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A Study on Crowdfunding in India

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Abstract - Crowd funding, the term itself have a deeper meaning. Crowd funding makes an infant industry grow fast. It is simple as the name suggests "crowd "funds yours business. Now this may sound very simple process of collecting fund from the crowd or people who like yours business but underlines a giant puzzle which has to be started out. It provides new investment avenues and provides a new product for portfolio diversification of investors. Crowd funding is a new paradigm for the young individuals to start up a business. Crowd funding platforms, on the other hand, turns those funnel on-end. By giving you, the entrepreneur, a single platform to build, showcase, and share your pitch resources, this approach dramatically streamlines the traditional model.

Key words: Crowd funding, Portfolio diversification, Crowdfunding types, accredited investors, High net worth individuals, Systematic risk.

I. Introduction

Crowdfunding is new go-to strategy for budding startups. It is the practice of pooling in of resources by numerous people, thus the term 'crowd', to fund prospective projects. It is an alternative finance system where funds are raised through mediums like internet

The modern day crowdfunding is the modified, internet model of the same old concept. The Web has made the entire process of floating an idea and raising funds for the same much easier and faster. Apart from getting access to funds, another major advantage is to getting validation of the idea or concept. Crowdfunding has been used to fund a wide range of for-profit, entrepreneurial ventures such as artistic and creative projects, medical expenses, travel, or community-oriented social entrepreneurship projects.

One of the first instances of using internet to raise funds occurred in 1997 when the British rock group Marillion raised $60,000 from its fans to fund its North American tour. ArtistShare was the first US-based company to establish the crowdfunding website in 2001.

II. Literature Review

Ethan Mollick (2014) Crowdfunding permits founders of for-profit, artistic, and cultural ventures to fund their efforts by drawing on relatively little contributions from a comparatively sizable amount of people using the internet, whereas no regulated monetary intermediaries. Author realize that the overwhelming majority of founders appear to meet their obligations to funders, however that over 75% deliver merchandise later than expected, with the degree of delay foreseen by quantity and amount of funding a project receives. These results provide insight into the rising development of crowdfunding, and shed light on ways in which the actions of founders might have an effect on their ability to receive entrepreneurial funding.

SimaJegelevičiūtė, LoretaValančienė (2015) In this paper, a listing of crowdfunding agencies and their pursuits is furnished in addition to a top level view of crowdfunding guidelines in the countries like USA, UK, Canada, Germany, France, Australia and Italy. Author also recommended that even though all nations are developing legal frameworks, enlightening entrepreneurs and promoting a good crowdfunding cases, different actions including selling a excellent label for crowdfunding websites, educating investor and creating an overview of true crowdfunding platforms are done only by few of the service providers.

Prinsha K. (2016) The normal technique to commercial enterprise finance is largely the opposite of crowdfunding. Traditionally, to begin enterprise or launch new product the entrepreneur has to do marketplace research, put together a business plan, and make a prototype to validate the concept and look for investors to aid the business financially. These resources of financing included banks, angel buyers and assignment capital businesses, which really restricted the alternatives to more than one key players. This fundraising method may be seen as a funnel, which pitch at the extensive quit and the investor target market at the closed give up. This approach dramatically streamlines the traditional model, giving entrepreneur a single platform for building, displaying and sharing their capabilities.

Irma Borst, Et.al, (2018) Crowdfunding includes raising small quantities of money from a large array of investors, commonly through the Internet and social networks, to fund a new project. To look at how mission creators are searching for to attract funding from greater distant/potential resources in addition to current networks they examined usage of social media and the crowdfunding platform. They analyzed 10 cultural initiatives hosted at the Dutch crowdfunding platform

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"Voordekunst." The results make a contribution to theorizing on latent tie activation by demonstrating that social media messages and platform updates upload financial fee to the crowdfunding attempt. They also explain the moderating impact of these messages on funders of numerous strengths.

