

CROWDFUNDING: A STEP TOWARDS CHANGING DYNAMICS OF ENTREPRENEURSHIP IN INDIAN SCENARIO

Abstract

"Crowdfunding" is a phenomenon which is gaining its popularity due to the lacking traditional mechanism of acquiring loan. Even in the light of currently prevailing guidelines published by the regulatory bodies of India, its importance cannot be ignored. The present research work is an effort to understand the regulatory framework of crowdfunding. In today's scenario of Alternative Finance (AltFin), crowdfunding is a modern way of getting finance for start-ups and SMEs but the benefits and risks associated with crowdfunding work as a double edged sword while deciding for a finance alternative in a shared economy. The data collected is based on secondary research to gather the information provided by the regulatory scenario, policymakers, the key players, SMEs and start-ups trends, industry landscape, regional insights, technological innovations, key market challenges, and opportunities etc. The regulatory framework on crowdfunding does not provide a secure environment to cover the risks associated with the use of pooled funds from crowd. So, it has been found that RBI and SEBI can provide a solution that SMEs/Startups can easily raise capital but traditional financial sources are equally valuable to cover the risk of retail investors. No doubt, the government schemes launched for SMEs are providing a solution to enrich the entrepreneurial skills in India but crowdfunding with a better regulatory framework can assist to achieve the dream of 'Atamnirbhar Bharat Mission'. Hence, a balance needs to be created among traditional financial markets, available banking solutions, and

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new alternative for entrepreneurial growth of Indian MSMEs. A changed law and a vigilant attitude of the regulatory bodies can protect the crowd before putting their funds at stake.

Keywords: AltFin, Crowdfunding, SEBI, SMEs and Start-ups.

I. INTRODUCTION

The trending growth patterns for Indian start-ups reflect that India is moving ahead at a very fast speed on the global concept of sharing economy. As per the 36th edition of Inc42's 30 Start-ups Report, the current trends in SMEs and Start-ups in many of the Indian States are moving upward in the prevalent Indian scenario. This report highlighted a number of exciting fintech, e-commerce, and enterprisetech startups. Additionally, in recent years, these sectors have experienced exponential growth. Their ongoing success attests to the health of the nation's startup scene (inc42.com). Based on a report that was released by IMARC Group, the size of global market for crowdfunding has reached US \$ (Dollars) 14.9 Billion in 2022 and it is expected to touch US \$ 28.9 Billion by the year 2028. It also indicates a growth rate (Compounded Annual Growth Rate) of 11.6 % during the years 2023-2028 (imarcgroup.com).

Many of the MSMEs schemes of India are working on the concept of sharing economy to become 'Atamnirbhar Bharat' which means Self-sufficient India.

For fulfilling the dream of 'Atamnirbhar Bharat', a concept of sharing economy will have to be developed and implemented. A socio-economic ecosystem centered on the sharing of human, material, and intellectual resources is what is known as the "sharing-economy." It involves various individuals and organizations working together to jointly create, produce, distribute, trade, and consume goods and services. Digital platforms host sharing-economy business models, allowing for the more accurate, real-time measurement of spare capacity and the dynamic connecting of that capacity with those in need. Due to the changing needs of society, economic growth of any nation is becoming more and more dependent on the sharing economy, so the financial experts in India also have a view that on the competitive grounds, the SME growth can boost Indian future economic development. This combination opens up new avenues for alternative finance and technologically enabled financial solutions in India to match the global pace.

On the other side, the problem that any entrepreneur in real world has to face is about funding of the business. Alternative Finance (AltFin) provides a solution to this problem and Crowdfunding is one of the alternatives available in current financial markets to manage one's business.

As explained in an Australian Discussion Paper 2013, Crowd sourced funding is a way to raise money through small financial contributions from individuals who may number in the hundreds or thousands for a business venture, a charitable cause (such as a community-based social or cooperative initiative), or a creative project (such as a music, film, or book publication). These donations are requested via an internet crowdsourcing website, and social media may also be used to advertise the offer (Discussion Paper, Australia 2013).

To understand the system of crowdfunding, various researchers describe it as a contribution because through crowdfunding, a business house receives tiny contributions from each individual in the community to help it attain its overall financial goal (Belleflamme et al., 2014; Manchanda and Muralidharan, 2014).

