



Crowd Funding - A New Horizon

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ABSTRACT

In present competitive world it is very difficult to give direction to your dream, thinking and ideas. The biggest hurdle is converting the idea in to reality is generating funds. Traditionally, entrepreneurs have relied on family, friends and associates for seed capital to launch their ventures. Presently banks, venture capital firms, other financial institutions and intermediaries really option for finance.

Financial intermediaries play vital roles in mobilizing of funds and make important contributions for the economy. But still funding is needed to bear direct and indirect expenses, huge transaction costs etc.

To bridge this recurring demand of funds, nowadays technologies have given entrepreneurs a plethora of new ways to make the dream in to reality. Crowd funding is one of the option amongst them. It is the process of raising money to project or business venture through many donors using an online platform.

Keywords— Crowd Funding, Finance, Transcations

I. INTRODUCTION

Crowd funding is a modern way of financing new aspirants as entrepreneurs. It is typically done through an online platform that allows the fundraiser to set up a public campaign for accepting donations. The campaign will advertise details such as the nature of the project or venture, the amount of money the company is hoping to raise and the campaign's fundraising deadline. People can donate a specified amount through the fundraising campaign's website and often receive some sort of acknowledgement or reward in return for their donation. Crowd funding platforms each tend to cater to specific categories, such as Kickstarter which focuses on creative projects or Crowd funder, an equity-based platform which is used for businesses looking to raise investment capital

Crowd funding has opened up a new world of financing for business owners. With these online platforms, you can raise money through many small contributions from individuals, the crowd, rather than working with one large financial institution. While crowd funding offers some interesting benefits, it's still not a replacement for traditional lending. It's important to understand how both systems work so you can figure out which is right for your company.

II. OBJECTIVES OF STUDY

1. Conceptual framework of Crowd funding
2. Advantages and Disadvantages of Crowd funding
3. Risk Associated with Crowd funding

III. METHODOLOGY

REVIEW OF LITRATURE

Prinsha K.,A (2016) stated in her paper that There is no doubt that crowd funding is rapidly being looked upon as a serious way of raising funds for start ups and new businesses. 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 start up ideas into reality. Crowd funding comes with many advantages compared to existing avenues available to start ups and SMEs. Capital raise under the Crowd Funding Platform not being a public offer and thus not triggering public offer related pre-conditions, and the related costs and compliances therein, is a good starting point for this platform available for such new generation companies. This will also enable the Eligible Entities to reach out to a wider section of investors and investor groups for raising capital. As there is an absence of track

record requirement for the Eligible Entities and such Eligible Entities can raise funds even before their venture actually becomes commercially viable, such capital investment through Crowd funding will be in the form of a risk capital. Thus, there is a greater need to have this space appropriately regulated rather than being over regulated (which may have overkill on the budding entrepreneurs and promoters and their creative and innovative business ideas).

Mollick (2014) extracted information from the Kickstarter web site and built a data set of 48,034 projects. Data is at the project level, that is, there is no information about individual transactions. His analysis suggests that personal networks (proxied by the number of facebook friends of the entrepreneur) and signals of high project quality (proxied by the availability of a video that describes the project and spelling errors in the project description) are positive determinants of project success. Project duration and a project's target amount are negatively correlated with success.

Kuppuswamy and Bayus (2013) study Kickstarter data. In addition to project level data they collect the number of backers of each project over time. Looking at the aggregate picture, they observe a decrease of backers after a busy starting phase and an increase of backers when the project deadline approaches. They also find that project updates tend to increase as the project deadline draws near

Bradford (2012) distinguishes between donation sites, reward/pre-purchase sites, lending sites with/without interest, and equity sites. However, in practice borders between them are blurred. Donation sites sometimes also allow for rewards to be offered to donors and reward/pre-purchase sites may allow for pledges without a reward in return.

Agrawal et al. (2011) analyze data from SellaBand, a platform that connects musicians who need money to produce their album and the crowd. They report that funders tend to invest in a project the more capital it already accumulated. They also look at the relationship between geographic distance and inclination to invest. While the average distance between bands and funders was circa 3,000 miles, they find evidence of a family and friends effect in the early phase of funding

IV. CROWD FUNDING V/S VENTURE CAPITAL

Venture Capitalists typically reserve additional capital for follow-on investment rounds. This is helpful for companies that have a long runway, or need more time to build out their businesses. Another huge value that VCs provide is access to their networks for employees or clients to use the products or services you are building.

V. TYPES OF CROWD FUNDING

Donation-Based Crowd funding

Where there is no financial return to the investors or stakeholders is donation-based crowd funding. Donation-based crowd funding initiatives include fund raising for, charities, disaster relief and nonprofits.

Rewards-Based Crowd Funding

Rewards based crowd funding describes a funding campaign where the individuals contributing money can expect to receive varying levels of "rewards" that correspond to the amount of money they contribute. It is like is no financial or equity return. This approach is a popular option here on Fundable, as well other popular crowd funding platforms like Kick-starter and Indiegogo, because it lets business-owners incentivize their contributor without incurring much extra expense or selling ownership stake.

