

CROWDFUNDING FOR STARTUPS IN INDIA

Dr. Vijayalakshmi P¹, Dr.V.Priyadarshini²

¹ Associate Professor, Sri Krishna College of Engineering and Technology, Coimbatore

² Associate Professor, Kathir College of Engineering, Coimbatore

¹vijayalakshminenon@gmail.com

² priya.management@gmail.com

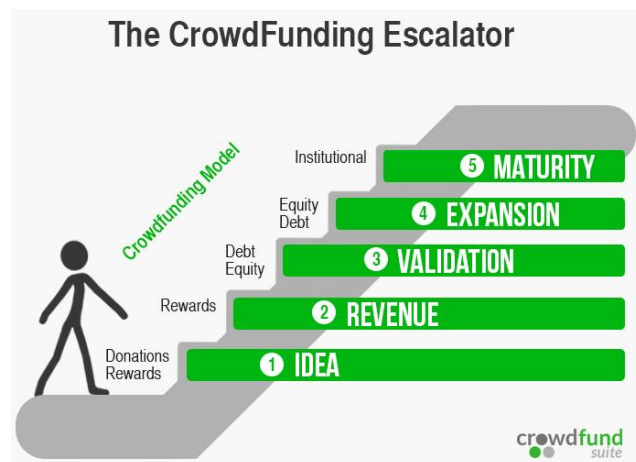
Abstract—Crowdfunding is a budding concept that links entrepreneurs and investors. It helps raising funds for entrepreneurs to individual projects through online with devoted sites. For the past few years, crowd funding industry has grown exponentially to raise billions to fund individual art projects to startups. The crowd funding model has potential to increase the financial environment for small entrepreneurs to big business enterprises. This article aims at the crux of crowd funding concepts, its benefits, risks and challenges involved to the startups in India; this can help entrepreneurs to convert their ideas into business ventures. India's growing economy with educated middle class can change the rules of game in fundraising for startups.

This phenomenon is spreading across the developing and developed countries. Crowd funding links investors with small business startups and projects through an online transaction portal which removes barriers to entry. Organized crowd funding should be alternative source of funds for the young entrepreneurs of startups particularly Small and Medium Enterprises.

Keywords—Crowd funding, Startups, Business Venture, Projects, SME, India.

I. INTRODUCTION

Crowd funding is an innovative concept started in UK and US. It is an upcoming trend for raising capital to the individuals, who propose great ideas. It makes the use of internet or social networking sites such as Facebook or LinkedIn or Twitter or even some dedicated websites in order to provide funds. Crowd funding is the online traditional financing by friends and family. In case of crowd funding there are three process steps where a project idea is proposed first then the individual or an organization needs to support a project and then project ideas are launched. Crowd funding has gained many number of transaction in an extreme level in all countries. Crowd funding can be defined as a process of funding a project or venture by raising contributions from a large number of people through web. Crowd funding connects investors with small business startups and projects through an online transaction portal which removes barriers to entry.



Source: www.crowdfundsuite.com

Figure I- The Crowdfunding Escalator

Crowd funding provides a much needed new mode of alternative fund for start-ups and SME sector and increases flows of credit to SMEs and other users in the real economy. Financial crisis in 2008 resulted in failure of number of banks. As a result banks have become increasingly constrained in their ability to lend money to the ventures or start-ups which may have high risk element. Hence, there is a need for funding for SME through alternative sources. SMEs are able to raise funds at lower cost of capital without undergoing through rigorous procedures. Crowd funding provides new investment avenue and provides a new product for portfolio diversification of investors. It increases competition in a space traditionally dominated by a few providers. The stakeholders of a crowd funding platform may engage in due diligence of projects to be included on their website to maintain the reputation of the website. In the upcoming months there is a chance of launching of half a dozen of crowd funding platforms. Attempts were made in India by introduction of crowd funding in goal project and teach for India. Crowd Funding has become an alternative funding for the film industries now a days. Artists and creative professionals are also using crowd funding techniques to raise money.

II. REVIEW OF LITERATURE

Crowd funding concept derived from crowdsourcing. More recently, some entrepreneurs have started to rely on the Internet to directly seek financial help from the general public (the “crowd”) instead of approaching financial investors such as business angels, banks or venture capital funds (Kleemann et al., 2008; Lambert and Schwenbacher, 2010). This technique, called “crowd funding”, has made possible to seek capital for project-specific investments as well as for starting up new ventures. According to (Cosh et al., 2009) an inherent problem that entrepreneurs face at the very beginning of their entrepreneurial initiative is to attract outside capital, given the lack of collateral and sufficient cash flows and the presence of significant information asymmetry with investors.

