

CROWDFUNDING: AN ALTERNATIVE SOURCE OF FUNDING

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Abstract

Innovations are inevitable and have been the order of the day in today's world. The ideas brew up from everywhere but finding a way to give wings to these ideas to help them take off the ground is something very crucial and important. Raising funds for projects conventionally has been tough since it required the very tough parameters to be met as set by the loan provider like Venture capitalists, angel investors, banks and financial institutions. The ideas are always not commercial and not at that big level to attract the venture capitalists or banks. Sometimes, the projects are just for the community or society benefits. Such projects traditionally used to get funded either through NGOs or through patrons. This traditional arrangement narrows the scope of the projects funding and sometimes even the good projects slip down the due considerations from the funders. Small projects whose fund requirement are small but have a potential to appeal a certain set of crowd gets the platform which is now known as crowdfunding platform which acts an intermediary between the fund raiser and the contributors/investors. The paper attempts to bring out the importance of crowdfunding as a medium to fund the project and the crowdfunding models currently prevailing in India.

Keywords: Crowdfunding, Crowdfunding Portals, All or Nothing (AON), Keep it All (KIA)

Introduction

Innovations are ubiquitous in almost all the fields. But not all innovations get commercialized at mass level and become accessible & available to all. One such innovation is crowdfunding which has almost become a disruption in the field of finance shaking up the things which once used to dominate and were traditionally sought after for raising finance. New entrepreneurs and individuals who were in need of money resorted to bank financing or venture capital but these avenues were soon started getting tight after the 2008 financial crisis. The various formalities regarding documents and concrete proofs for sure success made at least the new budding entrepreneurs fail from getting accepted for loans. In that case they either get their venture funded by bootstrapping or taking loan from their own family and friends which rarely used to suffice to take the project off the ground. Good project at times dies its own death due to lack of funds and the lack of opportunity to get across itself to people who might appreciate it and be part of this.

The idea of crowdfunding comes from crowdsourcing and microfinance. Crowdsourcing is where people outsource ideas of varied interest from the crowd, the internet is flooded with many examples where famous brands like Doritos, Starbucks, Lays (I) etc. outsource ideas from the crowd. Microfinance is where people borrow small amount. Now, if we blend both the concepts we come out with something which has come to be known as crowdfunding, where many people each contribute small amount to the fund raiser who has a convincing project with a purpose. Though the concept has been there in the late 19th century when the Statue of Liberty's base construction was funded by

American citizens, but it was only in 21st century that crowdfunding came into limelight and people started realizing its benefits.

With the above prelude, it could be said that crowdfunding is “Pennies from Many”. Instead of relying on one source which could be time consuming as well as typical with lots of complications and with low success rate, it is better to bring the project to many showcasing its highlights and benefits and increase the success rate. Crowdfunding is fund raising process where the fund seeker who could be an individual or a business entrepreneur with a cause or a business venture, uploads the request on the web portal which is a specific dedicated crowdfunding web portal by paying a certain amount of fee to the portal. The portal is a platform which invites crowd and the crowd, if they find any projects suitable which match their interests contribute a small amount towards the purpose. Crowdfunding is not purely investment based, it comes with many variants making it most sought after by people who need money and by investors who want to make their presence felt in the community or make easy money.

Literature Review

The Venture capitalists often consider those ventures for investments which are located nearby to facilitate both tacit and codified information while practicing due diligence (Olav Sorenson and Toby E. Stuart, 2001).

Crowdfunding has come as a disruption and has changed the way the financing of the projects used to be, it has emerged as an alternative source to financing social ventures for both initial capital and expansion capital (Lehner, 2013).

Crowdfunding has erupted from crowdsourcing in which the creator takes help from the crowd in gathering ideas, viewpoints, suggestions, and other inputs and resources (Belleflamme, Lambert, and Schweinbacher, 2014). The same goes in crowdfunding but here the primary focus is on gathering funds along with other benefits of crowdsourcing.

The crowdfunding platforms encourage the founders of the project to have a solid private network and then encourage these people to forward the link to the outsiders to spread a word about the project. In short the fund seeker solicit funds from their own private network as well as from outsiders. And as the network spreads they also get additional and often complementary resources (Baum & Silverman, 2004).

The fund size and the duration size are negatively associated with the project success, since people tend to be skeptical about the viability of the project. As suggested in many researches, the social media presence is a high predictor of success, likewise, the video about the project also enhances the success of the project. Spelling errors made in the project could lead to failure by 13 % (Ethan Mollick, 2014).

The crowdfunding model acts as a signal as to what extent the fundraiser and his business idea is credible. All-or-Nothing (AON) model is a credible signal that the project will start only when the necessary fund is accumulated (Cumming et al., 2014).

