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


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# 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 ensure that Start-ups/SMEs could raise funds at ease 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 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.

## 1.0 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 featured some promising startups operating in enterprisetech, ecommerce and fintech. Also, these sectors have seen exponential growth in recent years. Their continued success validates the vibrancy of the country's start-up ecosystem (inc42.com). According to a report published by IMARC Group, the global market size 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. This 'sharing-economy' is witnessed as a socio-economic ecosystem which is built around the sharing of human, physical and intellectual resources. It includes the shared creation, production, distribution, trade and consumption of goods and services by different people and organisations. Sharing-economy business models are hosted through digital platforms that enable a more precise, real-time measurement of spare capacity and the ability to dynamically connect that capacity with those who need it. Due to the changing needs of society, economic growth of any nation is increasingly reliant on the growing sharing economy, and it is imperative to use SME growth as the bedrock for future economic development in India now a days. This combination drives new possibilities presented by alternative finance and tech-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 means of raising money for a creative project (for instance, music, film, book publication), a benevolent or public-interest cause (for instance, a community based social or co-operative initiative) or a business venture, through small financial contributions from persons who may number in the hundreds or thousands. Those contributions are sought through an online crowd-funding platform,while the offer may also be promoted through social media (Discussion Paper, Australia 2013).

To understand the system of crowdfunding, various researchers describe it as a contribution because with crowdfunding, each individual member of the crowd provides a small amount of funding to a firm in order to assist the company in reaching its overall funding target (Belleflamme et al., 2014; Manchanda and Muralidharan, 2014).

## 1.1 NEED OF THE STUDY:

In India, gaining finance for start-up 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 between the small business borrower and lending banker and this dyadic relationship, however, is potentially disrupted with the advent of the sharing-economy model where online based alternative finance platforms are present in current scenario.

Entrepreneurs seeking capital from traditional sources such as bank loans, often find that the prudent, risk-averse nature of the banking sector does not chime with the culture of the smaller firm and the identification and transformation of opportunity that is characteristic of entrepreneurs populating that more dynamic sector (Butler and Durkin, 1995; Durkin et. al., 2013b).

So, despite a general easing of the credit environment, there has been little apparent improvement in SME-Bank relationships over recent years, especially in regard to start-ups and micro-businesses. In addition to making a significant contribution to the Indian economy, small firms also make an equally important contribution to 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, it is therefore important that assistance is provided to strengthen the channels of finance for start-up companies and in particular SMEs.

