema Bank following Providus Bank's instant shutdown of virtual accounts because of the February 2020 CBN directive ordering closure of bank accounts of cryptocurrency[8] operators.[9] Innovating around harmful regulation is the murky water tech founders have found themselves wading in Nigeria.

REGULATING FOR SCALABILITY[10]

Regulation is important but it is imperative that the regulatory environment promotes growth, funding, staffing and eventual viability of Startups, i.e., enable Startups achieve scalability within the shortest time, and for that to happen, regulations need to stimulate growth rather than stifle it.

The idea of regulating businesses is to ensure economic growth and boost investor confidence, while protecting customers and the society. Regulatory measures should be utilized to advance innovation, which is key to economic growth and typically entails defying the norm and experimenting with systems that improve processes. Regulations are intended to improve the efficiency of the markets in delivering goods and services – which influences the innovative process. There is a growing consensus that quality of business regulation and the institutions that enforce it are major determinants of prosperity. Regulations that show a lack of understanding of the tech ecosystem will have a negative impact on innovation and the economy at large.

Nigerian regulators have on several occasions opted for bans rather than regulating around innovative processes. The Central Bank of Nigeria by a letter dated 5 February 2021, directed Banks, non-bank financial institutions and financial institutions to immediately close bank accounts belonging to persons and/or entities transacting in cryptocurrency or operating cryptocurrency exchanges.

This directive comes when the popularity and general acceptance of cryptocurrency is on the rise globally as cryptocurrency presents the financial market with a possible alternative to the idea of fiat money. Governments like the United Kingdom and the United States have announced plans to develop their own Central Bank Digital Currency ("CBDC") to supplement the fiat currency[11]. Major corporations and entrepreneurs[12] are not only converting their fiat currencies to cryptocurrency but they are also now accepting payment for goods and services in cryptocurrency[13]. On 8 February 2021, Elon Musk announced that Tesla had purchased US$1.5BILLION worth of Bitcoin and that the electric car company will commence accepting Bitcoin as a medium of exchange for their cars[14].

Despite the volatility warnings around cryptocurrency, the business community is giving it a chance which in return is driving the value and popularity of this medium of exchange. The immediate effect of the CBN's directive was the inability of Nigerian users of web and app based crypto trading platforms like Luno, Binance and Trust wallet to liquidate their crypto assets directly to their Nigerian bank accounts, with bank accounts of active participants frozen with little recourse to the owners.

Regulators of Startups are called upon to be proactive and innovative to ensure that the country does not stifle its own development. Some commendable policies have been drafted by the regulators which have tremendously aided the growth of the tech ecosystem.

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[11] https://markets.businessinsider.com/news/stocks/the-federal-reserve-is-looking-into-developing-digital-currency-us-2019-11-1028705211; https://www.theguardian.com/technology/2020/jan/21/bank-of-england-to-consider-adopting-cryptocurrency
[12] https://techcrunch.com/2021/02/09/meet-the-entrepreneurs-bringing-bitcoin-to-institutions/
[13] https://africa.businessinsider.com/retail/more-companies-including-paypal-and-starbucks-are-accepting-bitcoin-and-other/6mt3b9f
[14] https://www.cnbc.com/2021/02/08/tesla-buys-1point5-billion-in-bitcoin.html
[15] A Regulatory Sandbox is a formal process for firms to conduct live tests of new, innovative products, services, delivery channels or business models in a controlled environment, with regulatory oversight, subject to appropriate conditions and safeguards.

In January 2021, the Central Bank of Nigeria issued the Framework for Regulatory Sandbox Operations in Nigeria which is a formal process for firms to conduct live tests of new, innovative products, services, delivery channels, or business models in a controlled environment, with regulatory oversight, subject to appropriate conditions and safeguards and without the significant investments in licenses. The apex bank followed the above Framework with the Issuance of the Regulatory Framework for Open Banking in Nigeria in February 2021, which aims to promote the sharing and leveraging of customer-permissioned data by Banks and Fintech Startups in order to build solutions and services that provide efficiency, greater financial transparency and enhances access to financial services in Nigeria while ensuring compliance with data privacy laws and regulations in Nigeria, including the Nigerian Data Protection Regulations ("NDPR").

In making laws relating to taxation of Startups, the taxes should be understandable and derivable, such that Startups can factor the taxes into their innovative products and accordingly make returns to the tax authorities. The Electronic Money Transfer Levy ("EMTL") introduced by the Finance Act 2020 introduces a one-off charge of NGN50.00 ($0.13) on electronic receipts, transfers and deposits of money in the sum of N10,000.00 (US$26) or more. The EMTL replaces the Stamp Duties charged on bank deposits and transfers which was outlawed by the Court of Appeal.[2] Depending on where you sit, this is understandable as countries worldwide are taxing digital or payment services, but another tax? On a still emerging sector? Does not exactly help Nigeria's "Ease of Doing Business" perception/ranking and this will have a knock-on effect.

Regulations relating to intellectual property rights, or the degree of protection granted by the government to creators and inventors for innovation are vital. These protections which are embodied in patents, copyrights, trademarks etc., are among the fundamental drivers of technological advances. With the rise in popularity of Non-Fungible Tokens ("NFTs") and Decentralized Finance ("DeFi"), creators and contractors can now make immediate returns on their creative materials or smart contracts, however, there is need for regulation to protect such proprietary rights against piracy and abuse. Weak protection for intellectual property rights can reduce the incentive to innovate.

CONCLUSION

Regulatory reform can be a powerful stimulus to innovation; however, regulatory reform may also lead to abuse of dominant positions in the form of monopolies, economic hazards and stunting business growth. For regulation to effectively address the needs of businesses, it should cater to the economic, social and administrative realities of the country while ensuring that laws are designed to aid the growth and scalability of businesses as opposed to stunting their growth or outrightly killing them.

The Nigerian regulator is charged to accommodate and promote innovation when drafting regulations and seek stakeholder engagement in preparing these regulations, while focusing on the advancement of commerce, industry, employment and a free market. Regulators ought to understand the ecosystem first and avoid overregulating Startups or regulating Startups to death.

Startups on the other hand are advised to seek legal advice early to ensure their innovative products do not run afoul of the law, to protect their intellectual property and to ensure they remain profitable when they need to innovate around perceived detrimental regulations.

A Regulatory Sandbox is a formal process for firms to conduct live tests of new, innovative products, services, delivery channels or business models in a controlled environment, with regulatory oversight, subject to appropriate conditions and safeguards.

[2]Appeal No.: CA/L/437A/2014

[16]A Non-Fungible Token is a unit of data stored on a digital ledger, called a blockchain, that certifies any digital file to be unique. NFT functions like a cryptographic token, but unlike cryptocurrencies, are not mutually interchangeable, hence their being non-fungible. [17]Decentralized finance is a blockchain based form of finance that does not rely on central financial intermediaries such as brokerages, exchanges or banks to offer traditional financial instruments, and utilizes smart contracts on blockchains