In 2014, crowd funding platforms raised \$16.2B which is an increase over the \$6.1B raised in 2013 (Massolution 2015), prominent crowd funding examples include Sellaband (which offers consumer investors an interest in the venture in the form of some sort of profit sharing agreement; Agarwal, et al. 2015), Prosper (involving peer-to-peer lending in which it is expected that the original principal is repaid along with some fixed interest; Zhang and Liu 2012), JustGiving (in which funders voluntarily donate their money with no expectations of any tangible reward; Smith, et al. 2014), and Kickstarter (where project backers receive non-financial rewards for their contributions; Mollick 2014). The different investors exist for larger amounts of capital such as VC funds and banks, entrepreneurial initiatives that require much smaller amounts to start with need to rely on friends and family or own savings. They then also make extensive use of bootstrapping techniques to mitigate their financial constraints (Bhidé, 1992; Winborg and Landstrom, 2001; Ebben and Johnson, 2006), by boosting their short-term profits. Finally, Franke and Klausberger (2008) notice that the phenomenon of crowdsourcing (and thus also crowd funding) is currently a working concept, because it is not broadly used. If more and more companies start using it, the resource ‘crowd’ will become scarce. They bear lower risk thanks to collateral and seniority of their claims over equity.

Many startup companies however cannot access debt finance, since they do not have the needed collateral nor stable cash flows to ensure regular interest payments (Berger and Udell, 1998). According to Mollick, Ethan R. and Kuppuswamy, Venkat (2014) stated that, the crowd funding may have substantial benefits for entrepreneurs beyond fundraising.

Ueda (2004) finds that entrepreneurs who go to VCs are more likely to have secured their ideas via intellectual property rights, which also implies that the entrepreneur’s legal environment has a direct influence on his choice. Different sources of financing exist among each category. Some of these types of financing can be used together with crowd funding. This is notably the case of bootstrapping techniques (Bhidé, 1992; Winborg and Landstrom, 2001; Ebben and Johnson, 2006). In addition, crowd funding actually looks pretty similar to bootstrapping in certain matters. In particular, bootstrappers try to use as many alternative resources as possible and that is what entrepreneurs do when they exploit capabilities of crowd funders. (Belleflamme & Lambert & Schwenbacher, 2013) concludes that the difficulty in attracting external finance is a constant problem that new firms face in their initial stage entrepreneurial initiative. Many ventures remain unfunded, partly due to lack collateral and sufficient cash flows and partly because of unsuccessful attempts to convince investors. Nowadays entrepreneurs have started to rely on the internet to seek financial support for their projects enabling global reach to attract funding.

III. TYPES OF CROWD FUNDING

There are four types of Crowd funding, they are based on Equity, Reward, Lending, Donation and Micro Crowd funding.

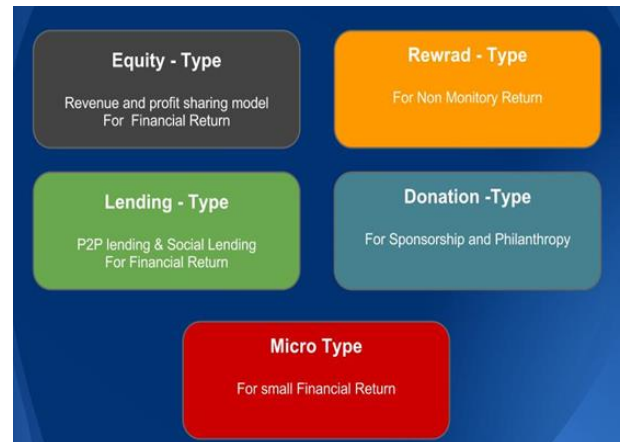


Figure II- Types of Crowd funding

Equity based Crowd funding

It refers to fund raising by a business, especially early-stage funding, offering equity interests in the businesses to investors online. Businesses seeking to raise capital by this mode typically advertise online through a crowd funding platform website, which serves as an intermediary between investors and the startups.

Reward based Crowd funding

It refers to solicitation of funds, wherein investors receive some existing or future tangible reward as consideration like membership reward schemes.

Lending based Crowd funding

It refers to peer-to-peer lending, an online platform matches investors/lenders with borrowers 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. Few platforms charge a fee based on the loan origination and have an incentive to push investors into larger loans which may not suit an investor's risk profile.