III. Scope of Crowdfunding

Crowdfunding is an exciting new possibility that permits non-profits and business start-ups to raise finances for his or her projects at the same time as additionally allowing them to develop their captive target market. Crowdfunding has taken the complete economic global hurricane and India is not any exception. India has already witnessed quite a few fulfillment testimonies owing to crowdfunding. The Indian marketplace does not take kindly to online investments & fundraising, which increases a top notch subject for potential entrepreneurs. some other motive that slows the growth of crowdfunding in India, as compared to other nations, is that the authorities is yet to take a stance on the concept of online fundraising. so far, policy makers have avoided the topic altogether and reputedly shrug to deal with it. A solitary assertion from the officers encouraging crowdfunding could move an extended way in helping the loads subsequently region their trust and comfortably receive crowdfunding. Entrepreneurship through crowdfunding poses to be a splendid solution for a number of India's unorthodox economic challenges that can't be tackled with traditional techniques alone.

How does crowdfunding work

Crowdfunding is a fairly new sector that is still developing. While it is an exciting prospect for many - and gives small businesses access to funding opportunities like never before - it can be a confusing arena for most people because it is presented in such a wide spectrum of ways.

Investments or donations are usually made through online platforms, which then coordinate and administer the fundraising.

Projects will range from those helping to finance community-based projects for no financial return (but a fuzzy, warm feeling inside), to sophisticated portfolio-picking, purely for monetary gain.

IV. Types of Crowdfunding

Crowdfunding varies depending on the product or service you offer and your goals of growth and reimbursement. There are three primary types including donation-based, debt-based and equity crowdfunding.

- **Donation-Based Crowdfunding**

Donation-based crowdfunding is where the investors or contributors are promised no financial returns. People usually invest because they believe in the cause as these campaigns are mostly cause-based. Nevertheless, minor tokens can be offered in order to express gratitude towards the investors.

These include fundraising for disaster relief, medical bills, charities, and other non-profit ventures.

- **Debt-Based Crowdfunding**

This method promises the contributors their money back with interest. It is also called 'peer-to-peer (p2p)' lending and doesn't account for much involvement of traditional banking.

Along with financial returns, the investors get the satisfaction of having contributed to the success of a prospective idea which speaks to them through micro-financing. These campaigns usually include personal startup ventures.

- **Equity Crowdfunding**

This type of funding is different from both the above-mentioned ones as the contributors become part-owners of your company. They acquire equity shares in exchange for capital receiving return on their investment as well as a share of the profits. They are also entitled to a dividend.

If the venture turns out to be successful, the share value goes up and if not, the value goes down. This type of funding is a sort of gamble which can go either way and is much more risky.

Some of the beneficial difference crowdfunding offer

Wider reach – It provides you wider access to thousands of investors whom you can personally interact with instead of a few unapproachable ones. They are likely to understand your campaign better.

Presentation – It helps you look at your idea from different angles helping you understand where it needs polishing. Thus, you are able to present it in a better way to the right people.

Marketing – It is a brilliant way of marketing your business before even starting it as provides exposure to millions of users and investors. It also provides media coverage of your campaign which you can use to attract traffic to your website.

Concept validation – Presenting your concept to the masses helps you acquire validation and refine it for potential investors. You can analyze the mistakes, find out what is missing and make changes accordingly in order to put your best foot forward. If they fund you, then you know your idea holds credibility.

Freedom from banks – In the present times where it is so difficult to get funding from banks, this a profitable approach. Moreover, most banks are mostly interested in big-shot customers promising big returns and have no room for small startups.