The success determinants of crowdfunding were studied by Mollick (2013). He also focused on the risk of entrepreneur not delivering the promised offer after collecting the funds for the same. His finding was that the entrepreneur delivers the promised product/service but much later than the

promised period just like the case with Pebble watch (Gannes, 2013).

The primary reason for switching from traditional bank borrowings to crowdfunding seem to be lengthy loan application process rather than inability to get the loan sanctioned despite the fact that even P2P lending sustainability is still questionable (Yannis Pierrakis & Liam Collins, 2013). It is mainly the intrinsic motivation which makes the investor to invest in any of the entrepreneurial or support projects and it is the return which will determine the extent the investor backs the project. Although, the equity based crowdfunding projects are suggested to focus on profits as well as on social gains to attract investors (Yannis Pierrakis & Liam Collins, 2013).

Any individual who is attempting to establish a start-up, generate an idea or think of getting into entrepreneurial activity faces many challenges and struggles be it in context to finance, resources, human requirement or any technical issues (Smith, 2013). Historically, the conventional methods like venture capitalists, angel investors, banks' loan and advances and governments grants if any have been in the market for any fund seeker (Kousari, 2011). None of the sources mentioned above is free of obstacles. Each and every source of funding comes with a stumbling block to be handled by the fund seeker. For instance, the venture capitalists prefers those projects which can scale large enough in less time and the entrepreneurs have a proven record of success (Voelker, 2013). Crowdfunding has emerged as an innovative way of bridging the gap of funding since it promotes small and low risk projects that have unsuccessfully tried to raise money from the typical conventional sources like venture capitalists and the angel investors.

The crowdfunding has changed the traditional mechanism of doing business transactions. It has challenged the traditional bank lending for start-ups and other fund requirements by approaching the crowd. Crowdfunding as an intermediary makes financing easier, faster and hassle free than resorting to banks for the same (Balnaves, 2012). The entrepreneur can also delete the unnecessary intermediaries in between like the Author can directly approach its audience than going it through a publishing house.

The crowdfunding in many countries is not yet clearly understood and in many cases it is not even legal. But many countries have taken the initiative and have a legal framework to include this concept of fund raising and investment. The crowdfunding can make its root stronger only when there's a congenial environment with proper laws making it appealing for start-ups. The stringent formalities and tight rules can make it unappealing. Secondly, the companies who are thinking to raise capital anytime in future through venture capitalist should think critically before raising money via crowdfunding, since VCs do not seem to be taking such fund raising positive because the ownership gets diluted to many.

Objectives of the Study:

1. To know crowdfunding as an alternative source of funding and its comparison with traditional sources of funding.
2. To analyze various crowdfunding models prevailing in the country with the crowdfunding portals offering these models.
3. To observe the factors that lead to successful funding of crowdfunding projects.

Crowdfunding as Alternative Sources of Funding

It has been quite some time since crowdfunding became a buzzword and people around who seek funds have started looking crowdfunding as another source of raising funds. The way the projects get funded conventionally is different from the way it gets crowdfunded. It lets the fund seeker with a creative and worthy projects to raise funds by convincing the crowd in consideration of suitable reward through crowdfunding platforms. Crowdfunding has democratized the fund accessibility which was traditionally confined to few big and large entrepreneurs.

Though the concept is new and people are becoming aware of such an innovation in the market, it has already proved its significant potentiality in developed economies. It needs an innovative and convincing idea with a proper presentation possibly with a video showcasing the prototype of the product/service. The setbacks of traditional funding have all taken over by this innovative source which allows even the smallest idea take off the ground. Crowdfunding comes with various other benefits which let even the novice entrepreneurs who lack experience in handling projects to go about the successful completion of the project.

Benefits of Crowdfunding

Crowdfunding is a more efficient way of raising funds as compared to traditional sources. As we know already, the traditional sources like bank loan, venture capital financing, angel investments and the like have become all the more difficult in terms of setting the parameters for loan approval due to which many loan applications get rejected. The crowdfunding comes as a savior for such projects, which lets the fund seeker to throw the idea to the right crowd who's interested in making the investments. The crowdfunding apart from letting someone to raise funds for the business or other purpose also validates the business idea for its acceptability among the customers in the market. It helps the business entrepreneur to build traction before hitting the market with real product and get a clear picture with genuine feedback from the people who could be the prospective customers. The more investors for the idea floated for fund raising itself is a validation that it has enough substance. It also becomes a source to gather feedback and ideas about the product. It helps in pre-selling the product and gain early adopters since the prototype of the product goes through various comments from people who are more likely to purchase it. Once the product gets traction among the people, it creates a snowball effect since the early adopters advocate the product to other friends who further advocate it to their other friends. Crowdfunding gives right amount of exposure to the project since it is promoted on all the major social platforms. Crowdfunding indirectly lets the entrepreneur do the market research without incurring cost. Once the product or the idea is floated on the internet, the people whom it appeal to start dropping in the ideas with many suggestions, thereby making the product more acceptable and customized as per the needs of the people rather the customers.