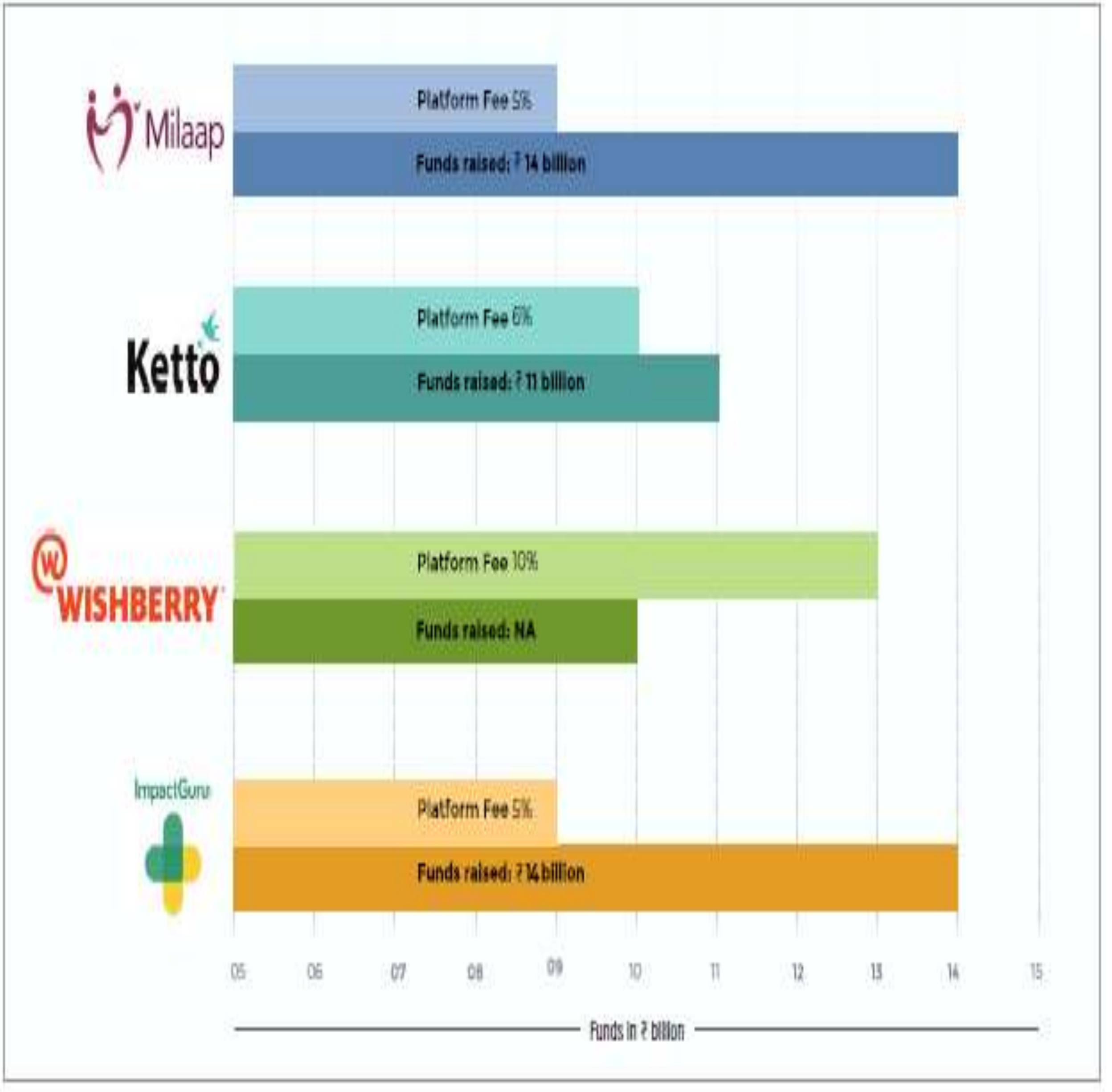
A start-up should always come up with new ideas from time to time to develop goods and services that meet with the shifting social needs, demands or preferences.  As per the report of Times Now News (2023), there are more than 90,000 Start-ups in India. Tier 1 cities like; Bangalore, Delhi-NCR, Hyderabad and Chennai, smaller cities like Cochin, Bhubaneswar, Jaipur and Indore have been 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, it becomes essential to study this relationship in the context of growing funding needs of the start-ups and modern available funding channel. 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.

## 1.2 CROWDFUNDING: A NEW FUNDING APPROACH TO REPLACE AN OLD TRADITIONAL FUNDING:

Crowdfunding differs from the traditional borrowing model where one bank would be asked to finance the full amount, with bank-led syndicated lending only being used for the largest funding projects. Due to the success of many crowdfunding campaigns, the crowd has been viewed as an “answer to the lack of appetite for risk among traditional finance institutions” (Dawson, 2014).

## 1.3 PLATFORMS FOR CROWDFUNDING IN INDIA:

Crowdfunding websites can be mainly divided into donation-/ reward-based websites 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. Kickstarter and Indiegogo; investment platforms where investors take an equity stake such as Seedrs and Crowdcube and debt-based platforms that offer peer-to-peer lending (e.g. Lend Invest, Trillion Fund); invoice trading (e.g. Platform Black, Market Invoice), and debtbased crowdfunding (e.g. Triodos Bank). With donation-based crowdfunding, non-monetary rewards are available such as the provision of invitations to product launches or the early availability of the product, or simply allowing the investor to feel they are part of a community, helping a creative initiative. With investment-based crowdfunding, a distinction can be made between funding for equity (for example, CrowdCube and Seedrs), or as a conventional loan (for example, Money&Co).

