CROWDFUNDING FOR INDIAN STARTUP ECOSYSTEMS – A STUDY

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Abstract
Crowdfunding is an innovative way to provide modest amount of funding to young entrepreneurs and technology professionals needing early stage or seed capital for startup companies which may spur entrepreneurship and ultimately assist in boosting the growth of real economy. As a concept, crowd funding is not new to India. From DhirubhaiAmbani's then small venture funded by locals to temples being built overnight with donations, India has harnessed crowd power for several decades. Crowd funding platforms now cater to a plethora of causes from disaster relief, entrepreneurship, art, individual causes, environmental issues and many others. People are defining what they want to do and what the crowd resonates with. Growth of such platforms have the scope to even lead to a level playing field in the start up ecosystem. With the startups fervour gaining ground, youngsters are enthused to strike it out on their own and such platforms give them capital to propel their ideas. This paper reviews the evolution of crowd funding in India and rest of the world. It also reviews a few research papers on crowdfunding and its scope of being a major source funding for start ups in India.The paper is also written to examine the history behind this growing platform of entrepreneurial finance; the challenges and issues in the context of India as also the opportunities in India for such platforms.

Keywords: Crowd Funding, Financing Start-Ups, Financial Services.

INTRODUCTION
Crowd-funding is the pooling of money and other resources by a group of people for a common goal.Crowd funded projects may include creative works, products, nonprofit organizations, supporting entrepreneurship, businesses, or donations for a specific purpose (e.g., to pay for a medical procedure). Crowd funding usually takes place via an online portal that handles the financial transactions involved, and may also provide services such as media hosting, social networking, and facilitating contact with contributors.

The consultation paper of Securities & Exchange Board of India (SEBI)defines "Crowdfunding as 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." Crowd sourced funding is a means of raising money for a creative project (for instance, music, film, book publication), a benevolent or public-interest cause (for instance, a community based social or co-operative initiative) or a business venture, through small financial contributions from persons who may number in the hundreds or thousands. Those contributions are sought through an online crowd-funding platform, while the offer may also be promoted through social media.

Crowd-funding is not new; it has deep international roots. It was in the 17^{th} century Europe that people used this manner of raising funds quite often, to fund book-prints. Hopefuls and book lovers, in particularly of their favourite authors, were able to place, well in advance, printed publications thus making it one of the world's first subscription-services. Crowd-funding was not confined to books alone; it was also used in music, as far back as the 1700s. Even famous musicians like Mozart lacked sufficient funds to bankroll concerts, and resorted to the use of crowd-funding to raise finances, to host three musical events at a Viennese concert hall. Mozart also began offering manuscripts of the concerts to his most loyal fans. Unsurprisingly, deprived of the power of the internet then, it took Mozart over two years, to raise finances for most of his performances.

Internet-led crowd-funding was developed primarily to fund arts, music and creativity-based industries (e.g., recorded music, film, video games),mostly due to network effects which are not direct yet similar to other online markets (e.g., eBay); crowd-funding has always been dominated by a single platform. Originally, Sellaband, a music-only platform based in Amsterdam founded in 2006 and Kickstarter, a broader creative projects platform started in 2009 and based in New York. Neither of those platforms allowed creators to issue equity for funding, although Sellaband did permit revenue sharing with investors of crowd-funding, during its first three years of operation. That is a very brief outlook of how and where crowd-funding made its beginning.

Categories of Crowdfunding
As per IOSCO Staff Working Paper "Crowd-funding: An Infant Industry Growing Fast", Crowd-funding can be divided into four categories:

1. **Donation crowdfunding –** It denotes solicitation of funds for social, artistic, philanthropic or other purpose, and not in exchange for anything of tangible value. For example, In the US, Kickstarter, Indiegogo etc. are some of the platforms that support donation based crowdfunding.
2. **Reward crowdfunding -** Refers to solicitation of funds, wherein investors receive some existing or future tangible reward (such as an existing or future consumer product or a membership rewards scheme) as consideration. Most of the websites which support donation crowdfunding, also enable reward crowdfunding, e.g. Kicktstarter, Rockethub etc.
3. **Peer-to-peer lending -** 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. Some of the leading examples from the US are Lending Club, Prosper etc. and from UK are Zopa, Funding Circle etc.
4. **Equity crowdfunding.**- In consideration of funds solicited from investors, Equity Shares of the Company are issued for such types of crowdfundng. It refers to fund raising by a business, particularly early-stage funding, through offering equity interests in the business to investors online. Businesses seeking to raise capital through this mode typically advertise online through a crowdfunding platform website, which serves as an intermediary between investors and the start-up companies. Traditionally, Start-ups are funded through private equity, angel investor or loan arrangements with a financial institution. Any offering of public equity takes place only after the product or business becomes commercially viable. However, in Equity based Crowdfunding solicitation is done at an earlier stage. Some examples of equity crowdfunding platforms are Syndicate Room, Crowdcube and Seedrs. In a few jurisdictions (like China), these platforms are restricted to offer this type of capital raising to sophisticated investors or to a limited number of individual investors. In China, an equity raising offer made to less than 200 individuals does not need to fulfil the public equity raising requirements.