- 1. Need of the Study:** In India, obtaining funds for newly launched businesses has never been easy. Also, using finance for start-up and new ventures has always been challenging and the enablement of finance is the biggest challenge because the failure or success of any start-up depends on this factor mainly along with other challenges. So, any financing decision for the new venture usually revolves around the dyadic relationship that exists between a lending banker and a small business borrower. This dyadic relationship could be upset by the emergence of the sharing-economy model, in which online alternative finance platforms are present in current scenario.

It has been felt by many entrepreneurs that when they look to more conventional sources of funding, like bank loans, they frequently discover that the cautious, risk-averse nature of the banking industry does not align with the smaller company culture or the ability to recognize and seize opportunities that characterizes entrepreneurs in that more dynamic industry (Butler and Durkin, 1995; Durkin et. al., 2013b).

Thus, there doesn't seem to have been much of an improvement in the SME-Bank relationship in recent years, especially when it comes to start-ups and micro-businesses, despite a general loosening of the lending environment. Apart from their substantial impact on the Indian economy, small businesses also play a crucial role in bank profits and this contribution has compelled banks to rethink and ease out certain documentation to promote start-ups. Mostly, banks provide the services to small firms in India and for this reason supporting hands are needed to develop the financial channels available to start-up businesses, especially SMEs.

A startup should constantly periodically generate fresh concepts to create products and services that adapt to the changing needs, desires, and preferences of society. As per the report of Times Now News (2023), there are more than 90,000 Start-ups in India. There are categories of cities like Bangalore, Delhi-NCR, Hyderabad and Chennai which are called Tier 1 cities. On the other side, Cochin, Bhubaneswar, Jaipur and Indore fall in the category of smaller cities and these cities have emerged as the hubs of new start-up of India (Timesnownews.com). The possible routes for funding are new but risky as compared to traditional funding system. Hence, studying this relationship becomes significant in changed environment of rising startup funding needs and the contemporary funding channels that are available. The global market for crowdfunding is exhibiting a continuous growth rate. For the upcoming projects such as Machine Learning (ML) Technologies and Artificial Intelligence (AI), the interest of the crowd funding activities is on rising trends. Chatbots in crowdfunding platforms and the rising crowdfunding activities on social media platforms are assisting the campaigners to raise fund. Due to the increased awareness of the masses and rising benefits of crowdfunding, a favourable market outlook has been created for crowdfunding. Hence, these influencing factors are propelling the market growth of crowdfunding in the near future.

2. Crowdfunding: A New Funding Approach To Replace An Old Traditional Funding

The concept of Crowdfunding differs from the traditional borrowing model because unlike bank-led syndicated lending, which is only utilized for the largest funding projects, crowdfunding does not require one bank to finance the entire amount. As a result

of numerous crowdfunding campaigns' success, the crowd has been viewed as an “answer to the lack of appetite for risk among traditional finance institutions” (Dawson, 2014).

- 3. Platforms for Crowdfunding in India:** The primary categories of crowdfunding websites are those that are reward- or donation-based, such as Milaap which is the India’s largest crowdfunding platform (startmilaap.org). Scoreme has clients like Union Bank of India, Mannapuram Finance Limited and Care Ratings. Crowdfunder Limited, GoFund Me Inc. SS&C Intralinks.com and Ketto.org etc. are other popular platforms.

There are crowdfunding sites like Indiegogo and Kickstarter; equity-based investment platforms like Seedrs and Crowdcube; debt-based platforms that facilitate peer-to-peer lending like Lend Invest and Trillion Fund; invoice trading sites like Platform Black and Market Invoice. One example for the category of debt-based crowdfunding is Triodos Bank. Donation-based crowdfunding offers non-cash incentives like early access to products or invitations to product launches, as well as the opportunity to support creative initiatives and feel like a part of a community. It is possible to distinguish between funding for equity (like CrowdCube and Seedrs) and funding as a traditional loan (like Money&Co) with investment-based crowdfunding. Following is the glimpse of famous crowdfunding platforms:

