
A Study on Crowdfunding

Harsh Agarwal

Student

St. Joseph's Degree and PG College, Hyderabad

Abstract

Crowdfunding is the use of small amounts of capital from a large number of individuals to finance a new business venture. Crowdfunding makes use of the easy accessibility of vast networks of people through social media and crowdfunding websites to bring investors and entrepreneurs together. Crowdfunding websites such as Kickstarter and Indiegogo attract thousands of people hoping to invest in the next big thing. Crowdfunding is a form of crowdsourcing and of alternative finance. Crowdfunding has the potential to increase entrepreneurship by expanding the pool of investors from whom funds can be raised beyond the traditional circle of owners, relatives and venture capitalists. Crowdfunding sites are sometimes referred to as platforms because they provide a venue for all aspects of a campaign, such as creation of the public interface, campaign and project tracking, a payment mechanism and disbursement of funds. Crowdfunding has been around for a while, but in the world of finance, fundraising using online platforms is fairly new. For this reason, rules and regulations to govern it have not been clearly defined and therefore, a lot of the campaigns happen with barely enough supervision to minimize the risk such as fraud: the funds may be used for some other purpose rather using for the purpose for it has raised; Risk in investing in startup's: the investor may not get a proper return on capital; There are limited follow up mechanisms; The objective of the research is,

-) *To study the investors awareness of crowdfunding ; about different crowdfunding websites*
-) *To study the risk of investor ; risk involved in investing the in newly startup company*

Keywords: *Crowdfunding, risk, investors*

Introduction

Crowd funding is the use of small amounts of capital from a large number of individuals to finance a new business venture. Crowd funding is "the" alternative method for entrepreneurs, creative thinkers, and non-profits to get funding. In its basic form, it is the pooling together of small amounts of money from a group of people that share your passion and that you interact with online using social media.

Crowd funding makes use of the easy accessibility of vast networks of people through social media and Crowdfunding websites to bring investors and entrepreneurs together. Everyone can use Crowdfunding. Anyone can go to a Crowdfunding website, create an account, build a campaign and post it. Crowd funding websites such as Kickstarter and Indiegogo attract thousands of people hoping to invest in the next big thing.

Crowdfunding is a form of crowdsourcing and of alternative finance. Crowdfunding has the potential to increase entrepreneurship by expanding the pool of investors from whom funds can be raised beyond the traditional circle of owners, relatives and venture capitalists.

Crowdfunding sites are sometimes referred to as platforms because they provide a venue for all aspects of a campaign, such as creation of the public interface, campaign and project tracking, a payment mechanism and disbursement of funds.

According to the **UK Crowdfunding Association (CFA)**, there are officially three different forms of crowdfunding: Donation/Social lending crowdfunding, Reward Crowdfunding, Peer-to-Peer lending, debt and equity Crowdfunding

Donation Crowdfunding:

Donation crowdfunding denotes solicitation of funds for social, artistic, philanthropic or other purpose, and not in exchange for anything of tangible value. For example, In the US, Kickstarter, Indiegogo etc. are some of the platforms that support donation based crowdfunding.

Reward Crowdfunding:

Reward crowdfunding refers to solicitation of funds, wherein investors receive some existing or future tangible rewards as consideration.

Peer-to-Peer lending:

In Peer-to-Peer lending, an online platform matches lenders/investors with borrowers/issuers in order to provide unsecured loans and the interest rate is set by the platform. Some Peer-to-Peer platforms arrange loans between individuals, while other platforms pool funds which are then lent to small and medium-sized businesses.

Equity Based Crowdfunding:

In Equity Based Crowdfunding, in consideration of funds solicited from investors, Equity Shares of the Company are issued.

Regulatory framework for Crowdfunding in various Jurisdictions

As of date, very few jurisdictions have come out with regulations for crowdfunding. Some jurisdictions are in the initial stages of introduction with concept papers for feedback of the industry.

Two areas that have seen rapid growth in recent years are Peer-to-Peer lending and Equity Crowdfunding. Financial Reward (FR) crowd-funding globally has grown rapidly in the last 5 years, with data suggesting that the peer-to-peer lending market doubles each year. It accounts for approximately \$6.4 billion outstanding globally. Collectively, the US, UK and China make up 96% of the overall FR crowdfunding market, with USA accounting for 51%, China for 28% and UK for 17%.

