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Crowd-Funding and its Perspectives.

KEYWORDS

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Introduction:
Money have been on forefront on all the policy and strategic decisions taken in an organization. Raising of money, utilization of money , return on capital invested are some of the questions that still remain important due to it increased importance in the system of modern liberalized, globalized and competitive environment. With opening of economies the challenges of raising money has multiplied with the opportunities, the complexities involved are inevitable. The concept of crowd funding finds its root in the broader concept of crowdsourcing, which uses the "crowd" to obtain ideas, feedback and solutions in order to develop corporate activities. In the case of crowd funding, the objective is to collect money for investment; this is generally done by using social networks, in particular through the Internet (Twitter, Facebook, LinkedIn and different other specialized blogs). The crowd-funders (those who provide the money) can at times also participate in strategic decisions or even have voting right. Obviously, the main objective of crowd funding is to provide entrepreneurs with an alternative way to raise funds.

Concept:
The crowd funding model is fueled by three types of actors: the project initiator who proposes the idea and or project to be funded; individuals or groups who support the idea; and a moderating organization (the "platform") that brings the parties together to launch the idea.

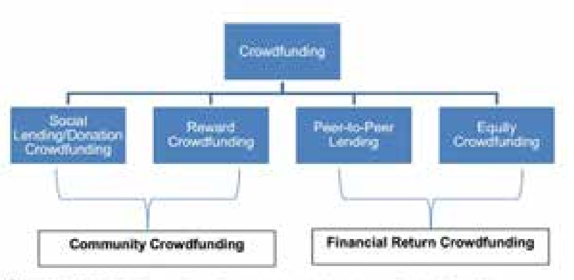
Crowd funding could be rightly defined as a practice of funding a project or venture by raising monetary contributions from a large number of people, typically via the internet.

With traditional banks less willing to lend, entrepreneurs started to look elsewhere for capital.

Crowd funding began as an online extension of traditional financing by friends and family: communities pool money to fund members with business ideas. In less than a decade, crowd funding has gained traction in a number of developed economies. This exciting phenomenon is spreading across the developed world and is now attracting considerable interest in the developing world as well.

Crowd funding, a popular concept started in the US and the UK, is an emerging way of raising capital, entails the use of internet or social networking sites such as Face book or LinkedIn or Twitter or even some dedicated websites. Crowd funding is the process of one party financing a project by requesting and receiving small contribution from many parties in exchange for a form of value to those parties. Crowd funding connects investors with small business startups and projects through an online transaction portal that removes barriers to entry.

The types of crowd funding are narrated below:



Source: IOSCO Staff Working Paper - Crowd-funding: An Infant Industry Growing Fast , 2014

Social Lending/ Donation Crowd funding: It refers to the funding raised for social causes for the benefit of masses. Such of type of funding is found in development of various community projects like small dams, roads etc.

Reward based Crowd funding:It refers to solicitation of funds, wherein investors receive some existing for future tangible rewards as consideration. It has been used for a wide range of purposes, including development of free software's, scientific inventions and civic projects.

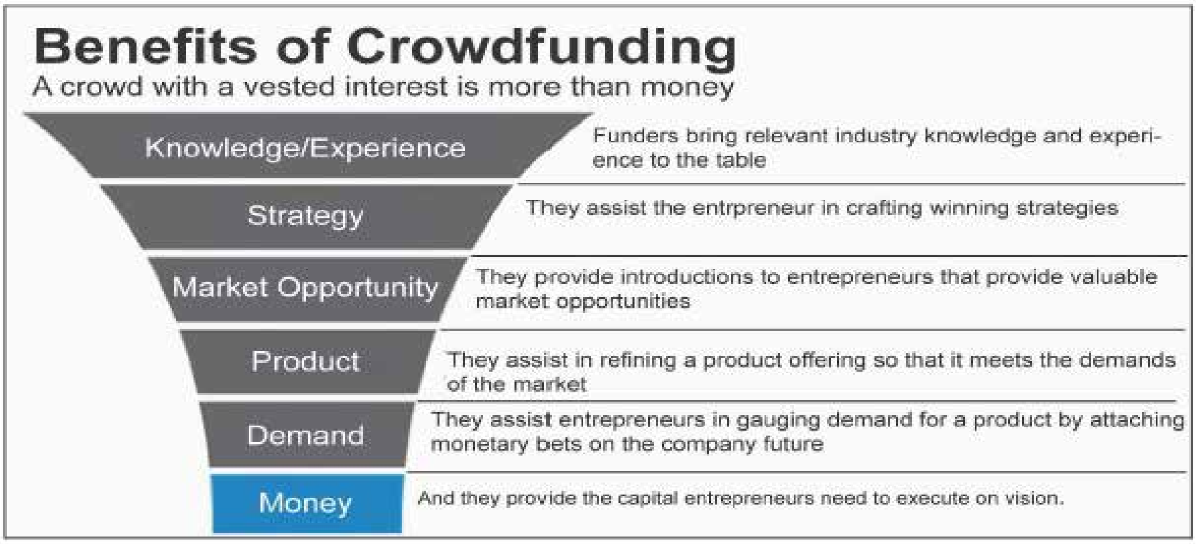
The above types of crowd funding falls under community crowd-funding where profitability factor plays a secondary role after community benefits.

