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Financial Inclusion and Crowdfunding: A Critical Examination of Opportunities and Constraints

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***Abstract*– Crowd funding is the linkage between entrepreneur and investor. It is the practice of raising money online or through social media in small sums from a large number of investors to support new enterprises in business, the arts, movies, and other endeavors.This platform not only raises funds for business ventures but for charity and social purposes also. In India, it is in inceptive stage even though the potential seems to be extremely high. The idea of raising funds from investors is not new but the use of technology for the same is eye catching feature. The aim of this paper is to study the scenario of crowd funding in India and also examine its regulatory framework to support its foster growth. The paper will also highlight its contribution towards the financial inclusion along with the hurdles faced by it.**

***Keywords*– Crowd funding, Business Venture, Technology, Financial Inclusion, India**

I. Introduction

In the context of financial inclusion, crowd funding is the process of raising funds from a significant number of individuals, generally via online platforms, in order to support initiatives, projects, or businesses. Contrarily, financial inclusion refers to the effort to make financial services and products accessible to people and communities who have traditionally been underserved by the formal banking sector. Financial innovations such as microfinance, mobile payment, crowdfunding, and cryptography are playing a vital role in providing greater financial access to the financially underserved populations. Particularly, the increased adoption of blockchain technology and crowdfunding platforms has produced new ways to connect with those who are struggling financially, both personally and professionally.

II. Definition

Crowdfunding's Potential for the Developing World (World Bank 2013)

"Crowd funding is an Internet-enabled way for businesses or other organizations to raise money—typically from about US$ 1,000 to US$1 million—in the form of either donations or investments from multiple individuals."

Crowd-funding: An Infant Industry Growing Fast (IOSCO 2014)

"Crowd-funding is an umbrella term that describes the use of small amounts of money, obtained from a large number of individuals or organizations, to raise funds for a project, business/personal loan or other financing needs through online web-based platforms. Peer-to-peer lending is a form of crowd-funding used to fund loans, which are paid back with interest. Equity crowd-funding is the raising of capital through the issuance of stock to a number of individual investors using the same method as crowd-funding."

Consultation Paper on Crowdfunding in India (SEBI 2014)

"Crowdfunding is solicitation of funds (small amount) from multiple investors through a web-based platform or social networking site for a specific project, business venture or social cause."

III. Review Of Literature

Although crowd funding lacks the lengthy literature as it is emerging topic. Schwienbacher & Larralde (2010) made first attempt to describe crowd funding by briefing French music startup crowd funding and also attempted to build a model when individual choose crowd funding option. Hemer(2011)attempted to classify the categories of crowd funding and business models for it. Along with the models, economic relevance of crowd funding and its applicability to the start up financing was also discussed. Gerber et al.(2012) studied the motivational force for creators and funders behind crowd funding as funders and creators both satisfy each other's needs. Mollick (2014) suggested that the success and failure of crowd funding ventures are many a times depends on the personal networks and quality of projects. Sarkar (2016) made a descriptive study on the issues and challenges and acceptance of crowd funding in Indian Market also the regulatory framework of crowd funding in India. Jenik et al., (2017) explained how crowd funding plays a vital role in financial inclusion by providing access to financially excluded people and line out the characteristics of crowd funding.

Muneeza et al., (2018) studied the relevance of crowd funding in financial inclusion and also how block chain technology mitigate the issues and hurdles faced by different platform operators and fuels the crowd funding.

II. Research Objectives

1. To study the scenario of crowd funding in India.
2. To read the types of crowd funding.
3. To study the regulatory framework for crowd funding in India.
4. To study the contribution made by crowd funding in financial inclusion.
5. To find out the hurdles in the way of crowd funding.

III. Research Methodology

The study is descriptive in nature based on secondary source of data which is collected from various articles, journals, published papers issued by government authorities and other websites.

IV. Types Of Crowd Funding

According to the staff working paper (2014) of IOSCO-Crowd Funding: An infant Industry Growing Fast, Crowd funding can be broadly classified into four categories:

1. Donation Crowd funding
2. Reward Crowd funding
3. Peer to peer lending or debt Crowd funding
4. Equity Crowd funding

1. *Donation crowd funding:* This type of crowd funding is mainly used for some social or charitable purposes like in case of natural disaster, offering free food to needy, organizing some free medical camps etc. In this type of funding there is no monetary returns expected and no minimum or maximum amount needed.
2. *Reward crowd funding:* As the name suggest it is alternative for donation crowd funding. In this funding there is some sort of tangible return for donation that would be some coupons, gift hampers, movie tickets etc.
3. *Peer to peer lending or debt Crowd funding:* P2P lending is a method of raising loans that are usually unsecured in nature and interest is attached to it. Fund raiser can be individual or corporate. Fees or commission is paid by both funder raiser and provider to the online platform through which loan is being raised.
4. *Equity crowd funding:* Equity crowd funding is method in which equity interest is offered by the fund raiser by online platform.