Key benefits of Crowdfunding: Some of the key benefits of crowdfunding are as under:

1. Crowdfunding 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.
2. 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.
3. SMEs are able to raise funds at lower cost of capital without undergoing through rigorous procedures in this mode.
4. Crowdfunding provides new investment avenue and provides a new product for portfolio diversification of Investors.
5. It increases competition in a space traditionally dominated by a few providers (providing finance to Start-ups and SMEs).
6. The operators of a crowdfunding platform may engage in vetting or due diligence of projects to be included on their website, to maintain the reputation of the website.

Risks of Crowdfunding

Substitution of Institutional Risk by Retail Risk: Presently, the risk in financing Start-ups and SMEs is borne by the Venture Capital Funds (VCFs) and Private Equity (PE) Investors. In crowdfunding, these entities solicit investments in smaller sums from large number of investors.

Hence, the risk taking by VCF/PE (informed investors) 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. 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. VCF/PE Investors will be able to negotiate a better pricing and some influence on management, which would be absent in the Crowdfunding Route, where smaller contributions are sought from multiple investors. Uninformed and unsophisticated investors (retail investors) may act with a 'herd mentality'.

Risk of default: There is no or less recourse to the investors against the issuer, in case of default or fraud. Funds are not directly solicited by the issuer and issuer also do not come out with any offer document. 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.

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There is no collateral (even in case of peer to peer lending), 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.

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 VCF/PE Investors, banks or other financial institutions who provides funds under the traditional business model.

Eg: Bubble and Balm was a fair trade soap company, who were also the first company to raise funding for their start-up through the equity crowd-funding platform Crowdcube, based in the UK, in 2011. It raised £75,000 in return for 15 per cent of the company's equity from 82 investors, who contributed between £10 and £7,500 each. In July 2013 the business closed overnight, leaving no way of contacting the company or a way to recover losses. The investors lost 100% of their investment.

Risk of Fraud: There is possibility of genuine websites being used by fraudsters claiming to be promoters of projects or of false websites being established, simply to defraud the investors or to entice individuals to provide credit card details etc. Thus, there is a risk of misuse as well as cyber-security and/or identity theft.

Central role of the Internet: Crowdfunding platform is an internet based market place for issuers to sell their own securities to raise capital. 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 fundraising. 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.

Systemic Risk: Due to the "individual" nature of crowdfunding, there is a possibility that investors may not practice good diversification principles.There may be no secondary market in which investors can sell their investments and exit and hence, there is a risk of illiquidity.There is also possibility of Money laundering.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.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.

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. There is no monitoring of these platforms, as to which account the money goes. There is lack of transparency and reporting obligations on issuers including with respect to the use of funds raised. 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 actual return. This may induce the investors to invest in a product that would not align with their risk tolerance.

Crowdfunding: Global Overview

Conversations in the United Statesare abuzz with crowd-funding. There are discussionsabound on the potential impact of crowdfundng and millions of dollars were raised on crowd-funding platforms. This movement of raising capital onlineis gaining momentum world over now. There appears to be a national-noise, and in it, it might get lost that crowd-funding is not an American innovation of raising funds. On the contrary,USA was one of the later countriesto do a bit of a catch-upin the case of crowd-funding.

In the modern days this platform, crowd-funding, has become aforce to reckon with, for businesses across the world. As more and more countries are taking steps to regulate and legalize equity crowd-funding, more investments are finding its way into early-stage-businesses across the world to venture fund start-ups.

There may be some crowd-funding-platforms which are operating across multiple countries, however, for the time being, equity crowd-funding platforms are being regulated and operated, within individual countries. Whether or not for rewards or equity in return, crowd-funding platforms are becoming an incredibly exciting movement, giving the necessary fillip to the international startup-community to grow. Let us begin a peek into some countries to examine how this movement is changing the landscape of venture-capital funding in some these countries.

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Canadapermitsminimal regulations and a rewards-based crowd-funding system,,however like all other countries it has more stringent rules governing equity-crowd-funding. Canada's first equity crowd-funding portal, Optimize Capital Markets, was launched in Ontario in the year 2009. Because of the segmentation of regions within Canada, equity crowd-funding growing yet at a regional level within Canada. In 2013 the Ontario Securities Commission announced that it would permit equity crowd-funding, via accredited investors. In 2013, the province of Saskatchewan became the latest to in legalizing equity crowd-funding.

New Zealandissued legal guidelines surrounding equity crowd-funding in 2013, making it a legal form of raising equity-capital within the country. Several platforms have been launched since then, allowing start-ups in New Zealand to raise up to $2 million in a 12-month period without filing the typical offer documents required under present securities law.

*Italy***,** like U.S. and Canada, has several well-functioning reward-based crowd-funding websites, and has been active since 2011. In just two years, Italy became the first country in Europe to implement a complete regulation on equity-crowd-funding.It creating a national registry for crowd-funding operators. Equity crowdfunding platforms are now operational in Italy.

