

A Study on Crowd Funding as a new concept of raising capital

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Abstract: *Many people have different innovative business ideas. But these people need money or a loan to fund their idea. The most common method is to apply for a loan from bank. But banks take a back step to invest in new ventures due to the level of risk involved especially in economic downtrends. That is the main reason for low innovation and development in business. Crowd funding is concept of gathering small amounts of money from many parties in exchange for a form of value to those parties. This is practical money making concept which consists of production, sales, jobs creation, social responsibility and income to the government. An online transaction portal connects investors with small business start-ups and projects that remove barriers to entry. This paper concentrates on the concept of crowd funding, its types, process of crowd funding, funding platforms, key points and challenges in India and suggestions to uplift this concept. It studies to what extent India is responding in adopting this new concept of raising capital.*

Keywords: *Crowd Funding, Innovative Projects, Ventures, Financing*

I. Introduction

The crowd funding concept has been stated since 18th century. But the first successful activity occurred in 1997, when a British rock band funded their reunion tour through online donations from fans. Artist share has become the first dedicated crowd funding platform in 2000 which inspired this innovative method of financing. More crowd funding platforms began their activities shortly and then the crowd funding industry has grown rapidly in each year. It is a practice of funding a project or venture through raising financial contribution from a large number of people with the help of internet.

There are different methods to execute this concept. They are mail order subscriptions, benefits events etc. Crowd funding is a popular concept which is a popular in United States and United Kingdom. It is an emerging way of raising funds through the use of internet/social networking websites like twitter, Facebook, LinkedIn or some dedicated websites. It is a modern method of financing to a project. In this model there are three parties, the first party is the one who is the initiator who has the idea about a project to be funded. Secondly individuals or groups who support the project idea and lastly a moderating organization who brings all the parties together to support that project. Crowd funding concept is origin from crowd sourcing concept. Crowd sourcing is defined by Merriam – Webster as the process of obtaining needed services, ideas as content by soliciting contributions from a large group of people and especially from an online community rather than traditional employees or suppliers.

Definitions of crowd funding

According to the SEBI consultation paper on crowd funding in India defines “Crowd funding is 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”. According to Lambert and Schwienbacher (2010) define crowd funding as “an open call, essentially through the internet, for the provision of financial resources either in form of donation or in exchange for some of reward and/ or voting rights in order to support initiatives for specific purposes”.

Basically in olden days entrepreneurs want to start up of a business they have to approach the banks and other financial institution for financing their projects. The process of sanction loan or giving financial support they have series of step which is time taking activity. But with the help of crowd financing/funding we can easily get funding for the innovative projects. Internet will provide different platforms for investors and entrepreneurs for borrowing and lending activities.

II. Literature Review

Crowd-funding is a novel strategy for subsidizing an assortment of new pursuits, permitting singular authors of revenue driven, social, or social tasks to ask for financing from numerous people, frequently as a by-product of future items or value. Crowd-funding activities can go enormously in both objective and extent, from little aesthetic tasks to business visionaries looking for a huge number of dollars in seed capital as a contrasting option to conventional funding venture (Schwienbacher and Larralde, 2010). It is a greater amount of a casual type of financing ventures – either business or non-business. Here, countless (the group) finance little measures of cash to amass into a venture sufficiently expansive to fund a task (or a new business). Crowd-funding is an aggregate exertion by individuals who system and pool their cash together, as a rule by means of the web, keeping in mind the end goal to put resources into and bolster endeavours started by other individuals or associations (Ordanini, 2009). New pursuits expect assets to succeed, and a standout amongst the most condemning of these is financing (Gompers and Lerner, 2004; Gorman and Sahlman, 1989; Kortum and Lerner, 2000). In the course of recent years, crowdfunding has developed as novel route for entrepreneurial dares to secure assets without looking for funding or other customary wellsprings of wander speculation. Schwienbacher and Larralde (2010) characterize crowd-funding as an open call, basically through the Internet, for the arrangement of budgetary assets either in type of gift or in return for some type of reward as well as voting rights with a specific end goal to help activities for particular purposes. Therefore, the group produces money related help for as of now proposed activities. The crowd-funding component is additionally identified with person to person communication, where shoppers effectively take an interest in online groups to share data, information and recommendations about another activity as well as brand. Be that as it may, crowd-funding goes past traditional interpersonal organization cooperation by joining more proactive parts for customers, for example, choosing new activities to help and giving financial sponsorship to them.