V. Regulatory Framework For Crowd Funding

Crowd funding as compared to other public offering which requires filing of prospectus, minimum subscription, and minimum promoter's contribution etc. may not apply to crowd funding. Also in case of private placement has been regulated tighten in India but that so does not apply to crowd funding.

Very few jurisdictions have come up for regulating crowd funding. As of date, many of them are at introduction stage that is offered to various industries for suggestions so that it can be improved.

Before coming to regulation one need to know about following concepts:

- ➢ Who can invest in crowd funding platform
- ➢ The entities that are allowed to raise funds from crowd funding
- ➢ The entities that are allowed to allowed setting up online platform for raising funds for crowd funding.
- ❖ Donation and reward crowd funding as no monetary value or return is expected from these funding so these funding does not fall under the securities regulation.
- ❖ Peer to Peer lending crowd funding the regulation of peer to peer lending depends upon its nature of its issue whether pure lending or debt securities accordingly banking or securities market regulator. Mostly, P2P lending falls under the preview of Reserve bank of India (RBI).
- ❖ Equity crowd funding are mostly regulated by security market regulator.

In Indian scenario, it is proposed to permit only Accredited Investors to participate in crowdfunding.

The accredited investors

The proposed accredited investors who may be allowed to invest through crowdfunding platforms are as under:

- ➢ Qualified Institutional Buyer as defined by SEBI
- ➢ Companies incorporated under companies act with minimum net worth of Rs. 20 Crore
- ➢ Eligible retail investors
- ➢ High net worth individuals with minimum net worth of Rs. 2 crore or more.

Disclosure Requirement on Issuer

It is proposed that crowd funding follow a disclosure based regime. As in any public issue companies need to disclosure true and factual information to facilitate investors in an informed decision making same applies to crowd funding issuer. The issuer intended to raise funds from crowd funding platform need to submit Private Placement Offer Letter to crowd funding portal and this offer letter shall be circulated online to accredited investors who are registered with crowd funding platform.

All these disclosures shall be displayed by the platform on its websites and will be available to accredited investors who are registered with such platform.

Regulation for Crowd Funding Platform

To make sure that crowd funding platforms are not established for fraudulent activities therefore it is proposed that issue and sale through SEBI recognized crowd funding platforms only. Entities that fall under any of the following classes are allowed to set up crowd funding platform

Class I Entities:

- SEBI recognized depositories
- Recognized stock exchanges

Class II Entities:

- Technology Business Incubators

Class III Entities:

- Associations and Networks of PE or Angel Investors

This is proposed that crowd funding platforms along with taking all the care and diligence regarding the disclosure practices and the basic requirement provided by SEBI need to have "Screening Committee" with minimum strength of 10 members who are experts from different domains and sectors. Crowd funding platforms shall charge nominal fees for the services rendered by them.

Provisions related to secondary market

- Companies displayed on crowd funding platforms will not be treated as "listed companies".

Provisions regarding transferability of securities:

- Securities shall be transfer according to the provisions of Companies Act 2013 to other accredited investor
- Can be buyback
- to family members or relatives or friend of accredited investor or equivalent
- Promoters shall have at least 5 % of equity stake in company and that to for a minimum period of 3years from the date of issue.
- Investors can only exit the company at the time of sale of company or management buyout or floatation of IPO.

VI. Scenario Of Crowd Funding In India

Although crowd funding is in its early development stage in India, still gaining lots of interest in public. The Securities and exchange board of India (SEBI), aims to protect the interest of general public and as high percentage of risk is associated with the crowd funding SEBI considered equity crowdfunding as illegal. Risk associated with these types of platforms is high as the fund raiser and provider has little knowledge and has no clear regulatory framework.

As per some reports, over 200 companies have raised Rs.35,057,840- Rs.45,074,366 through crowd funding platforms. Transaction Value in the crowd funding segment amounted to $2 million in 2019 and average funding per campaign stood at$ 145 in 2019. In year 2021, volume of funds raised amounted to $1,711.42 million approx.