Donation based Crowd funding

It refers to solicitation of funds for social, artistic, philanthropic or other purpose and not in exchange for anything of tangible value. For example, Kickstarter, Indiegogo etc. are some of the platforms that support donation based crowd funding.

Micro based Crowd funding

It refers to small financial returns. Micro crowd funding typically means raising funds for a small amount for a crowd fund project. It could be as less as Rs. 1000 or may be higher. There are number of platforms in India and globally which allows crowd funding for both micro as well as large projects.

The project could be as large as funding a full feature film of may be 50 lakhs and above and as small as may be a few thousands for funding someone medical treatment or any other social cause.

IV. PLATFORMS OF CROWD FUNDING IN INDIA

The crowd funding platforms is increasingly occupied as more artist, entrepreneurs and creators are looking to these platforms to fund upcoming projects. To launch a crowd funding campaign is to select a platform. Many might recognize top players like Kickstarter, Indiegogo, Quirky, Kiva, etc. These large platforms have immediate name recognition and lot of projects being funded at the same time. This is the main reason for emerging new crowd funding platforms. These platforms help the campaigners to target the right audience and get opportunity to stand out in the niche market. Some of the crowds funding platforms in India are Bitgiving, Millaap (Social Causes), Ketto.org is a free website, Start51, Funddreamindia, Wishberry.in, Catapult.

V. BENEFITS OF CROWD FUNDING

- Crowd funding provides a much needed new method of funding for start-ups and SME sector and rises flows of credit.
- Financial crisis (2008) caused in failure of number of banks, capital adequacy norms have been made applicable to banks. As an outcome, banks have become progressively constrained in their ability to lend money to the ventures or start-ups which may have risk element. Hence, there is an essential for funding for SME through alternative sources.
- SMEs are able to increase funds at lower cost of capital without experiencing through rigorous procedures in this mode.
- Crowd funding offers new investment path and provides a new product for group of investors' diversification.
- It increases rivalry in a space traditionally dominated by providers (providing finance to Start-ups and SMEs).
- The operators of a crowd funding platform may involve in scrutinizing or due diligence of projects to be comprised on their website, to uphold the reputation of the website.

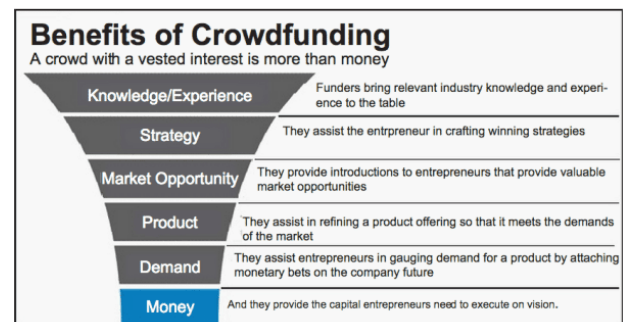


Figure III- Benefits of Crowd funding

VI. RISK AND BARRIERS IN CROWD FUNDING

According to Saviance Technologies - White paper, crowdfunding also comes with a number of potential risks or barriers for the startups.

Reputation

If creators fail to meet goals or to generate crowd interest, or unable to spread financial goals and gather substantial public support. Also, being not capable to convey on a project for some reason can severely harmfully impact on one's reputation.

IP protection

As there is little or no intellectual property protection provided by the sites themselves, there are high chances that, an idea can be copied once it is posted. Creators are

reluctant to openly broadcast the details of a project before creation, due to concern about idea holdup and guarding their IP from stealing.

Donor exhaustion

There is a risk that if the similar network of groups is reached out to multiple times, that network will eventually lose interest and stop to supply necessary support.

Public fear of abuse

Supporters are concerned that without a monitoring body, the likelihood of a scam or misuse of funds is high. The concern may become an obstacle to public engagement.

VII. CHALLENGES OF CROWDFUNDING

Replication of Product/Projects

This can happen because there are huge participants and an idea or the concept can be stolen by someone else because it does have the exclusive right of its owner from making, using, or selling the invention in a pattern period of time with nature of the crowdfunding projects.

Insufficient communication

Lack of tangible objectives and indistinguishable goals can complicate the potential stockholders about how truthful to the expectations of the entrepreneurs.