Clients assume an essential part in the group financing model. Buyers have a part to play in the whole group financing chain, for example, target customers (Barksdale and Darden, 1971), a key data sources (Kohli and Jaworski, 1990), co-makers (Fisk et al., 1993), accomplices for creative purposes (von Hippel, 1986), key assets and co-makers of significant worth (Vargo and Lusch, 2004) and furthermore as a financial specialist (Andrea Ordanini, Lucia Miceli and Marta Pizzetti, A. Parasuraman, 2011). Group subsidizing regularly tries to determine the issues of advertising and fund together. Where swarm subsidizing is appropriate, the members contributing through group financing would need to be allowed, as Accredited Investors, (for example, QIBs, HNIs and Eligible retail speculators), by SEBI, in the Indian setting. As per Schwienbacher and Larralde (2011), swarm sourcing helps a firm in outsourcing exercises, to make an offer of its item to the overall population (the group) with the assistance of an open call utilizing the web as a medium. A related idea is swarm sourcing. Buyers volunteer to add to generation forms and make esteem. Group subsidizing can be seen as consolidating ideas of group sourcing and microfinance. There are different sorts of group financing. Reward based and value based stages are higher in numbers in Europe and North America. Since the ventures have a test as absence of access to capital, they raise the assets out of individual funds or advances from companions and relatives, charge cards, and so on. Shortage of financing could bring about promising undertakings not getting started, costing an economy employments and loss of potential advancements (DevshMitra, Bradford, 2012).

Emergence of Crowd Funding in India

In less than a decade, crowd funding has gained traction in a number of developed economics including Australia, United Kingdom, Netherland, Italy, and the United States. This process of raising fund is spreading across the developed world and is now attracting considerable interest in every sector of the world as well. This concept popularly started in the US & UK in an emerging way of raising capital through the use of internet and social networking sites. With support from government and developed organisations crowd funding could become a useful tool in the developing world like India as well. In India Crowd Funding is very common in Film Industry. A most successful story of crowd funding projects in India emerges with the Bollywood Film Industry. Onir's Film *I am* a major crowd Funding project which rise around Rs. 80 lakhs from around 450 Contributors through crowd funding platform. Another massive funding story coined with the reliance industries founder Dhirubhai Ambani for his growing textile business in Gujrat. India is a huge market with Global business and investment opportunities which shows the possibilities for growing an infant industry to a large scale through crowd funding. But it is restricted only to micro financing category project and occasionally donation-reward crowd funding category.

Types of Crowd Funding Model

It is having four categories which are applied in the world wide. They are social lending or donation crowd funding, reward based crowd funding, Peer to peer lending and equity crowd funding.

1. Social lending/ Donation crowd funding

Social lending represents pooling of funds for social cause in terms of charity and humanity and not in exchanges for anything of tangible value as a return. In order to empower others to create impact through individuals directly share their money for a cause that they feel strongly about the project. It is a kind of internal joy; nothing will be getting in term of physical form. Example of donation based crowd funding is a private scholarship by an individuals.

2. Reward Crowd Funding

Rewards based crowd funding means gathering of funds from investors and they receive some existing or future tangible reward as a return or consideration. Most of the websites supporting reward based crowd funding. The return is in the form of incentivise whether it is in tangible or intangible form for their investment. This is a model of NGO type model where donor donates for a charitable or benevolent purpose and he receives some incentivise in the form of return.