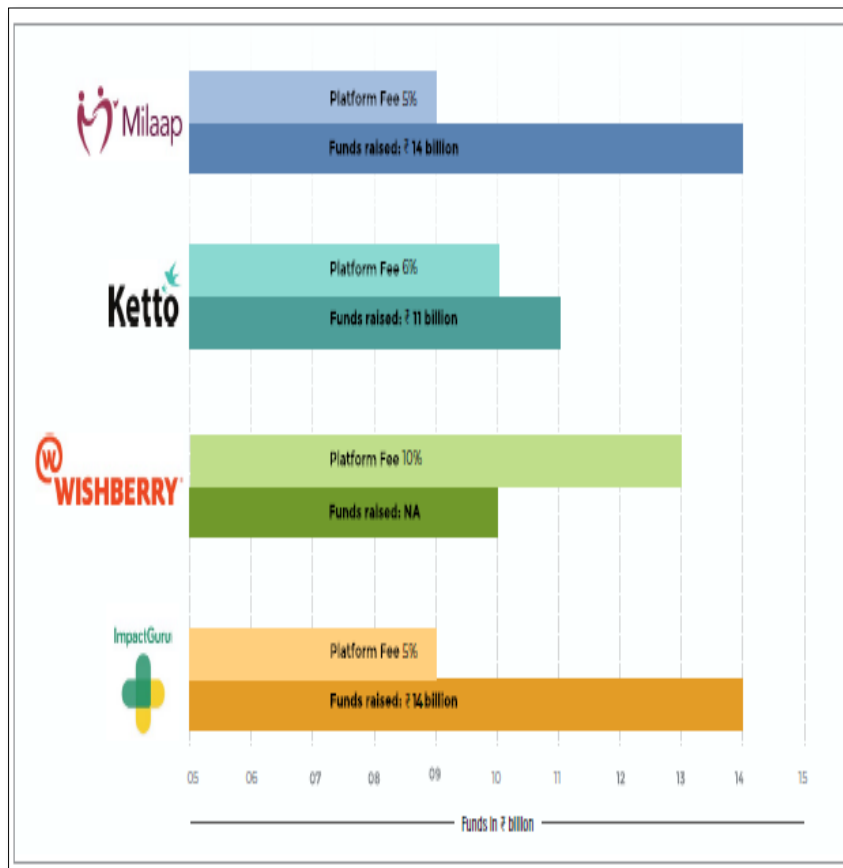


Figure 1: Crowdfunding Platforms

Source: Based on data from company websites (indiatimes.com) Thrive with the Crowd - Times of India. (n.d.). The Times of India.

According to government reports during pandemic days of 2020, a huge flow of funds through online crowdfunding platforms in the name of donations came to India. Online crowdfunding, especially was the source to send money for the sake of donations to Indian firms. Convenience of technology and Payment Interface platforms like UPI assisted the donors and beneficiaries to transfer money for start-ups and solved the financial issues of new entrepreneurs especially during pandemic days. The following information provided by Sattva Consulting in 2020 shows that how informal giving to community and religion accounts contributed towards a huge fund flow through crowdfunding platform due to loopholes noticed by the fund suppliers in Indian regulatory environment.