Sweden embraced crowdfunding early on, with the launch of Crowdculture in 2010, a platform for funding cultural projects. Equity crowdfunding became possible in Sweden in late 2012 and is currently being practice by platforms like FundedByMe.

United Kingdom**,** after years of active rewards crowdfunding in the UK, Seedrs was the first equity crowdfunding platform to be authorized by the FCA (Financial Conduct Authority) of the UK. U.K. regulators moved more quickly than those in the U.S. and elsewhere. Non-accredited investors can invest in startups as long as they agree not to spend more than 10 percent of their net assets in a year.The FCA of the UK has recently come forward with additional proposed regulations, but equity crowdfunding continues to grow.

Kenya is at the forefront of the evolution of startup financing. Home to several accelerators, they have become a hub of startup activity. Crowdfunding has never been a distant concept in Kenya; there is actually a word for the spirit of communal fundraising—Harambee—that is a keystone of Kenya's culture. South Africa and Nigeria are also home to a strong startup community and host multiple crowdfunding sites.

In Kenya, crowdfunding platforms Babandu and M-Changa have experienced great success due to their mobile payments features. Crowdfunding could solve a critical problem facing startups in Kenya: a lack of business angel networks. Most businesses in Kenya are self-funded and many fail due to lack of operating capital.

Crowd-funding, much like entrepreneurism, is truly an international movement. As countries hone in on their equity crowdfunding guidelines, one can look forward to seeing an influx in entrepreneurship across the globe.

Global Crowd funding (US $ bn)	**2013**	**2014**
Business andEntrepreneurship	1.9	6.8
Social causes	1.2	3
Firms and performing arts	0.8	2
Property	0.5	1
Music and recording arts	0.4	0.8
Science and Technology	0.6	0.7
Art	0.2	0.3
Publishing	0.1	0.3

Crowd-funding platforms which enabled individuals to club their investments to fund projects of any kinds raised $16.2 billion in 2015 in the USA, according to a research firm, Massolution.

Top 10 Sites of Crowd Funding in the USA

Website	**2014 Volume**	**Rank**
Gofundme	S 1051 m	1
Kickstarter	$ 444 m	2
Indiegogo	$ 372 m	3
Treespring	$ 431m	4

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Patreon	$ 572m	5
Youcaring	$ 321 m	6
Crowdrise	$ 411 m	7
Donorschoose.org	$ 301 m	8
KIVA	$ 254m	9
Giveforward	$ 119 m	10

US Aleaxa Rank

Global expansionary plans of firms, cross-border M&A coupled with regulatory reforms have lent a helping hand to boost the crowdfunding industry. Many investors who are seeking rewards or equity in return for their cash has only given boost to the demand for such platforms. Growth was highest in Asia, where there was a 320% increase in funding, with $3.4 billion raised in 20015, propelling the continent past Europe to become the second-largest crowd-funding region. North America retained first place in 2014 but its lead is being eroded. In 2015 crowd-funding in Asia grew by more than double the rate in North America.

LITERATURE REVIEW

Agrawal, Catalini, & Goldfarb et al, (2011, 2014), look into the importance of geographical proximity between entrepreneur and capital providers. The authors examine the role of distance in an online platform for financing early stage artist entrepreneurs. They found that investment pattern over time are independent of geographic distance between entrepreneur and investor, after controlling for the entrepreneur's offline social network. The research findings contrast with the existing literature that emphasizes the importance of spatial proximity in entrepreneurial finance. Instead, their research results suggested that online mechanisms can reduce economic frictions associated with investing in early-stage projects over long distances. Furthermore, their research emphasized the important role that friends and family might play online and offline in generating early investment in entrepreneurial ventures. Finally, they commented upon the implications of crowd-funding in their particular industry: recorded music. Over the past two decades, industry revenues had declined by approximately by 50%; many industry experts attributed it to piracy (Passman 2009). Simultaneously costs associated with production and distribution dropped substantially due to the development of inexpensive production software and internet enabled digital distribution of music. However recording artists were commonly cash constrained. As the major labels declined in importance, artists had fewer options. Crowd-funding helped them to overcome that constraint by creating a market for the most salient asset made available to aspiring new artists – their intellectual property which facilitated financing from distant strangers. Thus, crowd-funding might help reduce an important market failure.