Risk in crowdfunding

Crowdfunding has been around for a while, but in the world of finance, fundraising using online platforms is fairly new. For this reason, rules and regulations to govern it have not been clearly defined and therefore, a lot of the campaigns happen with barely enough supervision to minimize the crowdfunding risk such as:

1. Risk of fraud: the funds may be used for some other purpose and not for which they have been raised. The creator may also show an idea he/she doesn't own. The creator, who has been deemed malicious, may also use the campaign to go on a Phishing trip, where he/she gains access to a backer's personal and financial.
2. Risk of investing in startups: the investor may not get a proper return on capital or there may also be a chance of no return on capital. There are limited follow up mechanisms as well.
3. There is no protection of intellectual property on Crowdfunding platforms
4. A lot of the creators posting their projects online have good ideas and no business expertise. They have no idea how to set up a business or how to fulfill the legal requirements of owning a business and do not have experts to guide them on this. This is a recipe for disaster.
5. For Crowdfunding, transactions are one time, and not continuous. Business owners and project creators must learn how to balance the short term influx of cash raised through Crowdfunding efforts with the daily cash flow expense requirements of their business.

Risks of Equity Crowdfunding

1. Greater risk of failure:

A business that has been capitalized through equity crowdfunding may run into greater risk of failure because of lack of experiences.

2. Returns may take years to materialize:

It may take longer period for return on investor's investment and in some cases, there may be no returns.

3. Security of the crowdfunding portal or platform:

In recent years, hackers have displayed an alarming ability to break into seemingly impregnable data repositories of leading retailers and companies and steal credit card details and other valuable client information. A similar risk exists for crowdfunding portals and platforms, which are vulnerable to attacks from hackers and cyber-criminals. The prospect of possible credit card or identity theft from a crowdfunding portal is a risk that needs to be taken into consideration.

4. Lower-quality investments may be the norm:

The question arises whether a company would only use equity crowdfunding as a last resort. For example, if a company is unable to attract funding from conventional start-up funding sources like angel investors and venture capitalists, perhaps then it would turn to equity crowdfunding. If that is indeed the case, then equity crowdfunded businesses are likely to be more mediocre investment opportunities with limited growth potential.

Finally, tax laws governing the ecommerce environment are not clearly defined. For instance, since the funding happens across borders, do international tax laws apply? If rewards can be looked at as sources of income or material possessions, should these be taxed as well?

The Crowdfunding industry will need a lot of regulation to minimize the above mentioned risks. However, many governments are torn between regulating the industry, by leaving it as it is, or over regulation that will end up killing the innovation that has been borne by this wild finance market that it is. One thing is for sure, whether the governments choose to regulate it or not, we must be aware of the risks before embarking on Crowdfunding either as a backer or as a creator. Now that you know the risks, consider yourself saved.

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.



Select Suitable Platform: There are a lot of different crowdfunding sites to choose from, such as Crowdcube, Crowdfunder and Kickstarter. Choose the platform that is right for you and create your project.

Make an Impactful Idea: In order to get the attention of potential investors, be sure to have a short and snappy sales pitch and some great imagery or video content related to your idea. This will help you stand out.

Propose Investors with captivating rewards: With all projects, the rewards for investing are based on how much someone chooses to invest, but make sure the rewards are good. Don't just expect a 'thank you' to be enough of a reward. Consider early access to the product or service, discounts and extra goodies that will show people they will actually get something back for their money.

Introduce a wide range of investment levels: Some people will only want to invest a small amount, whereas others will be happy to provide a lot more (providing the reward is appropriate to their investment) so make sure you offer a few different levels of investment.

Make an Idea worth sharing: Successful crowdfunding projects often do so well because investors are excited about the idea they have contributed to and want to tell others, so make sure they can share it on social media easily.

And lastly, Let people know about your idea. Be sure to think about how you are going to get the word out, utilize social media, give networking a try, and definitely keep your investors updated on the progress of your campaign

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.