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THE CROWDFUNDING OPERATIONS

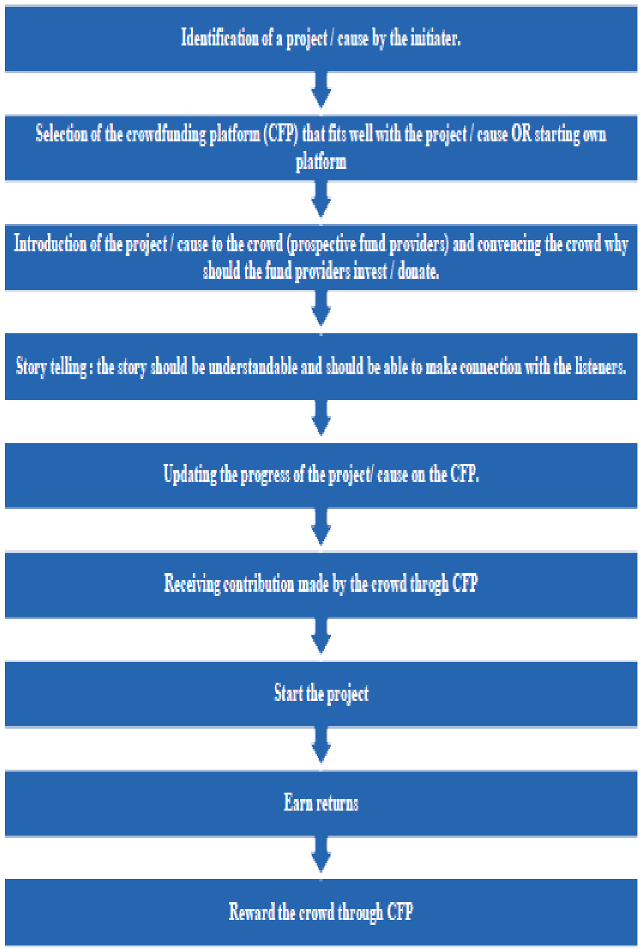

Fig. 1 – The working of crowdfunding

The risks for investors and how can they realise a profit

Let there be no doubt - crowdfunding can be a very risky business. Because there is no guarantee investors will receive a return. In fact, majority of start-up businesses fail investor could end up losing all of their money.

While investor may receive a share of a business or project, dividends are rare and their investment could be diluted if more shares are issued.

They must also take a long-term view to any returns - it can take a while before start-ups begin making the big bucks and investors should not expect instant returns on equity investments. Their stake will only become worth when the business floats on the stock market, in which case it will have enjoyed many years of success, or if management buy back stocks from investors.

However, most crowdfunds are illiquid, meaning it can be difficult, or even impossible, to claim back money invested or have it converted back into cash - an issue to bear in mind if investor is thinking of taking the equity route. There is no secondary market to sell their shares or crowdfunding investment.

There may also be the prospect of dividend returns and some projects will pledge to return ongoing profits to investors. But, in general, more ideas get financial support today than can possibly return capital so investors are advised not to risk more than they can stand to lose.

V. CROWDFUNDING IN INDIA

Crowdfunding is nothing new to India. Since centuries we have been donating ‘chanda’ for some or the other socio-cultural cause, such as building of religious infrastructure.

The online scene is a bit of a different matter though. Crowdfunding, a concept originated in the West, much like most of other western ideas has started infiltrating the Indian masses. But, the crowdfunding scene in India is rather new with not much awareness amongst people.

Regulation

Crowdfunding, presently in a pubescent stage, has to face a lot of problems in India. Firstly, there is no proper legal regulation setting up rules regarding and specifying the same.

But the lawmakers noticed the need to regulate this business model. Thus, Securities and Exchange Board of India (SEBI) released a consultation paper on crowdfunding released in 2014 acknowledging the need for the same.

SEBI defined crowdfunding as solicitation of funds (small amount) from multiple investors through a web-based platform or social networking site for a specific project, business venture or social cause.”

SEBI has proposed to put certain limitations on who could be a crowdfunding investor. They have proposed the limitations in India after looking at what other countries like US, UK, France and other have done.

Only Accredited investors can invest money in crowdfunding projects and here are the qualifications of an accredited investor.

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Limits to Crowdfunding Investment

SEBI will allow private placement offers through internet based crowdfunding platforms to any number of Qualified Institutional Buyer (QIBs) and a maximum of 200 High Net Worth Individuals (HNIs)

Collectively, QIBs will need to hold a minimum of 5% of the securities issued and a company will be required to purchase atleast 4 times the min offer value per person. A high networth individual is required to purchase at least 3 times the minimum offer value per person.