Peer-to-Peer Crowd Funding: 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 Crowd Funding: It refers to raising of funds for business, particularly at early-stage funding, through offering equity interest in the business. Business seeking funds advertise with their offers on crowd funding platforms.

It is the collective efforts by individuals to support initiatives by other people or organizations through the provisions of finance in the form of equity.

Benefits of Crowd Funding:
The following figure highlights the benefits associated with crowd funding



i. Crowd funding provides a much needed new mode of financing for start-ups and SME sector and increases flows of credit to SMEs and other users in the real economy.

ii. Financial crisis (2008) resulted in failure of number of Banks and, consequently the Basel III Capital adequacy norms have been made applicable to 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.

iii. SMEs are able to raise funds at lower cost of capital without undergoing through rigorous procedures.

iv. Crowd funding provides new investment avenue and provides a new product for portfolio diversification of Investors.

v. It increases competition in a space traditionally dominated by a few providers.

vi. The operators 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.

Risks with Crowd Funding:
Substitution of Institutional Risk by Retail Risk

Presently, the risk in financing Start-ups and SMEs is borne by the Venture Capital Funds and Private Equity Investors. In crowd funding, these entities solicit investments in smaller sums from large number of investors. Hence, the risk taking by is substituted with retail investors, whose risk tolerance level may be very low. Retail investors may not be able to understand the risk in these investments and will be unable to bear the loss of investments.

b. This may be more dangerous, considering the fact that investments in SMEs and Start-up may involve high risk and low liquidity and are generally treated as aggressive and long term investments. Investors will be able to negotiate a better pricing and some influence on management, which would be absent in the crowd funding route, where smaller contributions are sought from multiple investors.

2 Risk of default
a. There is no or less recourse to the investors against the issuer, in case of default or fraud.. Funds are solicited by the platform and such platform may or may not conduct proper due diligence of the issuer. If a platform is being temporarily shut down, or closed permanently, no recourse is available to the investors.

There is no collateral, as in case of corporate Bonds. Further, in peer to peer lending, there are no investor protection by way of a compensation scheme to cover defaults like deposit guarantee schemes for bank deposits.

c. Public funding is sought on the basis of future possibilities as against the clear evidence of a viable existing business model, which is needed under the existing regulations. Investments in companies without viable business model increase the risk of failure and loss to equity investors.

d. The risk of failure is further increased by the fact that the funding is potentially by participants who do not have the skills and experience needed to assess the risk before investing/lending, as compared to the Investors, banks or other financial institutions who provides funds under the traditional business model.

3 Information Asymmetry
There is high chance of information asymmetry associated with these platforms, where one party invests/trades based on some information which is unknown to other set of investors. Since there is lack of hard information, there is too much reliance on soft information based on the social networking platforms in this model, which increases the risks.

b) There is no monitoring of these platforms, as to which account the money goes.

c) There is lack of transparency and reporting obligations on issuers including with respect to the use of funds raised.

d) There is possibility of omission of information and misinformation providing distorted view of the issuer or the actual investment, which may result in over-estimation of the

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actual return. This may induce the investors to invest in a product that would not align with their risk tolerance.

4.Substitution of Existing Regulatory Framework

Peer to Peer Lending acts as a Bank by matching lenders/ investors with borrowers/issuers, without complying with any of the rigid requirements of Banks.

The Disclosure and due diligence involved in Crowd funding platform cannot be compared with existing framework of public offering through filing of Prospectus with adequate information, which is also subject to the scrutiny of the Regulators. Further, other public issue requirements for equity shares like to have minimum track record for the issuers, minimum promoters' contribution, lock in, and for debt securities like requirement to have trustees, rating by Credit rating agencies etc. may not be applicable in the crowd funding platforms.

Further, even private placement requirements have been tightened in India recently i.e. requirement to have Private Placement Offer Letter, restriction on number of investors to whom it can be made, restrictions on mode of placements, etc. Crowd funding Platforms may not adhere to any of the said requirements.

5. Role of Internet

Crowd-funding platform is an internet based market place for raising capital for their business venture. Thus the central role of the internet and its wide reach would increase the number of persons potentially affected, which can be significantly greater than the traditional means of fund raising. Younger investors may get influenced simply because of its link to social media and the internet.

Funds could be raised from investors residing at various countries without complying with requirement of local laws of various jurisdictions.

Indian Scenario:

India being a developing and a huge economy with dramatically rising middle class, capital formation power of such large crowd is dynamic in nature and would change the rules of game in raising finances. Equity crowd funding though not live in India yet, but is a potential avenue expected to be there in future.

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. Companies in India raising money for its ventures are to comply with requirements of laws which are cumbersome and time consuming procedures resulting in delays and escalations of project cost.

Conclusion:

With support from governments and development organizations, crowd funding could become a useful tool in the developing world as well. Interestingly, it can be said that India has seen a massive crowd funding success story many years before the term was coinedThere is no doubt that crowd funding is rapidly being looked upon as a serious way of raising funds for startups and new businesses. The US and European agencies have started implementing laws for this to function. There are serious concerns, which make it mandatory to bring this method under the laws of the land. India may soon bring in the requisite laws to support this in a big way, as efficient crowd funding system can really play the role of catalyst in bringing the startup ideas into reality.

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