

# An Empirical Overview of Crowd Funding – An Emerging Trend in India

**G.Pavan Krishna**

MBA student PACE Institute of Technology & Sciences

## INTRODUCTION

Crowd funding is an internet-enabled way for businesses or other organizations to raise money in the form of either donations or investments from multiple individuals. This new form of capital formation emerged in an organized way in the wake of the 2008 financial crisis largely because of the difficulties faced by artisans, entrepreneurs and early-stage enterprises in raising funds. With traditional banks less willing to lend, entrepreneurs started to look elsewhere for capital.

Crowd funding began as an online extension of traditional financing by friends and family: communities pool money to fund members with business ideas. In less than a decade, crowd funding has gained traction in a number of developed economies, including Australia, The United Kingdom, the Netherlands, Italy and the United States. This exciting phenomenon is spreading across the developed world and is now attracting considerable interest in the developing world as well.

Crowd funding, a popular concept started in the US and the UK, is an emerging way of raising capital, entails the use of internet or social networking sites such as Face book or LinkedIn or Twitter or even some dedicated websites.

Crowd funding is the process of one party financing a project by requesting and receiving small contribution from many parties in exchange for a form of value to those parties. Crowd funding connects investors with small business start-ups and projects through an online transaction portal that removes barriers to entry.

With support from governments and development organizations, crowd funding could become a useful tool in the developing world as well. Interestingly, it can be said that India has seen a massive crowd funding success story many years before the term was coined: the story of the Reliance Industries founder Dhirubhai Ambani.

His small yet growing textile business was crowd funded by communities across the Indian state of Gujarat. Today's India with its huge market and human capital has become a popular destination for global business and other investments that have identified opportunities. Its crowd funding however has been restricted to micro financing category projects, and the occasional donation-reward funding category.

## OBJECTIVES

1. The US and Indian scenario about crowd funding.
2. Key factors that have facilitated crowd funding in developed countries.
3. Models of crowd funding.
4. The legal issues and challenges in India.
5. Risks in crowd funding and how to mitigate them
6. Pros and cons of crowd funding

## RESEARCH METHODOLOGY

This research is a descriptive study in nature. The secondary data was collected from various websites, journals and news papers.

## US Scenario

The US Securities and Exchange Commission (SEC) has come up with a proposal for crowd funding, the highlights of which are as follows:

- A company could raise up to \$1 million for equity through crowd funding each year.
- A company raising more than \$500,000 must file more detailed information to the SEC.
- A company must provide educational information to investors, ensuring investors know what they are buying and understand their risks.
- Investors with a net annual income of less than \$100,000 would be permitted to invest up to only \$2,000 or 5 percent of their annual income or net worth every year.

- Investors with net income or annual income of more than \$100,000 would be able to invest 10 percent of that every year.
- Securities would need to be purchased through online crowd funding portals – a new class created by the SEC.
- Securities purchased through portals would have to be held a year before sold.

Key factors that have facilitated crowd funding in developed countries include:

- A regulatory framework that leverages the transparency, speed and scale that advances in technology and the internet can deliver to early-stage funding marketplaces.
- Strong social media market penetration and internet usage, which is necessary to harness demographic and technology trends to drive collaboration and cultural shifts.
- A regulated online marketplace that facilitates capital formation while providing prudent investor protections through education and training.
- Collaboration with other entrepreneurial events and hubs including business plan competitions, incubators, accelerators, universities and co-working spaces to create a channel for opportunity and oversight.

All of these factors are necessary to build the culture of trust which is essential for the funding of companies, projects and causes mediated primarily through web-based interactions.

### Indian scenario

India is a huge, developing country and enormous economy. With a population of over 1.2 Billion, and a middle class that is expanding dramatically, one would expect the capital formation power of crowd funding would be taking hold in this dynamic country. Equity crowd funding is not live yet in India, but it is expected to hit the country at some point in the near future.

In the next six months or so, many crowd funding platforms are expected to be in India. Worldwide, nearly a thousand such platforms will be launched. Recently, platforms such as Wishberry and Ignite Intent have been launched in the country. Most of them are in the rewards and donation space, as there aren't too many regulatory issues around this model. There have been attempts at crowd funding for events like the Goa Project and campaigns like

Teach for India. Crowd funding is slowly becoming an alternative funding channel for the film industry. Film Director Pawan Kumar from Karnataka recently raised Rs 50 lakh using Facebook and other platforms.