Agrawal, Catalini, & Goldfarb et al, (2013), through the simple economics of crowd funding observed that crowd-funding platforms would compete on variations in market design, employ different rules for engagement and tools for reputation, crowd due-diligence, and provisions point mechanisms, among others. New markets for trusted intermediaries might emerge. Despite the best efforts of policy makers and platform designers, there would surely be spectacular failures. Investors, the authors fear, would lose significant sums, to fraud, incompetent managers, bad ideas, and bad luck. Entrepreneurs might litigate their investors, and vice versa; there are possibilities of ideas and intellectual property getting stolen due to early-stage public disclosure. That the growing pains experienced by the equity-based crowd-funding industry would be even more dramatic and severe than in the non-equity setting is more a likelihood than not. Policy makers would be faced with the question: whether or not the benefit from the private gains as well as social gains due to spillovers and other externalities would outweigh those significant costs. The market most likely would solve many of its own problems through innovation but the benefits from crowd-funding would not be uniformly distributed. Certain types of ventures would benefit more from this new form of finance. Even still, these ventures might prefer to raise their funds from traditional sources unless the cost of capital was significantly lower or they were able to derive additional benefits from interacting with a crowd of heterogeneous, geographically dispersed investors. Fortunately, the authors feel that since crowd-funding would occur online, many of the actions of entrepreneurs and investors might remain in digital form and thus it would leave audit trail. Venture characteristics, entrepreneurial traits, investor histories, investment decisions, platform-based communications, and many other features are in those data. Unlike other channels for early-stage capital but like other online markets, the data collected on participant behavior would be extensive, says the authors. Using those data and analyses platform designers might be enabled to better the designs for addressing market failures. This, the authors claim, would enhance their ability to harness the upside potential of crowd-funding and realize the social gains from trade which might result from financing an important yet potentially undercapitalized sector of the economy.

FinkAndrew (April 25, 2012)through his research paper states that public frustration over a stagnant economy, growing fervor over jobs creation, and expanded social media platforms has pushed the crowd-funding exemptions into reality. The author opines that that crowd-funding investing industry represents unchartered territory for both regulators and issuers; he states that even though the early stages might be marred by instances of fraud, with timethese channels of raising capital would result in economic growth and creation of jobs. The bridge between small business in need of financing and the individual, unprofessional investors willing to contribute would not be built in one day. The author is of the opinion that if the SEC were to over-regulate during the rulemaking period then the crowd-funding exemption would be dead on arrival. He states that regulatory flexibility in the early stages of building that bridge would be essential to its long-term health, and permitting the crowd to control itself, with the help of the states, would ensure that start-ups and small businesses across the country could choose crowd-funding, as a viable capital-raising vehicle.

Kuti Monika&Madarsz' Gabor in Public Finance Quarterly 2014, Vol. 59 in their research noted that the reasons behind the emergence of new forms of financing are as a result of,innovation, enterprises' needs for growth, technological development and the increasingly roles of the masses through democratic capital markets.They feel thatinvestors through internet platform strive to gain, among other things, social benefits through the allocation of funds.They concur that both the allocation and solicitation is enabled quickly and efficiently by the presence of internet platform, which weeds out inefficiency.In their opinion it is only in the recent past that crowd-funding has become a dynamically increasing financing means, worldwide. The authors claims that through research about this untraditional form of financing has adequately amplified the numerous instructive results and has pointed out the importance of quality signals and social effects it has on the firms seeking investments, as indeed, in shaping thebehaviour of crowd-investors.

Crowd Funding – Issues and Challenges in Indian Perspective

Crowd-funding is not new to India. There are many instances of organisations reaching out to common people for funding. However, the emergence of platforms that promote crowd-funding is fairly recent to India. These platforms help start-ups or small businesses meet their funding requirements.

If one looks a little closely, the crowdfunding platforms themselves fall into two categories. The first comprises groups like PikAVenture and Wishberry who had a head start and were a part of the initial wave. Then there are the 'challengers' like TheHotStart and fundAPeer who are just about getting their products ready for the market. Interestingly, each platform has something going for them and they are all trying to fine tune their pitch to stakeholders.

Crowd-funding has been in India for quiet a few years now however still the quantum of funds collected is very much low as compared to the crowd-funding platforms in USA andEurope. From that perspective, it may not be wrong to say that the Indian crowd-funding space itself is in nascent stage. The aggregated volume of projects or the quantum of funds generated in India so far is very low compared to what some of the bigger names in this space have been able to achieve.The entrepreneur community in India are keen to have widely accepted Indian version of crowd funding platforms like Kickstarter, Indiegogo which not only helps Startups or individuals to launch a product but also test the acceptance of the product in the market.

The crowd-funding platforms themselves fall into three broad categories namely Social causes, Business or Startups and Arts & Culture. Listed below are some of the Indian based Crowd-funding platforms available for Indians along with their statistics:

Crowdfunding sites in India – Opportunity & Facts

	Category	**Funds raised so far**	**Fee**	**Site Fee**	**Upfront Fee**
BITGIVING	Social Causes	Rs. 35 lacs	Free	NA	NA
MILAAP	Social Causes	US $ 48 lacs	Free	NA	NA
KETTO.Org	All	Rs 4 crs	Free	5%	5%
START 51	All	Rs. 17 lacs	Free	5%	NA
FUNDDREAMINDIA	All	NA	Free	5%	NA
WISHBERRY.IN	All	Rs. 4.5 crs	Rs.2,500	10%	NA
CATAPAULT	All	Rs. 75 lacs	Rs 1,499	10%	NA

Source: *Amount arrived after summing up all the campaigns that were found on home pages as on Dec 15, 2015*

Crowdfunding Platforms in India

Some of the popular Indian platforms are given hereunder:

Ketto (.org) is an Indian crowd funding website that offers a user-friendly platform for individuals, NGOs, corporations and other groups to run campaigns for social causes, NGOs, creative projects (film, music, fine art, performing arts etc.), entrepreneurial ventures and personal causes (a vacation, educational expenses etc.). Starting a campaign on Ketto is simple and is free, with no penalties if one doesn't raise his target amount. Ketto team provides guidance and tailor-made marketing

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tips to help one promote the campaign. They send updates on campaign progress and also notify the fund raiser with emails or SMSes each time a new contribution is received. For the convenience of contributors, these websites provide several secure online methods to make contributions (credit card, debit card, net banking, Paypaletc) but also offline modes of cash and cheque pick-up options for those who are not comfortable with transacting online just yet.