The global Crowdfunding industry generated about \$ 34.4 billion in capital last year. No reliable numbers are available for India though it is estimated it accounts for a small fraction of this. "Yet local Crowdfunding sites are proliferating and drawing attention from backers, and India is now the world's second largest internet market with more than 342 millions mobile users and online payment options that make it easy money, says Bloomberg"

Crowdfunding is limited to giving donations and loans. The securities and exchange board of India (SEBI) claims that the Indian public lacks adequate investment knowledge or experience and requires strict protection. It has recently sidelined an incomplete aim to create a regulatory framework for investment Crowdfunding and equity Crowdfunding in India remain on hold.

The biggest player in the market, Milaap, has raised the equivalent of over US \$12.7 million through donations and micro loans, though spread across close to 50 thousand projects it has averaged around just \$260 per project. The beneficiaries of these low cost loans and relatively small donations have largely been people in rural India and in underprivileged sections of society. Other platforms better serve the creative arts and larger community benefits, through beyond micro-business Crowdfunding isn't yet a major opportunity for entrepreneurs.

India top Peer to Peer lending platforms are,

Rang De, Founded in Bengaluru in 2008, **Co-founders:** Smita Ram and Ram N. K. A remarkable aspect is that over 93% of borrowers have been women.

Faircent **Co-founders:** Rajat Gandhi, Vinay Matthews, Nitin Gupta, Located at Gurgaon. Faircent has more than 6,000 potential lenders and 26,000 want-to-be borrowers on its platform and has disbursed total loans worth almost USD 973,000 in the last 24 months.

Ketto, Co-founders: Kunal Kapoor, Varun Sheth and Zaheer Adenwala

Founded in 2012, Mumbai-based Ketto supports fundraisers in three main categories:

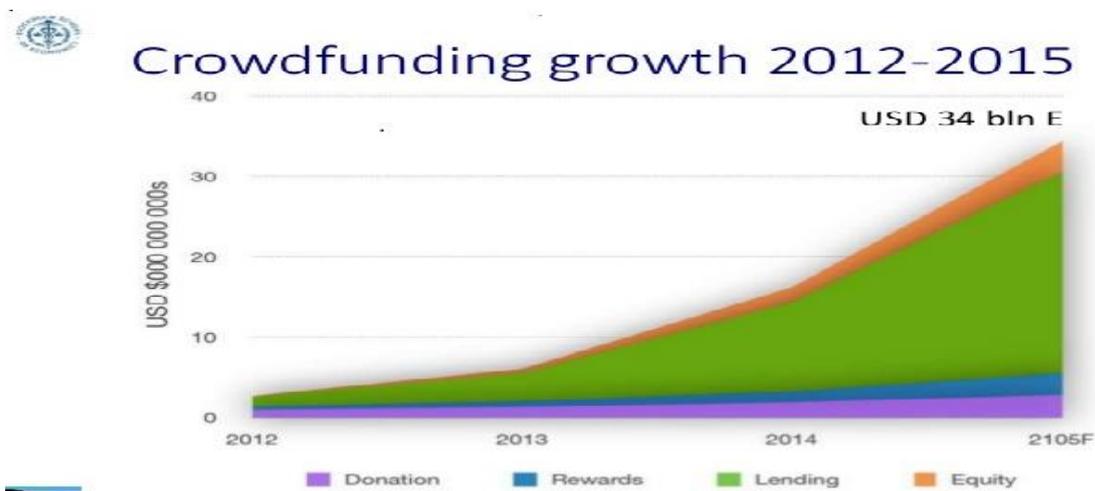
Community, Creative arts and Personal development.

Wishberry, Co-founders: Priyanka Agarwal, Anshulika Dubey

Wishberry is a donations-for-rewards crowdfunding platform founded in 2010 in Mumbai and is exclusively dedicated to funding creative projects – music, stand-up comedy, film production, art, dance, design, photography, publishing, theatre.