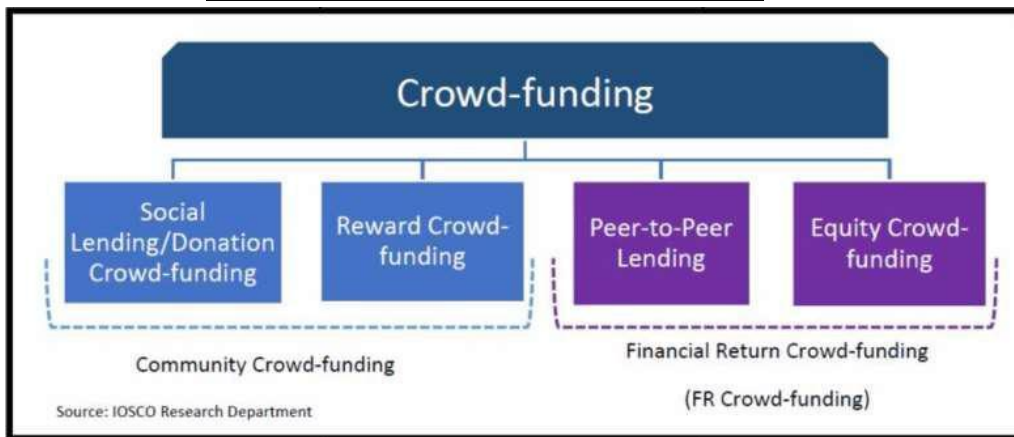
3. Peer to Peer Lending

Peer to peer lending activity is related to financial return crowd funding activity. It is a platform for borrowers/ issuers with lender/ investors to provide unsecured loans. The persons who are having idea or a project require loan or financial support. The lender supports through providing small amount of fund to the project based on his effort. These loan parts are then collected by the online platform and when there is enough to recover the required loan, the loan is originated and paid to the borrower/issuers with a graduate financing, real estate financing, funeral financing, art project financing, venture capital, technology start-ups or consumer to consumer loans for transactions such as e Bay purchases.

4. Equity crowd funding

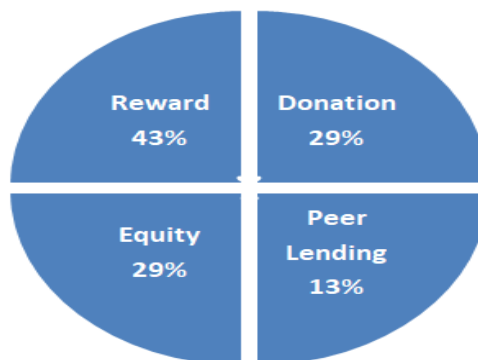
It is also one of the method of financial returns crowd funding, In this method the entrepreneurs approach the investors through internet platform to invest in that project as a shareholder. They can retain certain amount of shares in the start-up or that project. Many individuals invest in a business through this having right to raise funds in any other forms form the public.

Figure-1 Types of Crowd-Funding



What is the share of each crowd-funding model?

Figure-2 Pie-Chart showing share of different sources of crowd-funding



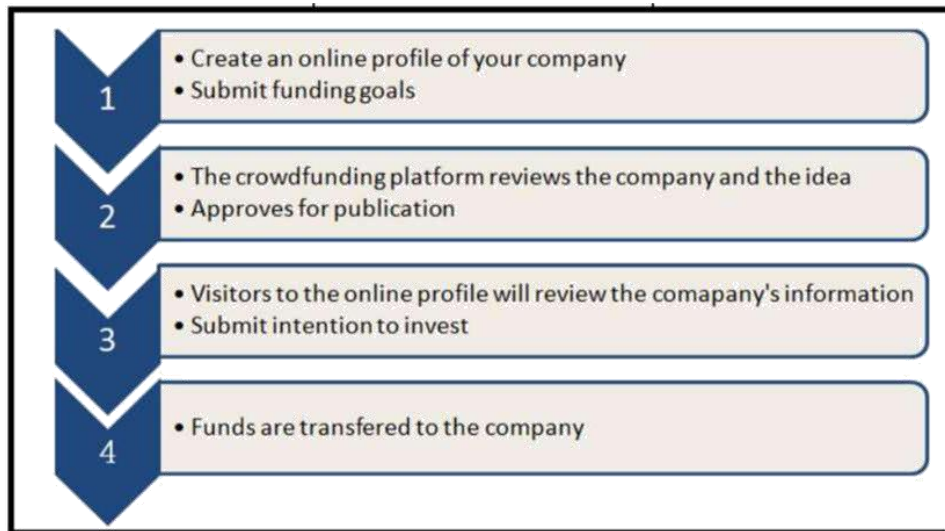
Source: PWC updated data 2016

From the above figure it is observed that, out of the 4 models of crowd-funding, Reward based funding has taken a high proportion that contributes to 43% of the total funding acquired through this source of financing, followed by Donation, Equity and Peer lending.

Crowd Funding Process:

Crowd funding platforms provide an alternative source of capital for start-ups and established companies. While crowd funding platforms vary in offerings, most follow this essential process.

Figure-3 Process of Crowd-funding



There is a wide variety of crowd funding sites for businesses of all sizes to choose from. Below is a comparison of crowd funding sites using donation-based systems using different models and varying in focus.

Benefits and Risks of Crowd-Funding

Some of the advantages of crowd-funding are due to the regulatory frame work, easy access to capital is possible which boosts the growth of micro, small and medium scale industries and start-ups leading to recovery and boost of economy and enhanced job creation. Unlike banks which have a rigid regimes of raising capital, un-collateralised peer to peer lending leads to higher generation of capital at minimum amount of times and inculcate the habit of saving and investment in public.