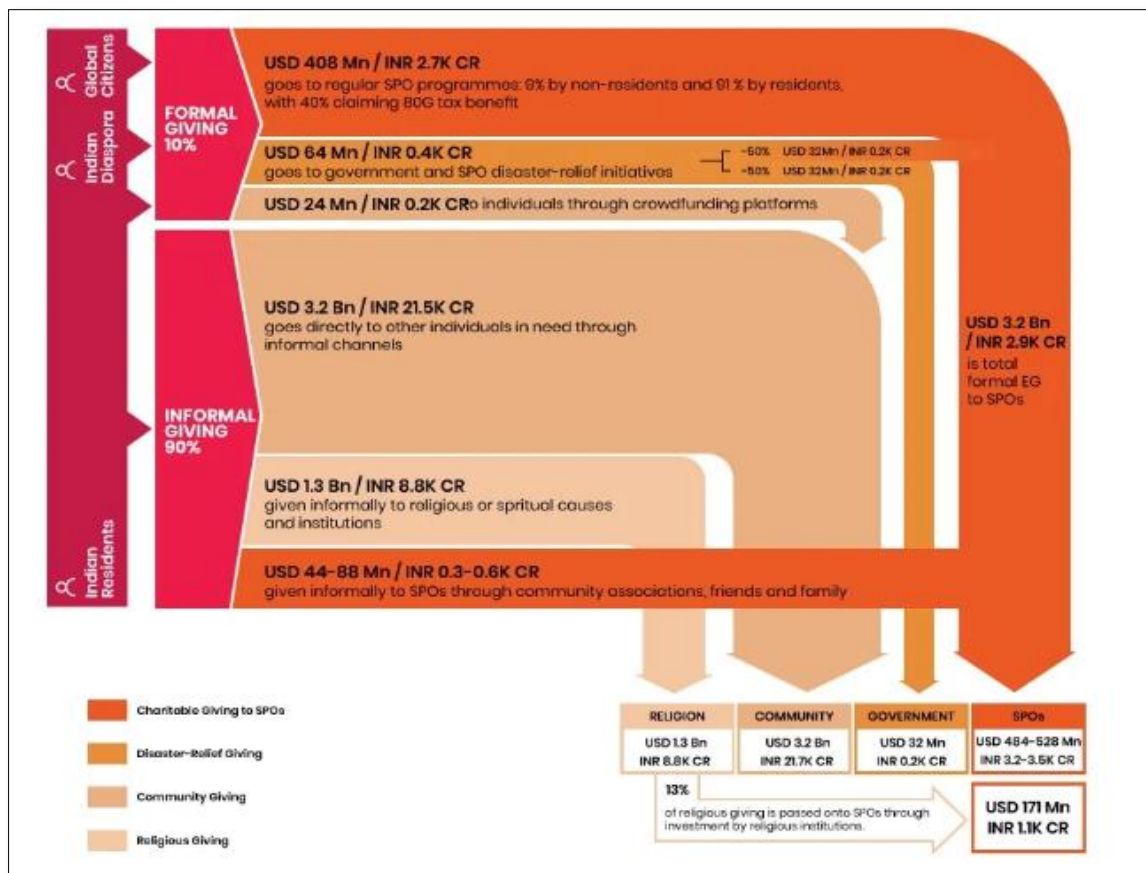


Figure 2: The Flow of Everyday Giving in India
 Source: Sattva Consulting, 2020, inc42Media

II. LITERATURE REVIEW

The advent of online platforms and the use of the Internet have completely changed how people communicate with one another. This has made new financing options, like Crowdfunding platforms (CFPs), available to business owners and their cutting-edge new products. CFPs have become more well-known among small investors and entrepreneurs with limited resources in recent years (Martínez-Climent et al., 2020). Drilling down deeper into country level data published in June 2021, the Analytical Centre of International Holding, Robocash Group mentioned in a report on money and banking, “India features strong

potential for growth of alternative lending (needs of 0.5 on a scale of 0 to 1), along with the highest opportunities across all countries analysed. India takes the largest share of the alternative lending market in South Asia - 81.3 per cent in 2018.”

China leads the world in the transaction value of crowd-sourced projects in 2020, ahead of the United States and the United Kingdom, according to a Statista report. After Canada, India comes in sixth place with US\$ 1.8 million. According to projections given in this report, India's transaction volume would reach \$9.1 million in 2020 and grow at a 1.4% Compound Annual Growth Rate (CAGR) to reach \$9.7 million by 2024 (inc42.com).

According to the same report, the global crowdfunding market was estimated to be worth US\$ 13.9 billion in 2019 and was expected to grow threefold by 2026 (indiatimes.com).

III. RESEARCH METHODOLOGY

The present study is based on secondary sources, which include government agencies, associations, discussion papers, annual reports, investor presentations, white papers, articles by well-known authors, business websites, directories, databases, certified publications, and the reviews given in newspapers. Also, the relevant information has been gathered from published reports at government websites and external databases such as inc42.com and statista.com. The data collected is based on secondary research to gather the information provided by the regulatory scenario, policymakers, the key players, SMEs and start-ups trends, industry landscape, regional insights, technological innovations, key market challenges and opportunities etc. All these data sources helped to present the information in a meaningful way otherwise it was not easy to capture and summarize the information for the present study. Further, the forecasts for the recent market data and crowdfunding influential factors have been presented through a pictorial view to understand the Indian crowdfunding scenario.