Other Peer to Peer crowdfunding webstutes are ,FuelADream, Catapooolt ,Bitgiving ,crowdera , Millap , Impact guru etc

Other Crowdfunding Websites are Start 51, Dream wallets, FundDream India, Ignite Intent, TheHotStart, etc



From the above chart , we can conclude that equity and lending crowdfunding has been increasing rapidly form 2012 to 2015 , whereas Donation and Reward crowdfunding has not been increased much from 2012 to 2015 Total Global Crowdfunding Industry estimated fundraising volume in 2015: **\$34 Billion** Breakdown:

- Lending \$25B
- Reward and Donation Crowdfunding: \$5.5B
- Equity Crowdfunding \$2.5B

Problems of crowdfunding

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 seem to have noticed the need to regulate this business model. Thus, late last year, the Securities and Exchange Board of India (SEBI) released a paper acknowledging the need for the same. It 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.”

Some problems with regard to crowdfunding are,

1. Trust: The newly startup company have built trust among the investors because without trust they can't raise funds.
2. Choosing right platform:the company has to select the most appropriate platform to raise funds. There are various websites from which they have to select like Kickstarter , Millap etc
3. Realistic targets and deadlines: Another common problem often faced by crowd funders is not setting up the right targets and the time to achieve the goal.
4. Building Interest : It is common fail point in crowdfunding The biggest mistake is when businesses create their campaign first and then to try to generate interest ,but instead business need to built interest of their campaign all east before 2 to 3 months prior to the start of their campaign.
5. Fulfillment: This is very important. Your brand image is hanging on your ability to not just deliver the crowdfunding goal, but also to provide contributors with their rewards in a timely manner.

Suggestion

- Companies should try and venture into this zone too, as it is easy, fast and effective way to raise money more quickly.
- Proper laws for governing crowdfunding should be put into place by the government.
- The SEBI(Securities Exchange Board of India) should be brought into picture to govern the activities of crowdfunding platforms.
- There is a strong need for powerful campaigns in India to spread more awareness about the crowdfunding activities.
- Awareness levels can be increased by making people aware of the benefits of these platforms.

Conclusion

We can observe that crowdfunding has shown a rapid increase in India, especially in equity and lending crowdfunding. It is a quick and easy mode to raise funds for the long as well as for short term. There is a need to spread awareness about crowdfunding and crowdfunding websites to attract new investors. Thus, steps need to be taken by the government as well as by the companies to promote this kind of funding as well.

There are certain risks which go hand in hand with the current crowdfunding system in India, like fraud, misuse of investor's fund, no proper tax laws etc. The Government of India needs to bring the purview of crowdfunding either under the control of the SEBI or pass an act which will govern all the transactions relating to the crowdfunding system. Once there is a governing body, all the transactions can be tracked and safeguarded. The question of misutilization of funds would then not arise as each individual will be liable to this governing body. Since there would be a governing body, this would reduce all the risks and attract more investors to raise funds. The several risks related to equity crowdfunding such as risk of failure, security issues on the portal or platform will all be kept under check.

Choosing the right platform, selecting an impactful idea, setting up right target and time to achieve the goal can help in overcoming the crowdfunding problems from the innovators side. The government can help in reducing the risk by setting up a governing body. Together, these would reduce the risk to investors and encourage crowdfunding in India.

References

1. Crowdsourcing week: <http://crowdsourcingweek.com/blog/indias-top-ten-crowdfunding-platforms/> "Study on crowdfunding platforms around the world "
2. Crowdfund.co: <http://crowdfund.co/nine-risks-associated-with-crowdfunding/> " Risk associated with crowdfunding industry "
3. Floship: <https://www.floship.com/7-potential-problems-with-crowdfunding/> " Problems faced by Fundrasiers during crowdfunding activities"

-
4. The Balance: <https://www.thebalance.com/a-guide-what-is-crowdfunding-985100> "Crowdfunding: Meaning and types of crowdfuning"
 5. This is Money: <http://www.thisismoney.co.uk/money/smallbusiness/article-2333399/Crowdfunding-does-work.html> " How starts-up can tap cash from ordinary people and give the prospects of huge profits in return? What is crowdfunding and how does it work?"
 6. Finder: <https://www.finder.com/how-crowdfunding-works> "How does crowdfunidng work for businesses in India"
 7. World Economic Forum: <https://www.weforum.org/agenda/2015/11/what-problem-does-crowdfunding-venture-capital-solve/> "Growth of crowdfunding from 2012-2015"