They provide NGOs with an excellent opportunity to multiply their database and raise more funds quickly and efficiently. Corporations too have unique solutions for their recruitment and team-building needs, with the additional advantage of CSR. And individuals of all ages and backgrounds (the youngest campaigner so far is an 11-year-old schoolgirl) are encouraged to start crowdfunding for whichever cause they choose.

START51: This website offers new creative fund platform to transform unique ideas into reality. The crowd-funding platform runs with an aim of offering direct financial support from contributors. This is an initiative to support projects from all industry verticals that meet project guidelines.It is a platform and a resource that follows all-or-nothing funding policy, in which projects must reach their funding goals to receive any financial aid. Providing a new way to crowd-fund projects, the organization adds life to creative projects and ideas. It is a fund raising platform where creative ideas meet financial contributors. Start51 offers new way of exploring innovative ideas and helping them to turn in to reality. It supports projects for different industries, from films to games, music to technology, art to design, etc.

BITGIVING: It is a Social Crowdfunding platform, which focuses on fund-raising for causes online. With an immense focus on Social Media integration and inherent virality, BitGiving envisions bringing together projects and social campaigns and helping individuals, organisations and NGOs raise funds for their projects. It’s open to both open to both individuals and organisations. It catersthe**need for Social Causes only.**

MILAAP: It disburses loan of which 100% goes to the borrowers. Milaap is not a charity where one donates money, but actually loan them to people who need it. The idea of not making people dependent, but making them independent, making them productive is fantastic. It too catersthe**need for Social Causes only.**

Comments on SEBI’s Consultation Paper on Crowdfunding

Currently, no crowd-funding regulation exists in India, but the Securities and Exchange Board of India (SEBI) released a consultation paper in 2014 where it spoke about need for regulation. It is expected that the regulations will be bought in soon and the acceptance of crowd-funding among the Indian backers at a lower speed though.

This consultation paper aims to provide a brief overview of the global scenario of crowdfunding including the various prevalent models under it, the associated benefits and risks, the regulatory approaches in different jurisdictions etc. The paper also covers the extant legal structure governing the fund raising for start ups and SMEs in India. The paper discusses legal and regulatory challenges in implementing the framework for Crowdfunding. This paper proposes framework for ushering in crowdfunding by giving access to capital market to provide an additional channel of early stage funding to Start-ups and SMEs and seeks to balance the same with investor protection. Through this consultation paper SEBI intends to invite comments and suggestions from industry and market participants regarding the different possible structures for crowdfunding within the existing legal framework and other associated issues.

A quick review of SEBI’s consultation paper to regulate equity-based crowd-funding in India gives us pointers as to what possible regulations could be. The proposition identified, three entities to be regulated. They are:

1. the platform,
2. the investorand
3. the issuing company

Restriction for the issuing company would be, in terms of its size, the amount of funds to be raised and its age. Restrictions for the investor would be in terms of its accreditation, minimum net worth and, in the case of eligible retail investors, restrictions might be for maximum investment made either overall or in a single crowd-funding event. Crowd-funding platforms would also be restricted in terms of who might set them up and the checks and balances which would be put in place.

SEBI has drawn extensively upon matters such as accredited investors and maximum caps on investment in a single crowd-funded venture from the Jumpstart Our Business Startups (JOBS) Act in the U.S; others are homegrown. SEBI did not give an exemption to small companies to access public funds, as in the case of the JOBS Act because this stems from the fact that Indian corporate finance markets were simply not as developed or sophisticated as those in the U.S. and other well-developed

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economies. Equity crowd-funded companies would have to follow requirements as per Section 42 of the Companies Act, 2013. This would mean that companies might offer their securities to a maximum of 200 persons; might have up to 50 shareholders, without having to undertake a public issue. Thus, the act of crowd-funding, under SEBI's mandate could not include an offer for shares; could be used only to garner interest in the company, seeking funds.

However, SEBI has ignored a crucial aspect: that of cross-border crowd-funding. Regulations passed by a few countries fall under one of the two models: the U.S. model, which created an exemption as described previously and others like Australia, Italy, Japan, New Zealand and Singapore. The second category included nations such as India, Hong Kong and Malaysia which did not offer exemptions. However, New Zealand's crowd funding laws are of particular interest: it specifically allows intermediary service providers, such as crowd-funding portals, to be licensed. It is intended to facilitate suitably regulated 'peer-to-peer lending' and 'crowd-funding' services to operate. With regard to the fund-seeking company, the upper limit for raising funds is capped at NZ$2 million, but there are no upper limits on investment, neither is there a distinction between sophisticated and retail investors, making New Zealand one of the most crowd-funding-friendly jurisdictions.