IV. OBJECTIVES

- To understand the benefits and risks associated with the novel platform for crowdfunding as a medium of Alternative Finance.
- To learn about the structure that would allow SMEs to interact with the new crowdfunding platform as a medium of Alternative Finance.

V. ANALYTICAL VIEW

1. Benefits Associated With the New Crowd funding Medium For Small Businesses

- **Public Validation:** A supply of funding will only be possible if the fund providers feel impressed from the innovative idea of the fund seekers or if they believe in the fund seekers. Before investing, the product in relation to current environment customer needs is judged and the potentiality is recognised before investing by these backers. Appreciation for the ideas can attract attention of future investors as well as future customers' likes and dislikes. Hence, feedback from the stakeholders is the real environment test for validation.

- **Accessing of Funds can be Easier** : Now a days, people do not invest only with a single motive of financial gains, rather they invest for other reasons such as exploring new cultures, new trends prevailing worldwide or helping someone to get rid of the channels of traditional banking loans. The formal requirements asked by banks to get a loan are often very hard to reach for startups. So, crowdfunding campaigns are becoming an easier and popular medium to access funds.
- **Business Optimisation with Pre-planned Production:** Before investing, the information provides by the backers or fund providers or audience can help in managing lag and lead times of supply and scale-up as per the needs of market. The fund user will become more cautious to utilise in an optimised manner to get a better feedback from the stakeholders. So, crowdfunding can open a path for lower storage costs, optimised pre-orders of products for supply, better deals and appropriate production levels.
- **A Medium of Free Marketing:** Crowdfunding can be a solid base for brand advocates. The word ‘Crowdfunding’ indicates that the fund providers in this medium will represent a bunch of ambassadors which circulates the innovative idea among the crowd; so the crowd itself interacts and promotes the campaign. In this way, the idea spreads among the audience and early adopters. Additionally, it means through the crowdfunding campaign the start-ups can promote through right people as well as can advertise free of cost by interacting with a crowd.

2. Crowd Funding and Involvement of Risk

- **Level of Retailers’ Risk as a Substitute of Institutional Investors** : The role of small and retail investors is prominent in case of crowdfunding and these small investors are the substitutes of big institutional players. The risk bearing capacity of these retail investors is quite low as compared to high risk takers (institutional investors) which can lead to a critical or dangerous situation for start-ups. Hence, these SMEs and Start-ups in the incubation or growth stage can fail and such a risk goes beyond the tolerance level of these retail investors as compared to informed investors such as Venture Capital Funds (VCFs) or Private Equity (PEs) Investors.
- **Connecting to the Risk by Default:** The route adopted under crowdfunding is a platform and this platform works as per the desire of issuer. If this platform shuts down on temporary basis or permanently, no choice is left with the investors for any SMEs unit or Start-ups. In the absence of collaterals, offer documents, guarantee schemes and protection schemes like bonds etc. a disastrous situation arises for these investors. Hence, this ‘herd mentality’ can convert the funds into zero because such frauds become irrecoverable for the crowd who acted irrationally. A crowd fund suppliers named ‘Crowdcube’ (based in the UK) is an example which provided funds in 2011 to a business house ‘Bubble and Balm’ and lost all their investments in the year 2013.