Possible Drawbacks of Crowdfunding

Crowdfunding is yet growing and many people are not even aware of this new avenue. This would make project attract less attention of people. Raising funds through crowdfunding go through a series of things which is time consuming. This does not just require time but also a strong presence on social media platforms and bit of knowledge to use these media to promote the campaign. On an average every platform charges 8 to 12% of fee to launch the project on the crowdfunding platform. The fund seeker should also know which crowdfunding model he should go for to raise money, since each

model has its own unique features and pros & cons. The right selection of the crowdfunding portal along with right model is as important as coming up with the right business idea. If we look at the data analyzed in this study we see that only about 60 to 65 % of the projects succeed in raising funds and rest go in vain. Just like minimum subscription is required to successfully call it the issue, the crowdfunding too works on the same lines which has been technically termed as AON (All or Nothing Model), this poses the risk when the project does not meet its deadline within the stipulated time. The projects posted on the crowdfunding portal are sometimes taken as the rejected ones by the banks and other fund providing institutions which could spoil the image. It also poses a threat of idea being stolen by the competitors.

There are different models of crowdfunding as mentioned earlier which range from simple donation to equity crowdfunding. The model selection would depend on the nature of business project, the stage in which it into, and many more things. The four crowdfunding models are as follows:

- **Donation Based Crowdfunding Model**

In this model, the supporters donate small amounts. These contributions are not backed by any reward or return except for a small thank you note as token of gratitude of the project creator. These models are used for non-profit projects like a social cause or for a project creator's personal needs like some serious illness treatment. In short, the money raised through donation crowdfunding model goes for a social and charitable cause and the person who runs the campaign is not expected to give anything in return to the donors who have donated money for a cause (Rubinton, 2011).. The Kickstarter and Indiegogo are some of the U.S platforms that run donation based crowdfunding. In India, Ketto, Wishberry are leading names which specializes in donation based crowdfunding models.

- **Reward Based Crowdfunding Model**

The contributors in this model contribute a small amount in consideration of a reward. The reward is usually the product or an idea which the project creator has proposed in the project. The supporters receive some tangible item as return for the money they parted with. This model is apparently the most famous and sought after model both by the fund seeker as well as the investors. Reward and donation based crowdfunding is more popular among all the models of crowdfunding (Schwienbacher & Larralde, 2010). Generally, the websites running donation based crowdfunding also run reward based crowdfunding too. Kickstarter, Rockethub are some of the examples. Wishberry, Catapoolt and Impact Guru are some of the renowned names in reward based crowdfunding in India.

- **P2P Crowdfunding Model**

This is also known as debt or P2P based crowdfunding models. The person who gives money is a lender/investor and not addressed as a backer or a donor. The person receives the interest in return for the money he invests in the venture. In short, the amount they give is called as loan and in return the lender expects that the principal will be paid back along with the interest as agreed upon. It's just like borrowing from the bank but instead of going for the entire money with single institution, the lending based crowdfunding model enables the entrepreneur to raise money in small amounts for many people (Berger & Gleisner, 2010). In this type of crowdfunding, there is no investor protection and there is every possibility for the investor to lose even the entire money. But in some countries like

Germany and Italy, such lending falls within the legal framework and hence it is regulated just as any other lending is regulated.

- **Equity Based Crowdfunding Model**

This is also called as investments based crowdfunding where investors invest comparatively a large amount of funds in return of a part of ownership known as equity. This type of crowdfunding is normally used for start-ups or for growth purposes (Ahlers et.al,2015). The projects are the innovative ones with scale potential but not the creative ones. The entrepreneurs in equity crowdfunding have the discretion to set the minimum and the maximum pledge amounts. With JOBS Act (Jumpstart Our Business Startups) in April 2012 in the U.S, equity crowdfunding is becoming the most preferred choice for raising funds by entrepreneurs. Crowdfunding in India is limited to donation, reward and loan based models. The people lack required knowledge for equity crowdfunding and to make this legal, India will need to make strict laws to regulate the investments and protect the investors.

Tips for Successful Crowdfunding Campaign

The fund raiser who runs the crowdfunding campaign presents the idea with a video along with incentives or other benefits which he is willing to offer to the supporters. It has been observed that featuring the idea through a video or other visual is always an added advantage and hence increases the chances of success to get funded.

