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Crowd Funding at a Glance

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Abstract

Crowd funding through the Internet, a new fundraising technique for small business ventures, can benefit fund-seeking companies by helping to overcome funding difficulties, providing value-added involvement, facilitating access to further funding, providing publicity and contacts, and enabling fundraising with only limited or no loss of control and ownership. This paper aims to provide a global overview of crowd funding, benefits and risks associated with it.

Introduction

In the 21st Century, Crowd funding is consider to be a new internet based method to raise capital- short term investments from the individual investors. This approach for entrepreneurs not only lead to marketability but also helps to raise small capital for the business. It also helps small investor individuals to present their ideas for the business. Governments encouraged such crowd funding techniques, showing a positive effect on the economy by way of creating jobs, fostering economy recovery and also innovations. Generally, crowd funding techniques are widely used for funding movies, films, role acts, etc.

Crowd funding is the practice of funding a project or venture by raising monetary contributions from a large number of people through the collective effort of friends, family, customers and individual investors. Crowd funding is a form of crowd sourcing and an worldwide alternative finance. In 2015, it was estimated that worldwide over US$34 billion was raised this way.

Although the concept can also be executed through mail-order subscriptions, benefit events and other methods, it is now often performed via Internet-mediated registries. This modern crowd funding model is generally based on 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.

How is Crowd Funding Different?

Crowd funding is essentially the opposite of the mainstream approach to business finance. Traditionally, if one wants to raise capital to start a business or launch a new product, he would have to pack up the business plan, market research and prototypes, and then shop his ideas around a limited pool or wealthy individuals or institutions. These funding sources included banks, angel investors and venture capital firms, limiting the options to a few key players. You can think of this fundraising approach as a funnel, with you and your pitch at the wide end and your audience of investors at the closed end. If one fail to point that funnel at the right investor or firm at the right time and money is lost.

The Benefits of Crowd Funding

From tapping into a wider investor pool to enjoying more flexible fundraising options, there are a number of benefits to crowd funding over traditional methods. Here are just a few of the many possible advantages,

- **Reach** – By using a crowd funding platform like Fundable, you have access to thousands of accredited investors who can see, interact with, and share your fundraising campaign.
- **Presentation** – By creating a crowd funding campaign, you go through the invaluable process of looking at your business from the top level—its history, traction, offerings, addressable market, value proposition, and more—and boiling it down into a polished, easily digestible package.
- **PR & Marketing** – From launch to close, you can share and promote your campaign through social media, email newsletters, and other online marketing tactics. As you and other media outlets cover the progress of yourfundraise, you can double down by steering traffic to your website and other company resources.
- **Validation of Concept** – Presenting your concept or business to the masses affords an excellent opportunity to validate and refine your offering. As potential investors begin to express interest and ask questions, you'll quickly see if there's something missing that would make them more likely to buy in.
- **Efficiency** – One of the best things about online crowd funding is its ability to centralize and streamline your fundraising efforts. By building a single, comprehensive profile to which you can funnel all your prospects and potential investors, you eliminate the need to pursue each of them individually. So instead of duplicating efforts by printing documents, compiling binders and manually updating each one when there's an update, you can present everything online in a much more accessible format, leaving you with more time to run your business instead of fundraising.

Types of Crowd Funding

Just like there are many different kinds of capital round raises for businesses in all stages of growth, there are a variety of crowd funding types. Which crowd funding method you select depends on the type of product or service you offer and your goals for growth. The 3 primary types are ***donation-based, rewards-based and equity crowd funding***.

Donation-Based Crowd Funding

Any crowd funding campaign in which there is no financial return to the investors or contributors are termed as donation-based crowd funding. Common donation-based crowd funding initiatives include fundraising for disaster relief, charities, nonprofits and medical bills.

Rewards-Based Crowd Funding

Rewards-based crowd funding involves individuals contributing to business in exchange for a "reward", typically a form of the product or service the company offers. Even though this method offers backers a reward, it's still generally considered a subset of donation-based crowd funding since there is no financial or equity return. This approach is a popular option on popular crowd funding platforms like Fundable, Kick starter and Indiegogo etc., 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 the company by trading capital for equity shares. As equity owners, 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 Crowd funding

Debt-based crowd funding (also known as "peer to peer", "P2P", "marketplace lending", or "crowd lending") arose with the founding of Zopa in the UK in 2005 and in the US in 2006, with the launches of Lending Club and Prosper.com. Borrowers apply online, generally for free, and their application is reviewed and verified by an automated system which also determines the borrower's credit risk and interest rate. Investors buy securities in a fund which makes the loans to individual borrowers or bundles of borrowers. Investors make money from interest on the unsecured loans; the system operators make money by taking a percentage of the loan and a loan servicing fee.