In the context of India there are two ways through which we may consider the case for cross-border crowd-funding. Firstly, company which has sought to raise funds from investors who are not residing in India; secondly, a case of a company, set up outside of India but has sought funds from investors around the world, including India. In the first case, the provisions of Section 42 of the Companies Act, 2013 would continue to apply. Therefore, the question would arise, whether or not it would be possible to have a foreign company raise funds in India and for foreign investors to participate in crowd-funding activities in India, subject to extant inward and outward bound investment regulations and policies. But given the nature of both crowd-funding and the global reach of the Internet, it is possible that Indian investors may be involved in crowd-funding activities in other jurisdictions too apart from similar activities pertaining to Indian markets.

The ability of Indian resident-investors to invest in overseas companies, coupled with crowd-funding-friendly laws in other countries, come together to create an interesting scenario. Hypothetically a company incorporated in India but was unable to raise funds in India, now sets up a parent-firm in a jurisdiction which has crowd-funding-friendly regulations. It then sought crowd-funding from investors around the world. An Indian retail investor, never participated in equity funding in India, is now able to do so, subject to the Overseas Direct Investment regulations. The funds raised by parent company are then invested in the Indian subsidiary. This possible scenario brings to light the globalised nature of internet enabled corporate fundraising. The cross-border aspect of the platforms and, uncertainty surrounding contract law applications in different jurisdictions will have to be dealt with effectively. IOSC has acknowledged this gap.

Thus, from jurisdictions where crowd-funding activities are less or minimally regulated it would be easier to raise funds and invest in an Indian company. The opportunities arising from regulatory arbitrage could then be used by fund-seeking companies in India. Such regulatory arbitrage activities has always been used in other modes of equity/debt financing as well; is not unusual to see companies offer a minimal IPO in India only to undertake a substantially higher fundraising exercise through a GDR issue in a listing-friendly jurisdiction, such as Luxembourg.

How does a regulator of securities market deal with such opportunity then? One option would be to blanket ban: that of overseas investment by individuals unless they conform to the crowd-funding regulations. A more plausible — albeit difficult — solution would require regulators across the world to integrate their regulatory observations and work together to remove possible means of regulatory arbitrage.

It is feared that this might lead some jurisdictions to use this opportunity to begin a 'race to the bottom' in terms of crowd-funding regulations. Coupled with low capital gains taxation policy prevalent in such jurisdiction and a relatively low level of crowd-funding regulations it would certainly attract fund-seeking companies' attention.

The internet has acted as an enabling development in almost all industries disrupting existing business practices and forcing people to sit up and re-look at their business models. Traditional methods of corporate finance practices are being obliterated by this disruptive thing called internet. The best way to deal with this new-age disruptions are by integrating the regulatory mechanisms and to adopt a global-level regulatory practice that espouses all jurisdictions bound by economic interconnectedness and divorced from political differences.

Indian Financial Services Industry

India's financial services sector consists of the capital markets, insurance sector and non-banking financial companies (NBFCs). India's gross domestic savings (GDS) as a percentage of Gross Domestic Product (GDP) has remained above 30 per cent since 2004.It is projected that national savings in India will reach US$ 1,272 billion by 2019. Over 95 per cent of household savings in India are invested in bank deposits and only 5 per cent in other financial asset classes.

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Amount raised in Indian Capital Primary Market

(Amount in billion)

		2013-14	2012-13	2011-12	2010-11	2009-10
		Amt	Amt	Amt	Amt	Amt
	1					
I.	**PRIMARY MARKET**					
	A. Prospectus and Rights Issues*			128.6	37.6	32.6
	1. Private Sector (a+b)	116.8	161.0	81.5	248	25,479
	a) Financial	60.6	44.5	37.9	43	326
	b) Non-financial	56.2	116.5	43.6	203	25,153
	2. Public Sector (a+b+c)	439.7	147.6	47.1	127	7,128
	a) Public Sector Undertakings	105.7	1.9	–	80	4,026
	b) Government Companies	37.0	0.0	1.3	–	2,777
	c) Banks/Financial Institutions	297.0	145.7	45.8	47	325
	3. Total (1+2, i+ii, a+b)	556.5	308.7	128.6	376	32,607
	Instrument type					
	(i) Equity	132.7	138.8	128.6	376	32,427
	(ii) Debt	423.8	169.8	–	–	180
	Issuer Type					
	(a) IPOs	12.4	49.4	59.1	171	21,609
	(b) Listed	544.1	259.3	69.5	205	10,998
	B. Euro Issues (ADRs and GDRs)	1.2	10.4	27.2	94	15,967
	C. Private Placement					
	1. Private Sector (a+b)	1,188.9	1,412.8	619.1	1214	2332
	a) Financial	859.8	865.7	387.1	719	1424
	b) Non-financial	329.0	547.1	232	494	908
	2. Public Sector (a+b)	2,710.4	1,889.2	1560.7	1168	1099
	a) Financial	1,759.3	1,376.5	1234.7	989	743
	b) Non-financial	951.1	512.7	326	179	356
	3. Total (1+2, i+ii)	3,899.2	3,302.0	2179.8	2383	3432
	(i) Equity	272.1	66.8	51.6	137	367
	(ii) Debt	3,626.4	3,235.3	2128.2	2247	3065
	D. Mutual fund Mobilsation (net)	537.8	765.4	-220.2		
	1. Private Sector	488.4	637.9	-154.5	-192	549
	2. Public Sector	49.4	127.5	-65.8	-301	281

Source : Securities and Exchange Board of India, Bombay Stock exchange, National Stock Exchange and various merchant bankers.