- **Risk Associated with Cyber - Crime:** Projection of false websites seems similar to genuine websites and can lead to frauds. Many transactions have been witnessed for Cyber security or theft of identity because the hackers trap the fund suppliers. Due to the leakage of credit card details such crimes are taking place very easily.
 - **Manipulations on the Internet:** Social media and Internet play an influential role to attract young investors because the frequent use of internet stimulates these visitors to buy and sell on the website. Earning quick money fascinates such internet users on this internet based platform and money is raised by selling own securities. In addition, money could be raised from investors living in different nations without adhering to the requirements of local laws of various jurisdictions.
 - **Risk Arising from Misleading Information:** The issuer can mislead by omitting the relevant information. Any wrong presentation based on over estimation of returns and account statements can never align with the true facts later on.
- 3. Regulatory Framework for Crowdfunding In Indian Scenario:** Nowadays, the viable source for Start-ups and small companies in India has caused a proliferation of platforms that give businesses a chance to engage with investors and crowd-source their funding objectives. The Companies' Act of 2013 and the Securities Act, which includes the SEBI Act of 1992, the Securities Contracts (Regulation) Act of 1956, and the Depositories Act of 1996, regulate the provisions in the current legal framework for capital-raising by companies. Securities Laws regulates the raising of created investment funds that are pooled by different organizations, like mutual funds (MF) and alternative investment funds (AIF), etc. Donation crowdfunding and Reward crowdfunding are not under the Securities market regulators because the donor/grantor does not expect any financial return in the form of a yield or return on investment; only donations or grants are requested. To check compliance, the Income Tax Act of India primarily governs the payment of donations. Also, Peer-to-peer lending (P2P) is governed by banking or securities market regulators, depending on whether it involves only pure lending or the issuance of debt securities. Securities market regulates the Crowd Sourced Equity Funding. SEBI released the "Consultation Paper on Crowdfunding in India" on June 17, 2014 and this paper looked at the security-based crowdfunding framework that India has within its current legal system and mechanism (SEBI, 2017, rbi.org.in). In light of the existing legal and regulatory framework that governs the financial intermediation industry, this paper suggested three categories under Security Based Crowd funding namely:
- **Equity-based crowd funding (EbC):** Using a crowd funding platform to raise equity.
 - **Debt-based crowd funding (DbC):** Funds are raised by issuing debt securities or debentures via a crowd funding website.
 - **Fund-based Crowd Funding (FbC):** Using a crowd funding platform, funds are raised to be consolidated under an Alternative Investment Fund (AIF).

Considering the SEBI (Alternative Investment Funds) Regulations, 2012, which established the framework for registering and overseeing Alternative Investment Funds

(AIF) on May 21, 2012, it was explained that by virtue of its trust deed, memorandum, articles of association, and partnership deed, AIF cannot invite public to subscribe for its securities. The regulations further describe that AIF cannot accept investments from investors worth less than Rs. 1 Crore, and no AIF scheme may have more than 1,000 participants. Also, the minimum corpus for each AIF scheme must be Rs. 20 Crore. Additionally, a specific percentage of the corpus will remain in the manager's or sponsors' ongoing interest in the AIF (Consultation Paper on Crowdfunding in India, 2014).

Usually, the operators at crowdfunding platforms follow the similar guidelines and procedures to create a genuine base for investments which are old more than a decade. Under our regulatory framework of SEBI, many steps have been taken to assist Start ups and SMEs for their benefits but Indian regulators are still not able to protect the investors from the risks associated with crowdfunding model for SMEs and Startups. With the growing needs, again traditional banking System is launching various MSMEs Government schemes to prepare the Startups to meet the challenges for the visible growth of Entrepreneurship in various sectors in India.

VI. SUMMARY AND CONCLUSION

Crowdfunding is a collection of funds through the pool of small amounts which comes from multiple investors and this collection has a medium based on website or social media site for a particular project, commercial activity, or welfare/charitable purpose. This simulation of amount can be beneficial for SMEs because as compared to traditional funding through banks, SMEs find it easy to raise money at a reduced cost of capital and without facing difficult processes of the traditional mode. Also, crowdfunding is a channel or way for investors to diversify their portfolios. In addition, it fosters greater competition in an industry that has historically been dominated by a small number of fund providers for start-ups and SMEs and also helps to launch easily a new product through this new investment avenue. In order to preserve the online reputation of the social media platform, crowdfunding operators may conduct due diligence on projects or they can opt for vetting before giving any green signal to these projects for funding on their website. On the other side, this avenue has a possibility of risk associated with Money Laundering. Also, there can be a risk of illiquidity because there might not be a secondary market where investors could sell their holdings and withdraw their money to exit. Risk of default and Cross-border implications can also be a challenging situation for the fund providers. Research supports the general observation that the G20 Summit of 2023 has created a picture of Developed India which builds a roadmap for the 'Atam Nirbhar Bharat' through SMEs and Start ups in India. Hence, in order to establish a more regulated environment in accordance with the guidelines set forth by the Securities and Exchange Board of India and the Reserve Bank of India, policy changes are required for supporting G-20 dream of a developed nation through SMEs and Start ups.

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