CROWD FUNDING IS THE PRACTICE OF FUNDING A PROJECT OR VENTURE BY RAISING MONEY FROM A LARGE NUMBER OF PEOPLE, TYPICALLY VIA THE INTERNET



CROWD-FUNDING IN INDIA

### Who is doing this?

Filmmakers, software developers, scientists and others have successfully raised funds for their projects through crowdfunding

### CROWD FUNDING: DRIVERS

As India being the one biggest country for Non Government Organizations (NGOs), crowd funding stands a big chance. "Lot of new platforms are going to come in the next few days". Many colleges and even individuals will push students to list causes on crowd funding platforms.

The new companies act, which mandates all companies to spend 2% of their profits on corporate social responsibility, will also help them crowd funding gain traction.

## Models

1. Donation model – In this model, individuals make a financial contribution to a project without any expectations of financial benefits.
2. Lending model – In this, the investor will loan money to the project with the expectation of being repaid under the terms and conditions agreed.
3. Investment model - The investor receives an equity stake in the project.

## Challenges in India

1. The idea of crowd funding is not new in India. Places of worship, for example, are built overnight using a large number of donations. However, the concept of online crowd funding is new to the country.
2. The industry is also not very investor-friendly. It seems people are still not ready for this concept.
3. Low trust levels of doing the things online are also a challenge. India's ecommerce space needs to really mature before anything substantial can happen in this space. People need to be spending more and more online for them to even start thinking about backing online projects online.
4. Ecommerce in India only got a boost when they initiated the concept of cash on delivery. Similarly, crowd funding will have to look at building an offline base to finally induce mass awareness and encouraging larger participation.

## Legal issues

There are legal issues around crowd funding in India, since equity-based online crowd funding is not legalized in India yet. It was made legal in the US recently when the Jumpstart Our Business Startups Act (JOBS) act was passed. Some of the key points of this Act are:

- The JOBS Act has put much restriction on the amount that can be borrowed via crowd funding.
- The Act has put an audit compulsion by certified public accountant in some cases of crowd funding. Disclosures need to be made by the company raising funds and utilizing it.

- The company needs to explain everything about its project for which it is raising funds. The fund utilization plan needs to be disclosed.

Here in India, the concept is catching up fast and is posing a danger at the same time, as very soon these funds could scale up. Many money laundering schemes might run in the name of crowd funding via social media, pushing SEBI to set up a regulatory framework if it is found that such platforms involve large amounts of money or issuance of securities. A discussion is on to find a nodal agency for such activities following a talk with various stakeholders like banking regulator RBI, Finance Ministry and Corporate Affairs Ministry. An official from SEBI stated that apart from setting up new rules after discussions with the stakeholders, any crowd funding involving sale of securities can be either regulated under SEBI's existing norms for Collective Investment Schemes or Alternative Investment funds.

## THE RISKS IN CROWD FUNDING AND HOW TO MITIGATE THEM

Crowd funding comes with risk to the investor. CFI is not unique in this regard, but it does have characteristics that require regulatory protection and robust investor education for crowd funding to contribute meaningfully and successfully to a country's economy. Crowd funding markets have been operating in many countries for several years with few reported instances of fraud. However, as the market expands, there will inevitably be attempts to circumvent regulations and defraud investors. Despite this, the biggest concerns regarding risk are business failure and execution or fulfilment challenges. Failure may result from poor management decisions, lack of funds, or miscalculations of market demand. Execution or fulfilment challenges may occur in some successful crowd funding campaigns when a company is not ready with, for instance, the necessary logistics and manufacturing capacity to meet the demand generated by their campaign. These risks may be mitigated through regulation, technology, social and cultural approaches:

- Regulation
- Technology
- Social
- Cultural

### **ADVANTAGES OF CROWD FUNDING**

It is a new concept in India and many of us are unaware about its advantages. Crowd funding has proved to be very advantageous.