CAPITAL MARKET - PRIMARY AND SECONDARY

(Amount in billion)

		Issues	2013-14	Issues	2012-13	Issues	2011-12	Issues	2010-11	Issues	2009-10
			Amt		Amt		Amt		Amt		Amt
1											
I.	**PRIMARY MARKET**										
	A. Prospectus and Rights Issues*					51	128.6	77	377	71	326
	1. Private Sector (a+b)	70	116.8	54	161.0	49	81.5	70	248	68	254
	a) Financial	26	60.6	12	44.5	10	37.9	6	434	3	326
	b) Non-financial	44	56.2	42	116.5	39	43.6	64	205	65	251
	2. Public Sector (a+b+c)	20	439.7	14	147.6	2	47.1	7	128	3	72
	a) Public Sector Undertakings	5	105.7	3	1.9	–	–	2	80	1	41
	b) Government Companies	1	37.0	0	0.0	1	1.3	–	–	1	27
	c) Banks/Financial Institutions	14	297.0	11	145.7	1	45.8	5	48	1	33
	3. Total (1+2, i+ii, a+b)	90	556.5	68	308.7	51	128.6	77	377	71	326
	Instrument type										
	(i) Equity	55	132.7	48	138.8	51	128.6	77	376	70	324
	(ii) Debt	35	423.8	20	169.8	–	–	–	–	1	18
	Issuer Type										
	(a) IPOs	38	12.4	32	49.4	34	59.1	51	171	39	216
	(b) Listed	52	544.1	36	259.3	17	69.5	26	206	32	108
	B. Euro Issues (ADRs and GDRs)	1	1.2	5	10.4	22	27.2	42	94	18	159
	C. Private Placement										
	1. Private Sector (a+b)		1,188.9		1,412.8	588	619.1	1,337	1214.5	2,270	2331
	a) Financial		859.8		865.7	527	387.1	877	719	1,630	1424
	b) Non-financial		329.0		547.1	61	232	460	494	640	909
	2. Public Sector (a+b)		2,710.4		1,889.2	266	1560.7	250	1196	218	1099
	a) Financial		1,759.3		1,376.5	230	1234.7	212	989	151	743
	b) Non-financial		951.1		512.7	36	326	38	‘79.1	67	356
	3. Total (1+2, i+ii)		3,899.2		3,302.0	854	2179.8	1,587	2393.4	2,488	3423
	(i) Equity		272.1		66.8	6	51.6	19	137	49	367
	(ii) Debt		3,626.4		3,235.3	848	2128.2	1,568	2247.1	2,439	3065
	D. Mutual fund Mobilsation (net)		537.8		765.4		-220.2				
	1. Private Sector		488.4		637.9		-154.5		192		54
	2. Public Sector		49.4		127.5		-65.8		30		28
II.	**SECONDARY MARKET**										
	BSE Sensex: End-Period		22,386.3		18,835.8		17404		19,445		17,528
	Period Average		20,120.1		18,202.1		17423		18,605		15,585
	Price Earning Ratio@		18.3		16.9		17.8		21		21
	Market Capitalisation to GDP Ratio		65.3		63.2		70.1		87		99
	Turnover										
	Cash Segment				5,487.7		6670.2		11034.6		13788.9
	Derivatives Segment		5,216.6		71,635.8		8084.8		154		234
	S&PCNX Nifty: End-Period		6,704.2		5,682.6		5296		5,834		5,249
	Period Average		6,009.5		5,520.3		5243		5,584		4,658
	Price Earning Ratio@		18.9		17.6		18.7		22		22
	Market Capitalisation to GDP Ratio		64.1		61.7		68.8		85		96
	Turnover										
	Cash Segment		28,084.9		27,082.8		28108.9		35774.1		41,38,024
	Derivatives Segment		382,114.1		315,330.0		313497.3		292482		1,76,63,6

* : Excluding offers for sale. - : Nil/Negligible. @ : As at end-Period.

Source : Securities and Exchange Board of India, Bombay Stock exchange, National Stock Exchange and various merchant bankers.

The asset management industry in India is among the fastest growing in the world. Total asset under management (AUM) of the mutual fund industry clocked a Compound Annual Growth Rate (CAGR) of 12.05 per cent over FY07-15 to reach US$

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179.6 billion. Corporate investors accounted for around 45.9 per cent of total AUM in India, while High Net Worth Individuals (HNWI) and retail investors account for 28.6 per cent and 22.9 per cent, respectively.