MAJOR CROWD FUNDING PLATFORMS IN INDIA

Name	**Founder**	**Year**	**Commission/ fees**
Fuel A Dream	Rangnath Thota	2016	Processing fees 3% Contract fees: 6%
Ketto	Varun Sheth, Zaheer Ademwala & Kunal Kapoor	2012	0% processing fees
Milap	Mayukh Choudary, Anoj Viswanathan, Sourabh Sharma	2010	0% fees
Catapooolt	Satish Kataria	2017	Fixed 10% + 18% of 10%(gst)
Impact Guru	Moneka Gandhi	2015	0% fees

VII. Why Crowd Funding Is Important In Financial Inclusion?

The major benefit of crowd funding is its efficiency of raising funds without giving up the major share of equity. As a result, efforts are made to encourage the development of these platforms to help entrepreneurs to seek funds more effortlessly.

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Crowd funding has the potential to contribute to financial inclusion by providing more access to funds and financial assets. Crowd funding benefits the financial inclusion in the following ways:

Enhanced access to funds

Most important benefit of crowd funding platform is easy and effortlessly access to the finance by neglected, excluded and undeserved sector of society. MSMEs, SMEs and other entrepreneur having no credit history can easily raise funds and can build better credit score for them. Quick and cheap transactions are another important benefit over the traditional modes of raising funds.

Bridges the funding gap left by banks

Market based platforms like crowd funding is the alternative for the traditional forms of finance that particularly target to niche groups that are mostly ignored by the banks and other financial institutes as they do not meet the traditional requirements of finance.

Innovative modes of finance

As crowd funding platforms deals digitally and have many types of funding forms are available that suits the versatile needs of today's business environment, entrepreneurs prefers to raise funds from these digital platforms. These platforms also contribute and encourage the government's digital initiatives.

VIII. Hurdle In Crowd Funding

Being innovative or having a great company idea is not the only one requirement for starting a business. In order to make aspirational corporate goals a reality, adequate capital is required. Equity crowd funding gives business owners additional options for raising money for their enterprises. Although advantageous, crowd funding is not necessarily a direct path to success. All business owners should be prepared to deal with the numerous obstacles that come with this type of finance.

However, there are a number of things you may do to get around the problems with equity crowdsourcing and expand your company. So there are a lot of hurdles that any entrepreneur has to face in crowd funding.

Incompetency

Beneficiaries and donors may initially have unrealistic expectations for the results. Entrepreneurs could lack experience in dealing with suppliers, logistics, and product development, which couldcause delays or low-quality products.

Limited funding

Funding limits, or the maximum amount that can be raised, are frequently present in crowdfunding projects. For attempts requiring significant financial resources, such as extensive research programmes or infrastructure construction, this limitation can be troublesome.

Competition and saturation

As crowdfunding platforms have grown in popularity, there is more competition amongst campaigns. It might be difficult to differentiate out and draw potential sponsors when there are thousands of projects competing for attention. Because of this saturation, it may be challenging for less well-known ventures to get traction and raise the necessary funds.

Uncertain outcomes

Although crowdsourcing provides a venue for concept validation, success is not ensured. The likelihood that the financial goal will be reached is not guaranteed, not even with a carefully planned campaign. There may be disappointment and potential reputational harm when certain projects fall short of the expectations of their funders or fail to attract sufficient interest.

Limited audience reach

To market campaigns, crowdfunding platforms generally use internet exposure and social media networks. This reliance can limit the target group that projects are exposed to, potentially excluding potential backers who are not frequent users of these platforms or who feel discomfort making purchases online.

Lack of feedback and mentoring

Traditional funding strategies, such venture capital or angel investors, frequently include extra advantages, like mentorship and feedback from experts in the field. Contrarily, crowdfunding campaigns could not have these safety nets, forcing entrepreneurs to face the difficulties of execution alone.

IX. Conclusion

India has risen as second largest internet market as over 900 million internet users in the country. This figure clearly indicates that internet market will rise over the years and crowdfunding industry is also expected to grow in India. Conceptual framework of crowd funding clearly explains its importance as likeminded and creative entrepreneurs can easily get into touch and can raise funds with minimal cost.

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Although there are chances of being cheated over these platforms more precise and regulated framework should be there to protect the interest of investors. Crowd funding platforms significantly contributing to financial inclusion by giving access of funds and innovative financial assets to the public which is generally neglected by the banks and financial institutes or who do not have credit score before. As with the growing market, crowd funding has a bright future ahead.

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