Unrealistic financial goals

The project carriers now and again ask for excessively or insufficient. If they ask for excessively, the potential shareholders might think they are materialistic and if they ask for insufficient, the shareholders would doubt if the project carriers recognize what they are doing.

Slow to update

People just don't donate their money to crowdfunding concepts but they ready are to donate time and attention. It is important to boost sponsors to check back often. No spoiling in posting of updates all along the technique may result in loosing potential shareholders.

No Clear Budget

The entrepreneur does not have spent efficiently with collected amount of money or idea to spend the collected. The projects detail let budding sponsors where their money is going, the sharing of budget is foremost stepping pebbles that splits the projects that just look stimulating from the projects that actually position a logical chance of creating their anticipated results.

Creativity

It is the key to creation of an outstanding movement. In this economy whoever can attract and drag or pull the attention of the crowd, will win. The crowd-funding platforms reports that the more imaginatively presented projects have higher success rates.

Intricate Business concept

Crowdfunding entrepreneur may not be right for the complicated business concept that people may find difficult to understand. They have their abilities to explain their business idea in a well-defined manner way that is clear, short and charming if they want to invite investors on a crowdfunding website.

VIII. CONCLUSION

In India, startups are in dearth of funding from investors. Crowd funding is the alternative solution for their financial needs. Entrepreneurs must know the advantages of crowdfunding and then develop their ability to effectively influence their need for funds through online crowdfunding platforms. The quality of online campaigns can be improved by offline activities offered by platforms such as entrepreneurial innovation education, campaign promotion workshops and business skill training. Entrepreneurs must be exposed to social media, marketing strategies, training on technological skills, support and legal advisory for initial entrepreneurs to take advantage of the emerging crowdfunding market more effectively.

IX. DIRECTION FOR THE FUTURE RESEARCH

A review of the literature on crowd funding notes the importance of further research into the practices of using crowd funding across all sectors of business ventures. In India, market size of crowd funding is in the budding stage. The business model of crowd funding should be familiar with the startups. More platforms in the crowd funding and steering websites should be established. Big data analysis will bring in new ideologies about crowd.

References

- [1] Agarwal, A., C.Catalini, and A. Goldfarb (2015), "Crowd funding: Geography, Social Network, and the Timing of Investment decisions," *Journal of Economics and Management Strategy*, 24 (2), 253-274.
- [2] Belleflamme, P., Lambert, T., Schwenbacher, A (2013), "Crowd funding: Tapping the right crowd", *Journal of Business Venturing*.
- [3] Berger, Allen N., and Gregory F. Udell (1998), "The Economics of Small Business Finance the Roles of Private Equity and Debt Markets in the Financial Growth Cycle." *Journal of Banking and Finance* 22:6-8, 613-673.
- [4] Bhidé, Amar (1992), "Bootstrap Finance: The Art of Start-Ups." *Harvard Business Review*, 70:66, 109-117.

- [5] Cosh, Andy, Douglas Cumming and Alan Hughes (2009), “Outside Entrepreneurial Capital.” *Economic Journal*, 119, 1494-1533.
- [6] Ebben, Jay, and Alec Johnson (2006), “Bootstrapping in Small Firms: An Empirical Analysis of Change over Time.” *Journal of Business Venturing*, 21, 851-865.
- [7] Franke, Nikolaus and Katharina Klaus Berger (2008), “Design communities: Business Model of the Future?” Available at: <http://noori.abismo.org/crowdsourcing.pdf>.
- [8] Massolution (2015), 2015CF The Crowd funding Industry Report, <http://www.crowdsourcing.org/editorial/globalcrowdfunding>.
- [9] Mollick, Ethan R. and Kuppuswamy, Venkat (2014), “When Firms are Potemkin Villages: Formal Organizations and the benefits of crowd funding”. SSRN: <http://ssrn.com/abstract=2377020> or <http://dx.doi.org/10.2139/ssrn.2377020>.
- [10] Ueda, Masako (2004) “Banks versus Venture Capital Project Evaluation Screening and Expropriation.” *The Journal of Finance* 59:2, 601-621.
- [11] Winborg, Joakim, and Hans Landstrom (2001), “Financial Bootstrapping in Small Businesses: Examining Small Business Managers’ Resource Acquisition Behaviors.” *Journal of Business Venturing* 16, 235-254.
- [12] Zhang, H., D.Li, J.Wu, and Y.Xu (2014), “The Role of Multidimensional Social capital in Crowd funding: A Comparative Study in China and US”, *Information and Management*, 51 (4), 488 – 496.