India's equity market turnover has increased significantly in recent years. The annual turnover value in the National Stock Exchange (NSE) witnessed a CAGR of 20.7 per cent between FY96 and FY15 to reach US$ 718 billion.

The Government of India has taken various steps to deepen the reforms in the capital markets, including simplification of the Initial Public Offer (IPO) process which allows qualified foreign investors (QFIs) to access the Indian bond markets.

No of Issues Indian Capital Market- Secondary						
						Number of Issues
		2013-14	**2012-13**	**2011-12**	**2010-11**	**2009-10**
1						
I.	**PRIMARY MARKET**					
	A. Prospectus and Rights Issues*			51	77	71
	1. Private Sector (a+b)	70	54	49	70	68
	a) Financial	26	12	10	6	3
	b) Non-financial	44	42	39	64	65
	2. Public Sector (a+b+c)	20	14	2	7	3
	a) Public Sector Undertakings	5	3	–	2	1
	b) Government Companies	1	0	1	–	1
	c) Banks/Financial Institutions	14	11	1	5	1
	3. Total (1+2, i+ii, a+b)	90	68	51	77	71
	Instrument type					
	(i) Equity	55	48	51	77	70
	(ii) Debt	35	20	–	–	1
	Issuer Type					
	(a) IPOs	38	32	34	51	39
	(b) Listed	52	36	17	26	32
	B. Euro Issues (ADRs and GDRs)	1	5	22	42	18
Source : Securities and Exchange Board of India, Bombay Stock exchange, National Stock Exchange and various merchant bankers.						

Amount Tradedin Indian Capital Market - Secondary						
						(Amount in ` crore)
		2013-14	**2012-13**	**2011-12**	**2010-11**	**2009-10**
		Amt	**Amt**	**Amt**	**Amt**	**Amt**
II.	**SECONDARY MARKET**					
	BSE Sensex: End-Period	22,386.3	18,835.8	17404	19,445	17,528
	Period Average	20,120.1	18,202.1	17423	18,605	15,585
	Price Earning Ratio@	18.3	16.9	17.8	21	21
	Market Capitalisation to GDP Ratio (%)	65.3	63.2	70.1	87	99
	Turnover					
	Cash Segment		5,487.7	6670.2	11,03,466	13,78,809
	Derivatives Segment	5,216.6	71,635.8	8084.8	154	234
	S&PCNX Nifty: End-Period	6,704.2	5,682.6	5296	5,834	5,249
	Period Average	6,009.5	5,520.3	5243	5,584	4,658
	Price Earning Ratio@	18.9	17.6	18.7	22	22
	Market Capitalisation to GDP Ratio %)	64.1	61.7	68.8	85	96
	Turnover					
	Cash Segment	28,084.9	27,082.8	28108.9	35,77,412	41,38,024
	Derivatives Segment	382,114.1	315,330.0	313497.3	2,92,48,221	1,76,63,665
Source : Securities and Exchange Board of India, Bombay Stock exchange, National Stock Exchange and various merchant bankers.						

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CONCLUSIONS

The guidelines on crowdfunding by International Board of Securities and Exchange Board of India (SEBI) presents a set of guidelines for crowd-funding arrangements for startup entrepreneurs. These guidelines are being framed in consultation with the central government and expertise drawn from the financial services industry. The issue of crowd-funding has not been discussed in a detailed manner even in advanced economies such as Europe and United States and hence India plans to wait for sometime before contemplating on bringing out directives and regulations on the matter. However, the mere fact that growing social media is connecting strangers through online platforms perhaps, might give impetus to this growing funding mechanism. Conservative societies like India which has less inclination to take on risks may see platforms of crowd-funding growing over the years. But by putting up guidelines for crowd-funding SEBI is acting proactively and its effort should be commended.

Looking at the ease of raising funds, the simple economics of crowd funding suggest that crowd-funding platforms would compete on variations in market design, employ different rules for engagement, crowd due-diligence, and provisions among others. New markets for trusted intermediaries is also likely to emerge. Despite the best efforts of SEBI and platform designers, there would surely be a few cases of failures. The Investors too are likely to lose significant sums, to fraud, incompetent managers, bad ideas, and bad luck. Entrepreneurs might litigate their investors, and vice versa; there are possibilities of ideas and intellectual property getting stolen due to early-stage public disclosure. That the growing pains experienced by the equity-based crowd-funding industry would be even more dramatic and severe than in the non-equity setting is more a likelihood than not. SEBI may therefore have to decide whether or not the benefit from the private gains as well as social gains due to spillovers and other externalities would outweigh those significant costs. Though the Indian financial market may solve many of its own problems through innovation but the benefits from crowd-funding would not be uniformly distributed. Certain types of ventures would benefit more from this new form of finance. Even still, these ventures might prefer to raise their funds from traditional sources unless the cost of capital was significantly lower or they were able to derive additional benefits from interacting with a crowd of heterogeneous, geographically dispersed investors.

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