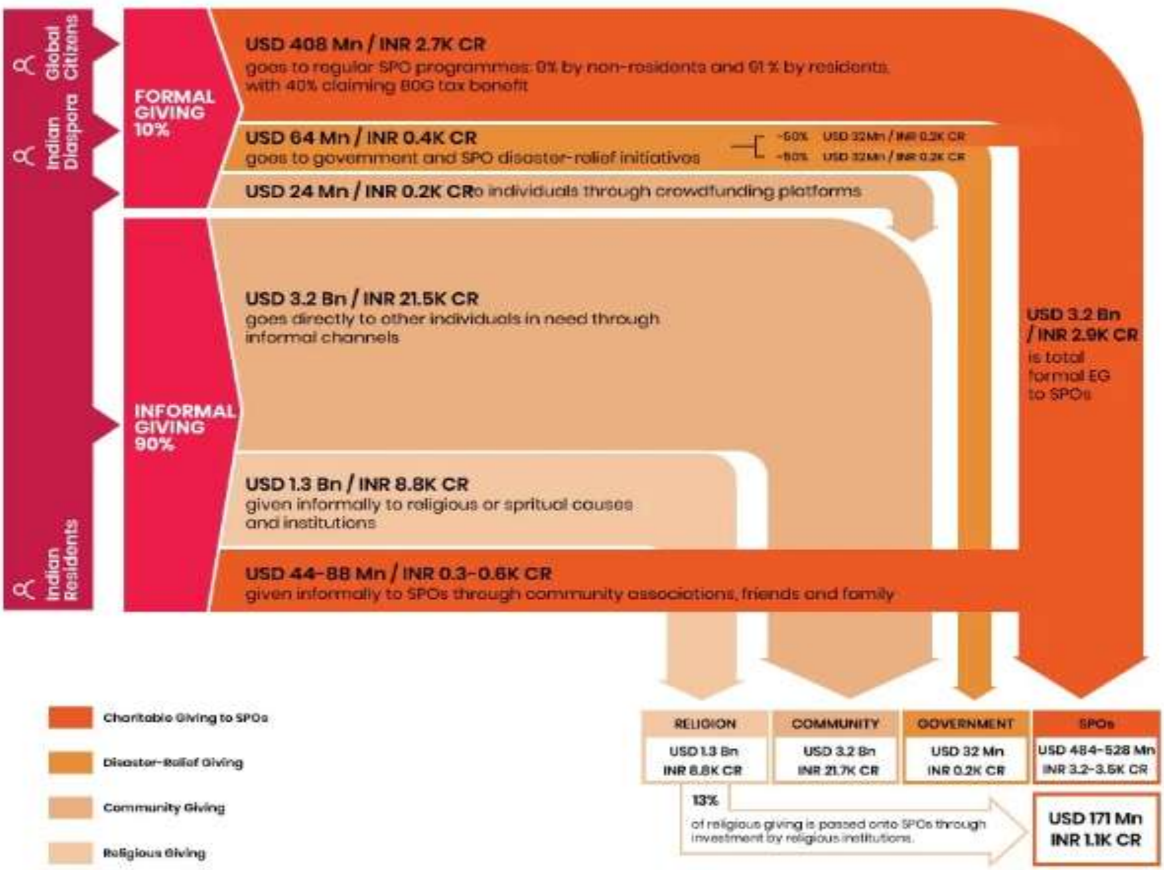



*Source: Based on data from company websites (indiatimes.com)*

*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.

**The Flow of Everyday Giving in India**




*Source: Sattva Consulting, 2020, inc42Media*

## 2.0 LITERATURE REVIEW:

The use of the Internet and the appearance of online platforms have revolutionized communication between human beings. This has allowed new financing alternatives such as CFPs to be available to entrepreneurs and their new innovative products. In recent years, CFPs have gained notoriety among capital-constrained entrepreneurs and small investors (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."

A report by Statista points out that China tops the list of countries which achieved the maximum transaction value for crowdfunding projects in the world in 2020, followed by the USA and the UK. India ranks sixth after Canada at US$ 1.8 million. In India, the projected transaction figure was expected to reach $9.1 Million in 2020 and expected to rise at a Compounded Annual Growth Rate (CAGR) of 1.4% to reach $9.7 Million by the year 2024 (inc42.com).

As per the same report, in 2019, the global crowdfunding market was valued at US$ 13.9 billion and was forecasted to increase threefold by 2026 (indiatimes.com).

## 3.0 RESEARCH METHODOLOGY:

The present research work is based on secondary sources which include discussion papers, annual reports, investor presentations, white papers, government bodies, associations, articles from recognized authors, company websites, directories, and 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.