In 2009, institutional investors entered the P2P lending arena; for example in 2013, Google invested $125 million in Lending Club. In 2014 in the US, P2P lending totalled about $5 billion. In 2014 in the UK, P2P platforms lent businesses £749 million, a growth of 250% from 2012 to 2014, and lent retail customers £547 million, a growth of 108% from 2012 to 2014. In both countries in 2014, about 75% of all the money transferred through crowd funding went through P2P platforms

Risks of Crowd Funding

As the retail investors are unable to handle the risk of default in payment through crowd funding, the Venture Capital Funds (VCFs) and the Private Equity (PE) borne the risks for the new Startups and the SMEs. The VCFs and the PE investors solicit the small amount of investments for different investors and helps as mediators for the start-ups and SMEs, along with handling high risk and low liquidity of money. There are chances of default in money getting back to the investors. The crowd funding platforms may in due course of time shut down either temporarily or permanently. Then no recovery is available to the investors.

The risk of failure and loss of equity to the individual investors through crowd funding is very high, as new companies in the market don‘t have viable business models. As compared to the Corporate Banks, there is no collateral, as such, so the risk in funding such companies is very high for the investors. As compared to the traditional investors, such as Banks or the VCFs, the chance to tackle such risk is very low among the crowd funding platforms. The crowd funding through online also increases the risk of fraud. False websites or the fraudsters may use such way of funding any projects and asking to disclose the credit card numbers of the investors. The individual investors may not practice a good diversification principle, which leads to increase in risk of fraud.In peer-to-peer crowd funding there is a chance of Money Laundering. Since, crowd funding is done online, there is lack of transparency of platforms or the websites and even the identity of the company may not be disclosed properly.

Regulation of Crowd Funding in Various Jurisdiction

United States To regulate crowd funding platforms, Jumpstart Our Business Startups Act, 2012 or (JOBS Act) had already proposed a basic regulatory framework for crowd funding. Before this in U.S there was ban on general solicitation or general advertising for investment in securities. Title II of the JOBS Act deals with accredited investors which deals with equity. Rules and Sec under this title came into effect from September 2013. Title III of the JOBS Act deals with Crowd Sourced Equity Funding (CSEF) which offers to investors only.

New Zealand Recently the Act name which enacted Financial markets Conduct Act, 2013 which contains provisions designed to facilitate CSEF. The new Regulations in New Zealand which raise up to a maximum of $2 Million from 20 investors in one year from the basis of crowd funding without any issues. This covers both of the varieties of crowd funding such as Equity and Peer-to-peer lending.

Australia The Australian Government (Corporations and Market Advisory committee) has recently came out with a new concept that it’s a paper based crowd funding and this process currently framing a ruled for Equity Based Crowd funding. In Australia the current regulations allow raising not more than $20 Million or transferring equity not more than 20 people in any given 12 months. The rules of it are under revision.

Canada Canadian Securities Administrators (CSA), an umbrella organization for different provincial and territorial securities regulators in Canada has published National Instrument (in 2014) involving prospectus exemptions that include the Offering Memorandum exemption (the OM exemption) which is used by registered dealers to sell securities on the internet to the public.

United Kingdom. Financial Conduct Authority (FCA) come out in year 2014 in month of March. These regulations govern the crowd funding in Britain. This new Regime is applicable to the firms operating on Loan- Based crowd funding and Investment-Based Crowd funding platforms.

Indian Scenario The existing legal framework for raising funds by companies are regulated under companies Act 2013 and securities Act (SEBI Act, 1993) Securities Contracts Act, 1956etc. They all raise money through Alternative Investment Fund, Mutual Fund etc. which is regulated under legal work.

Conclusion

It is imperative that government has initiated steps towards promoting Crowd Funding at a global level and thereby stimulating an environment of online transfer of money by the investors and funding the plans and many other projects in a very short span of time. The Grameen Bank is a major step towards lending short term loans to new start-ups and SMEs by the small investors as well as the large investors. The Crowd Funding platforms provide a very easy access to the investors, with a strong base and security of not defaulting in payment of their invested money and also speedy transfer of money from around the world.

Micro-credit and Micro Finance based crowd funding has also emerged now-a-days at the rural level, providing short term credit facilities to poor section of people and also easy availability of money to women which helps them to be self-sufficient. At last, by helping the aggregation of capital and removing friction from the process, crowd funding brings new ideas to the market. It is a powerful trend that we should all expect to continue in a big way.

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