It has been observed that keeping a small amount as a fundraise goal could lead to successful fund raising. The crowdfunding platforms should be chosen carefully as each platform has its own model with its pros and cons. The selection of platform depends on the nature of project the business entrepreneur has in hand, its financing stage and the type of money being raised. Many sites offer All or Nothing model which means if the project fails to raise the target amount in the said period the money raised would be returned back to the people, while other platforms have Keep it All model which means whatever amount the campaign collects from the people in the stipulated period will be disbursed to the fund raiser. Though the former model is not in favor of the fund raiser since the fund seeker can lose the entire campaign by a small fraction but it increases the chances of project being successful.

It is also equally important for the fund raiser to keep alluring rewards to attract the supporters. The fund raiser should actually have a convincing business idea, the idea which could sell among people like a hot cake. The fundraising period should be decently placed between 3 to 6 months and its imperative that the campaign is well planned and has already made the presence in the minds of people. The campaign owner has to spread a word about the project in all the possible social media tools and create a strong buzzword about the product even before the campaign is launched.

It is strongly advisable to involve the family, friends and their friends initially and having them made support/back the project to kick start the campaign and also to keep the boll rolling. Provision of inviting traffic on the social platform and having them drop the suggestion about the project idea or even the endorsement by some of the renowned people adds to the charm. In case of crowdfunding, the platform which acts as an intermediary extends the support to the campaign owner in this regard and makes sure the project reaches and captures many peoples' attention.

Research shows that the number of Facebook friends and followers also makes a huge difference

since that creates a sort of chain and let people connect to other people by sharing the idea. To crowdfund a campaign is not an easy task and one cannot expect a lot of people joining the league instantly as the campaign is launched. It goes through a lot of legwork and preparatory work before the launch in context to how the project would go about to finally hit the target. It needs not just the hard work but also the smart work along with the strong presence of social media and technology application. Along with online presence, the project should also be taken and talked offline which increases the trust level for the business proposal of the fund seeker. The posters, flyers and other content featuring the product and other details of the project could also be spread through local newspaper and near-by crowded outlets like coffee shops.

A good amount of research is required to give project a right start. The campaign owner can also talk to the other successful campaign owners who raised funds through crowdfunding. The effort they had put in making it a success and things which they avoided should be taken into consideration. It's important to be genuine and convincing to attract crowd to be part of the campaign with reasonable rewards and all the intention to fulfill the commitment. Many of the campaigns post raising funds fail to meet the commitment like timely delivery of goods.

The campaign owner must be prompt in answering the queries posted by the people who could be interested in backing the project. This shows the seriousness of the campaign owner and his dedication towards making his dream project come true. The quick revert is always appreciable and taken positively by the people. The team who is involved in launching the campaign should be dedicatedly working with passion with no stone leaving unturned so that it ultimately turns out to be an effort worthwhile.

Keeping the supporters updated with each and every single aspect of the project is very much essential. This enhances the credibility and interest of the people in continuously following up with the project. Once the funds are raised, a personalized thank you note is always one looks for in case if the funding is not a pure investment based.

Before finalizing on the target amount, one must work on the math twice because too high an amount can lead the project fail and too less an amount could lead the fund raiser struggle for the funds again and thereby making him yearn for money in the second phase of fundraising.

It is good to involve the people in the complete process of product development with due regard and consideration of their feedback as it enhances the interest and trust of the people. In short, crowdfunding lets customers turn into investors.

Conclusion

The investors have started becoming aware of crowdfunding as a means of raising funds with benefits which were unheard in traditional sources of fundraising. The value added benefits have made it more appealing and more sought after by crowd to raise money and also to invest money in the projects of their choice. Crowdfunding lets one raise small to medium amount of money making it more apt for small to medium sized enterprises through online crowdfunding platforms. The crowdfunding along with capital raising comes with non-financial advantages. It is more beneficial for the inexperienced fund seeker who has no prior hands-on knowledge; he suitably gets guided by the platform for a small fee. The decisions taken by the crowd have been found as good as decisions taken by the experts and thereby making people believe on the wisdom of the crowd. But at the same

time, it has been observed that people simply follow the crowd and endorsements of some of the renowned personalities rather than relying on the soundness of the project. The crowdfunded projects usually were seen as those projects which were let down by the banks and other traditional sources for financing but this trend seems changing with the time and with its easy and wide acceptability by masses. The concept which founded its identity as a source of raising funds only among creative artists has gone through a radical change and a makeover with many crowdfunding models brewing up on the way. The laws are on the way to include all the models under its ambit, since the major stumbling block is the absence of proper guidelines.

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