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# CORPORATE & COMMERCIAL ALERT

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The COVID-19 pandemic has hit South Africa's economy in unprecedented ways, with many businesses being forced to think of new and innovative ways of operating and staying afloat. The pandemic has seen a rise in businesses having to strengthen their digital presence and has also seen a rise in many businesses scrambling for creative and alternative ways of raising capital other than from existing shareholders or traditional types of loan financing.

## Crowd funding: Viable alternative finance during COVID-19?

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One such means of raising capital which has seen some interest during these times, is crowd funding. Crowd funding is a mechanism of procuring a large number of people to each contribute and pool together money in order to capitalise a certain company or project, typically using the internet, rather than seeking sizable amounts of capital from one or two large investors. Crowd funding, like any other way of raising capital, can take the form of donations, rewards based funding, loan financing and equity financing. The specific forms of crowd funding are based on what (if anything) the person contributing to the crowd fund will receive in exchange for their contribution.

Crowd funding in the form of donations is a type of funding that does not require the entity running the crowd fund to give anything or issue any instrument in return to the persons who contribute to the fund. The persons contribute to the fund because they wish to support the cause or the idea but do not expect anything in return for their contributions.

Contributions can range from resources to finances. This form of crowd funding typically works well in community based projects.

Equity-based crowd funding is a form of funding whereby the person contributing money for the crowd fund does so on the basis that he or she will receive some form of ownership interest in the company which is raising the funds, in the form of shares or other securities. Assuming the company is profitable, the contributors of capital can expect to receive profits in the form of distributions.

One such example of equity based crowd financing in South Africa is that of Beerhouse, the speciality beer hall which opened its first branch in South Africa in 2013. According to Beerhouse's website, it has officially launched South Africa's first crowd funding campaign and is seeking to raise R3,000,000 for its new Tyger Valley branch in Cape Town. The Beerhouse crowd funding campaign, although an equity based crowd funding, also features elements of rewards based crowd funding as is demonstrated by the different investment contribution levels ranging from a minimum investment of R1,000 to a maximum contribution of R250,000, the maximum contribution amount giving investors rewards from previous tiers and a voucher for all 99 different beers.

Although crowd funding itself is not regulated in specific terms in South Africa, the form it takes can determine which legislation applies to it. A company wishing to crowd fund through the offering of its shares to the public (i.e. equity based

## Crowd funding: Viable alternative finance during COVID-19?...continued

The requirement for a prospectus can place a heavy burden on smaller companies or start-ups that do not have access to the traditional types of financing and which are looking to raise equity financing through crowd funding.

funding) would be regulated by Chapter 4 of the Companies Act 71 of 2008 (Companies Act) which deals with public offers of securities. Notably, a "company" in terms of Chapter 4 of the Companies Act also includes a foreign company. Where debt is sourced publicly, or debt securities are offered to the public, one must additionally be mindful of relevant banking legislation pertaining to the soliciting of deposits from the public as this falls within the definition of the "business of a bank".

A key element to a company making an offer of its securities to the public in terms of Chapter 4 of the Companies Act is that such offer must either be accompanied by a registered prospectus which complies with the requirements set out in the Companies Act and Companies Regulations, or such offer can be in the form of an advertisement which satisfies all the requirements with respect to a registered prospectus and is subject to all the provisions relating to the making of a prospectus in terms of the Companies Act. There are extensive requirements related to the preparation, registration and publication of a prospectus. The requirement for a prospectus can place a heavy burden on smaller companies or start-ups that do not have access to the traditional types of financing and which are looking to raise equity financing through crowd funding.

Section 96 of the Companies Act lists instances where an offer, although arguably "public" in its nature and characteristics, nevertheless is deemed

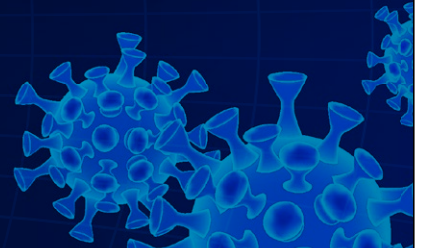
not to constitute an offer to the public (and therefore no prospectus is required). Smaller companies or start-ups wishing to capitalise through equity crowd funding should consider structuring their offers and targeting offerees in such a way as to slot into the safe harbours. Of potential interest for small-scale crowd funding is the particular safe harbour in section 96(1)(g) of the Companies Act, which provides that if, *inter alia*, the public offer is made to a maximum of 50 persons acting as principals, is finalised within six months and the total subscription price for the securities offered does not exceed R1 million, then the offer is not regarded as a public offer for purposes of Chapter 4. However, no such offer or series of offers can be conducted within 12 months of each other. Other safe harbours in section 96 that may be worth considering in the context of crowd funding are offers to persons whose business is to deal in securities, and to financial service providers – approaches to these categories of persons need not be accompanied by a prospectus.

With the lingering uncertainty of economic recovery and the rise of the technological revolution due to the pandemic, crowd funding presents itself as a potentially viable and effective alternative to the traditional types of raising capital for businesses, particularly small businesses and start-ups. However, the public's appetite for this type of financing remains to be seen and will determine the extent of its uptake.

*Yaniv Kleitman, Boipelo Diale and Murendeni Mashige*

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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