The web hosting platforms are cost efficient and hence charge nominal fees for service rendered. The added advantage is the convenience as they are easily accessible to millions of users internationally who surf internet. Platforms are flexible as the entrepreneur can change advertisements as and when it suits them all of which leads to prompt raise of money giving a boost to the economy.

Some of the risks related to crowd-funding are that there is no secondary market to dump the equity shares if they turn unproductive or in case of defaults. Companies Act, 2013 prohibits any kind of secondary market for private listing and hence investors are stuck with bad equity shares which are a huge risk as around 86% of crowd-funding investments turns out to be bad. The second risk is that in peer-to-peer lending there is a high rate of default as borrowers with no collateral as guarantee take the money from the lenders.

Third kind of risk is from the portals which also serve as intermediaries between investor and entrepreneur may temporarily or permanently shut down due to overdue maintenance, hacking etc. When this happens there is a chance that investors will not get their money as the money is kept by the portals for safe keeping until the target amount is reached. One such example is in 2011, Quackle which closed suddenly overnight leaving no information on the borrowers or lenders and consequently the contracts could not be fulfilled resulting in 100% loss. Also as intermediaries, portals face a significant risk of liability arising out of false disclosures by fund raisers. Since in most countries, the platforms are unregulated and crowd-funding are in nature of cross-border transactions, complex legal issues arise in case of recovery of money for defaults. Due to the unsophisticated nature of the platforms, it paves way for serious cyber-crimes from overloading the platform's infrastructure, to confusing accounts and identity theft.

The fourth kind of risk posed to contributors is the lack of transparency and information asymmetry. The information provided in the portal are inadequate many a times and it always requires specialised

knowledge to know whether the proposed project will yield revenue or not and since the unsophisticated investors lack such specialised knowledge, they can be duped easily.

Why do we need Crowd Funding in India?

Despite the evolution of Venture capital Funds (VCFs) and Private Equity (PE) investors, it is not easy for a start-up or an SME to raise money. The Crowd Funding route entities would be able to solicit investment in smaller sums from large number of investors. It provides new investment avenues and also provides new product portfolio diversification of investors. It seems to be the key towards boosting the start-up eco-system in India.

Key Factors of Crowd Funding

The Key factors which will make crowd funding success are:

- Idea should be clear
- Create a compelling video.
- Raise sufficient funds as required.
- Choose the right crowd funding platform.
- Plan a marketing campaign, which is needed. It will take creativity, effort and a lot of time.

All these factors are necessary to build the culture of trust which is essential for the funding of companies, projects.

Who can invest on a crowd-funding platform?

We as of now can just acknowledge authorize and institutional financial specialists to the stage, yet we additionally work with developers searching for subsidizing towards their land extends also. Inside those gatherings, we are searching for individuals who need to put resources into land; speculators who need to procure significant returns and need to include automated revenue creating land obligation to their portfolios. Any individual who has cash sitting in a low-yielding financial balance, or security or Treasury note, should come look at us in light of the fact that our profits are higher than any practically identical here and now instrument while secured with first position title liens on land.

Challenges of Crowd Funding in India

- The idea of crowd funding is not new in India. The concept of online crowd funding is new to the country. Places of worship, for example, are built over right using a large no of donations.
- Indian industry is not so investor friendly. People are still not ready for this concept.
- Low trust level of doing the things online is also a challenge. India is an e- commerce space that needs to really mature before anything substantial can happen in this space.
- To build long term credibility and transparency in Indian Industry, the crowd Funding platform should approach proactively.
- Crowd funding will have to look at building an offline loan to finally induce mass awareness and encouraging larger participation.

III. Conclusion

Idea, talent, desire and creativity are present but the required thing is money. With the help of crowd funding it is possible to create money for any kind of creativity project. First clarity on the project and evaluate the concept for preparation of the budget should be there. After preparation of budget, preparation of a presentation about our project idea is required in front of investors. In order to attract the investors offering of gifts and goodies to all those who help your way can be done. Then for more advertisement and investors attraction spreading of our presentation through Facebook, WhatsApp, twitter and LinkedIn will be performed because network is the net-worth of a business now a days. Once complete and clear sharing of project containing the creative idea, our friends and family members will be the first one who support. These people spread our idea viral there will be lot of people who might not know the respective project holding person.

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