### 3.1 OBJECTIVES:

1. To understand the benefits and risks associated with the new crowdfunding medium.
2. To understand the framework through which SMEs could potentially engage with the new crowdfunding medium.

## 4.0 ANALYTICAL VIEW

### 4.1 BENEFITS ASSOCIATED WITH THE NEW CROWDFUNDING MEDIUM FOR SMALL BUSINESSES:

**1. 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.

## 2. 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.

## 3. 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.

## 4. 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.

## 4.2 CROWD FUNDING AND INVOLVEMENT OF RISK

### 1. 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.

### 2. Association with 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.

### 3. 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.

**4. 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. Moreover, without complying with requirement of local laws of various jurisdictions, funds could be raised from investors residing at various countries.

**5. 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.

## 4.3 REGULATORY FRAMEWORK FOR CROWDFUNDING IN INDIAN SCENARIO

Nowadays, the viable source for Start-ups and small companies in India has led to the mushrooming of many platforms offering companies the opportunity to connect with investors to crowdsource their funding goals. The provisions in the existing legal framework for raising funds by companies are regulated under Companies' Act, 2013 and Securities Act i.e. SEBI Act, 1992, Securities Contracts (Regulation) Act, 1956, Depositories Act, 1996. Securities Laws regulates the raising of pooled managed investment funds by various entities such as Alternative Investment Fund (AIF), Mutual Fund (MF) etc. Donation crowdfunding and Reward crowdfunding are not under the Securities market regulators because only donations or grants are solicited and no financial return in the form of a yield or return on investment is expected by the donor/grantor. Payments of donations are mainly governed by the provisions of Income Tax Act of India. Also, Peer-to-Peer Lending (P2P), depending upon whether pure lending or anydebt securities are issued, are regulated by Banking or Securities market regulator. Securities market regulates the Crowd Sourced Equity Funding. The “Consultation Paper on Crowdfunding in India” was issued by SEBI on June 17, 2014. This paper examined Security Based Crowdfunding framework in India within the existing legal framework (SEBI, 2017, rbi.org.in). Having regard to the current legal and regulatory framework in place to regulate the business of financial intermediation, this paper suggested three categories under Security Based Crowd funding namely:

- Equity based Crowd Funding (EbC) – Raising equity through a crowd funding platform.
- Debt based Crowd Funding (DbC) – Raising of funds by issuing debentures or debt securities through a crowd funding platform.
- Fund based Crowd Funding (FbC) – Raising of funds for pooling under an Alternative Investment Fund (AIF) through a crowd funding platform.

Considering the framework for registering and regulating Alternative Investment Funds (AIF) through SEBI (Alternative Investment Funds) Regulations, 2012 on May 21, 2012, AIF should be prohibited by its trust deed/memorandum and articles of association/partnership deed from making an invitation to the public to subscribe to its securities. AIF shall not accept from an investoran investment of value less than Rs. 1 Crore and no scheme of the AIF shall have more than 1,000 investors. Further, each scheme of the AIF shall have a minimum corpus of Rs. 20 crore. Further, the manager or sponsor shall have a continuing interest in the AIF of certain percentage of the corpus (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.

## 5.0 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 networking site for a specific project, business venture or social cause. This simulation of amount can be beneficial for SMEs because as compared to traditional funding through banks, SMEs find it easy to raise funds at lower cost of capital without undergoing through rigorous procedures of the traditional mode. Also, crowdfunding is a channel or route for portfolio diversification of Investors. Also, it increases competition in a space traditionally dominated by a few providers (providing finance to Start-ups and SMEs) and also helps to launch easily a new product through this new investment avenue. The operators of a crowdfunding platform may engage in vetting or due diligence of projects to be included on their website, to maintain the reputation of the website. On the other side, this avenue has a possibility of risk associated with Money Laundering. Also, there can be a risk of illiquidity as there may be no secondary market in which investors can sell their investments and exit. Risk of default and Cross-border implications can also be a challenging situation for the fund providers. Research supports the general observation that as 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, the policy changes are necessary to create such an environment with more regulatory framework under the guidelines of Reserve Bank of India and Securities and Exchange Board of India.

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