1. Lack of money becomes a hurdle in the way of talented people. Crowd funding helps to cross that hurdle and fulfil dreams.
2. It is open to anyone with potential and a dream. Artists, musicians, painters, dancers, singers, photographers, writers, scientists, event managers anyone can benefit from crowd funding.
3. It helps collect funds for the project quickly and easily. Don't have to invest lifetime savings or wait for years to save money to make ones dream come true.
4. Crowd funding minimizes the tedious fundraising process (and its associated time and cost) so entrepreneurs spend more time where it counts, on the business. Scrappy entrepreneurs from humble means are no longer disadvantaged when trying to launch companies from scratch.
5. Anyone who is interested and has a little capital to spare can participate in financings. Ultimately, the industry shifts from "rich gets richer" to "smart gets richer." Diversification of the investor base is good for management, who receives a wealth of points-of-view but is no longer beholden to a small number of parties.
6. Complex, difficult, and niche ideas get funded. Entrepreneurs not constrained to 5-7 year payback windows can pursue models with high creativity, democratized invention, and positive externalities in society. Unusual companies have the opportunity to form, recruit sharp minds and push boundaries.

### **DISADVANTAGES**

1. By putting less of their own skin in the game and no longer facing investors one-on-one, entrepreneurs lose out on the truly valuable step of convincing others
2. Crowd funding information is highly asymmetric with respect to what VCs and (to a lesser extent) angels obtain in diligence. Investors are susceptible to fraud or just plain incompetence.
3. Crazy ideas get funded. More ideas get funded today than can possibly return capital, but with crowd funding the

percentage of successes markedly decreases. A lion's share of crowd funded investments will never make money and investors will be out-of-luck. While small, fragmented investments limit the catastrophic risk to any single investor, too many failures will give crowd funding a bad rap and prompt regulatory tightening.

### **PRESENT SCENARIO OF ORGANIZATIONS IN INDIA WORKING THROUGH CROWD FUNDING**

National Crowd funding Association (NCFA) of India is an organisation to promote crowd funding in India. NCFA provides its members with opportunities to shape the industry, learn the details of the marketplace, and stay informed and ahead in this dynamic industry. The mission of NCFA is to support, educate, and establish the Indian crowd funding market. NCFA India holds an independent position with membership open to the general public including interested parties such as entrepreneurs, investors, lawyers, technologists, financial advisors, regulators, educators, students, media professionals and those who serve the industry, whether donation-based or equity-based.

### **FUNDMYDREAM: A NEW AND UNIQUE CROWD FUNDING PLATFORM**

Fundmydream is a crowd funding platform for genuinely enterprising projects in India, packaged along with a breath of fresh air, with people bubbling with confidence and a sharp mind with creative bent. Crowd funding is a concept where creative people collect funds for passionate and creative projects, where the people who fund will get cool rewards.

India is geared to see a new and unique crowd funding platform. Launched in Dec' 2013, fundmydream will fulfill the dreams of thousands of entrepreneurs who couldn't start because of money. Fundmydream is a brain child of Rohith Subramanian. Rohith has entrepreneurship in his DNA, he did his first internship in the age of 14, made his first b-plan very next year and he started an NGO (Unity of Youth) when he stepped in the "Youth Phase" of his life (i.e., 18yrs Old).

Rohith started FundMyDream in Oct'2013. At this platform you can contribute by bare minimum amount of INR 100.

What makes them different from other crowd funding platform is that they assign a team for every project which goes live in the site and take personal care of it till its date of completion.

Anyone who appreciates the concept of supporting creativity, skill and talent can contribute either through

1. Online – Credit card or Debit card or Netbanking
2. Offline – Cheque, Demand Draft

### **HUNGER FREE INDIA FOUNDATION**

The project launched by Hunger Free India Foundation aims to build 100 restrooms across rural India in the year 2014. This project will benefit nearly two lakh government school children. Funds for the project are being raised through crowd funding via Fund My Dream, an online crowd funding platform. It brings together the entire nation to work for the welfare of its girls. Initiated by Sarathbabu Elumalai the project is a joint venture of every citizen of India.

### **CONCLUSION**

There is no doubt that crowd funding is rapidly being looked upon as a serious way of raising funds for startups and new businesses. The US and European agencies have started implementing laws for this to function. There are serious concerns, which make it mandatory to bring this method under the laws of the land. India may soon bring in the requisite laws to support this in a big way, as efficient crowd funding system can really play the role of catalyst in bringing the startup ideas into reality.

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