Equity-Based Crowd Funding

Unlike the donation-based and rewards-based methods, equity-based crowd funding allows contributors to become part-owners of your company by trading capital for equity shares. As equity owners, your contributors receive a financial return on their investment and ultimately receive a share of the profits in the form of a dividend or distribution.

Debt-Based (peer to peer)

In Debt-based crowd funding investors do not get any reward or equity but investor gets interest on the amount of principal. Investors make money from interest on the unsecured loans. Lending based crowd funding allows entrepreneurs to raise funds in the form of loans that they will pay back to the lenders with a set interest rate over a pre-determined timeline.

VI. BENEFITS OF CROWD FUNDING

It is very difficult to raise the funds to entrepreneurs but crowd funding make it easy for them. There are a number of benefits to crowd funding which are as follows:

1) Access to capital

An entrepreneur may think that other than their own network they can only raise capital from investors, financial institution, venture capitalists and banks. Crowd funding is a great alternative way to fund a venture. Debt-based crowd funding platforms allow entrepreneurs to raise funds from the community in exchange for simply giving them normal interest on the amount contributed or invested by the investors.

2) Hedges risk

To start a new company is a very risky and challenging task in current business world. In addition finding sufficient funding, there are always expenses that are impossible to forecast, challenges in market validation,

and other people who want a piece of your venture in order to help get it off the ground.

Launching a crowd funding campaign hedges these risks and serves as a valuable learning experience. Crowd funding as it is today allows an entrepreneur to gain market validation and avoid giving up equity before going all out and taking a product concept to market.

VII. ADVANTAGES AND DISADVANTAGES OF CROWDFUNDING

Advantages

- It is a **fast** way to raise finance with no upfront fees
- Working through the online platform can be a **valuable form of marketing**.
- One can get **feedback and expert guidance** on how to improve it
- It is a good way to **test the public's reaction** to your product/idea - if people are keen to invest it is a good sign that the your idea could work well in the market
- Investors can track your progress - this may help you to promote your brand through their networks
- Ideas that may not appeal to conventional investors can often get financed more easily
- Your investors can often become your most **loyal customers** through the financing process
- It's an alternative finance option if you have **struggled to get bank loans or traditional funding**

Disadvantages

- It will not necessarily be an easier process to go through compared to the more traditional ways of raising finance – **not all projects that apply to crowdfunding platforms get onto them**
- When you are on your chosen platform, you need to do a lot of work in **building up interest before the project launches** – significant resources (money and/or time) may be required
- If you **don't reach your funding target**, any finance that has been pledged will usually be returned to your investors and you will receive nothing
- Failed projects risk damage to the **reputation of your business** and people who have pledged money to you
- If you haven't protected your business idea with a **patent or copyright**, someone may see it on a crowd funding site and steal your concept
- Getting the rewards or returns wrong can mean **giving away too much of the business to investors**

KEY RISKS

• **Risk of default:** In equity crowd-funding the risk of default/ investment failure is estimated to be around 50%. In peer to-peer lending there has been a concerted effort by the industry to reduce default rates, which reached a high of 30% in 2009. While there has been some success in reducing the default rate, the actual rate of default in many cases is unknown as many of the platforms have only opened in the last three years and the loans originated by them have only recently started to mature.

• **Risk of platform closure/failure:** Despite the short life of crowd-funding, there has already been a case of a peer-to peer lending platform closing leaving no data on contracts behind and resulting in 100% investment loss. Investors bear a higher risk than in many other types of investments.

• **Risk of fraud:** This is compounded in both peer-to-peer lending and equity crowd funding by the anonymity created by the online aspect of these industries. This is the case for both the lender/investor and borrower/issuer parties, whereby the opportunity to defraud is an ever present reality.

• **Risk of illiquidity:** Investors cannot sell their participations as there doesn't exist a secondary market. This lack of liquidity in FR crowd-funding could be a risk for investors if they are not aware of this.

• **Risk of cyber-attack:** The online nature of FR crowd-funding makes FR-crowd funding vulnerable to the risk of cyber-attacks.

• **Lack of transparency and disclosure of risks:** Risks tend not to be disclosed until a lender/investor becomes a member of the platform

• Systemic Risk:

a) Due to the "individual" nature of crowd funding, there is a possibility that investors may not practice good diversification principles.

b) There may be no secondary market in which investors can sell their investments and exit and hence, there is a risk of illiquidity.

c) There is also possibility of Money laundering.

d) These platforms could expose other financial sectors to the risk of default, as occurred during the subprime mortgage crisis. If the rapid growth rate in peer to-peer lending continues, these risks could become systemic.

e) There are Cross-border implications, if the funds are solicited through internet, as there are disparities in Contract Act or securities law application in different jurisdictions.

VIII. CONCLUSION

It can be concluded that crowd funding is having a long way to go despite several risk associated to it, the benefits derived from it is plenty. Also, in future it can be achieved a new benchmark.

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