Also, for a retail investor, the total of all investments in crowdfunding in a year should not exceed 10% of their net worth.

Apart from these, there are certain conditions that an accredited investor should meet. As the investment will be done through Demat, the investors should hold a demat account and the payment has to be made through a DD or cheque. Payments by Cash or Credit Cards is not authorized. Also, a person will only be eligible as a investor he they are an Indian citizen or a NRI.

Who are eligible to Raise Crowdfunding?

An early stage startup or SME which is an unlisted public company incorporated in India are eligible to raise crowdfunding if they meet following criteria.

- The company intending to raise capital NOT exceeding Rs. 10 Crore in a period of 12 months
- A company which is not promoted, sponsored or related to an industrial group which has a turnover in excess of Rs. 25 Crores.
- A company which is not listed on any exchange
- A company which is not more than 4 years old
- A company which is not engaged in real estate and activities which are not permitted under industrial policy of Government of India.
- The companies should not haves directors, promoters or associates mentioned as a 'defaulter' or a 'willful defaulter' by RBI or CIBIL.

Apart from these, SEBI also states that a company wanting to raise crowdfunding should not list on multiple crowdfunding platforms. The companies should compulsorily route all crowdfunding issues through a SEBI recognized Crowdfunding Platform.

The company interested in crowdfunding should also provide provisions for oversubscription. Among other conditions, the issuers will not have any single investor holding more than 25% stake in the company and the promoter(s) shall be required to maintain a minimum of 5% equity stake in the company for at least 3 years.

India's Top Crowdfunding Platforms

- Rang De.
- Faircent
- Ketto.
- Wishberry.
- FuelADream.
- Catapooolt.
- Bitgiving

The crowdfunding platforms in India are still desirable and have a long way to go till they reach the status claimed by foreign crowdfunding giants like Kickstarter, Indiegogo, etc. Due to the restrictive admission policy of most of these foreign platforms, they are mostly unapproachable to budding Indian startups.

In the later part of 2016, over 20 crowdfunding platforms were deemed 'illegal' by SEBI. Reward-based and Donor-based platforms still operate, while equity based crowdfunding has seen a lot of scrutiny from SEBI. SEBI announced that it is taking a fresh look at crowdfunding regulations, including perhaps, even a legal framework allowing equity crowdfunding.

VI. Conclusion

Crowdfunding is developing in recognition, as bank liquidity is reduced and new regulatory requirements make getting loans for small and medium companies and individuals hard. In India, throughout the previous few years, the IPO marketplace has no longer been very energetic. although, SEBI, has been at the leading edge in facilitating fund elevating via SMEs via measures like SME section in stock Exchanges, category I- SME funds under AIF, Institutional Trading Platform, etc., nonetheless there is need to encourage innovative way of fund raising to offer an impetus to real SMEs/start-ups and to explore different alternative method of fund raising with appropriate framework in consonance with retail investor safety. To summarize the idea of crowdfunding which is going to be added within the Indian laws is a complicated idea having both its merits and demerits. Mostly all the risks related to crowdfunding are related to the internet. If the internet becomes a more secure area to perform activities of trade, then crowdfunding is a concept that would be capable of reaching its capability to complete and might feature as a channel in figuring out goals of various entrepreneurs. Awareness programs should be initiated by SEBI to educate entrepreneurs, issuers and structures intrinsic information about the method. The goal has to be to create confidence in entrepreneurs who will start trusting and move ahead to fulfill their dream tasks. It is essential to ensure that no systemic risks are created in which retail investors are lured by means of some

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unscrupulous gamers by using substituting the existing framework, which has been evolved over a time frame through experience and keen observation. Therefore, there's necessity to strike a proper stability between investor safety and the role equity markets can play in assisting financial development and growth.

Crowdfunding is fast growing and with the right set of rules in place might just be the next big thing in the startup sector. It is sure to go a long way.

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