

CROWDFUNDING IN INDIA: AN EMERGING TREND



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During the month of May, 2014, I, Gaurav Priyadarshi, B.A., LL.B.(Hons.) Vth Year Student, Damodaram Sanjivayya National Law University, Visakhapatnam, interned with R & A Associates, Hyderabad under the tutelage of Mr. Prashant Jain, Senior Associate, R & A Associates, Hyderabad. As a part of my internship, I was asked to research on the key topics of Crowdfunding and its present status in India prevailing in this regard as well as to substantiate it with certain examples and related scams. The project report, **“Crowdfunding in India : An Emerging Trend”**, is an attempt in understanding the present scenario and its legal status in India at large as well as important aspects of its challenges and its relevancy in Indian film industry with certain examples.

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INTRODUCTION

CrowdFunding is an internet-inspired means of raising money from the mass market, for a project or business. It simply means: “*A continuous and growing series of virtual on-line auction houses, matching borrowers and lenders; investors and investees; and donors and donees*”. There are three parties involved in it: namely **Project Campaigner or Entrepreneur**, **Website Platformer**, and **Crowd or Investor** as to constitute the business of crowdfunding, whereas the role of Website Plat former is to bring the other two Parties jointly and they meet together.

Crowdfunding has its origins in the concept of crowdsourcing, which is the broader concept of an individual reaching a goal by receiving and leveraging small contributions from many parties whereas Crowdfunding is the application of this concept. Hence, Crowd funding, a popular concept started in the US and the UK, is an emerging way of raising capital, through the use of internet or social networking sites such as Facebook or LinkedIn or Twitter or even some dedicated websites.

MODELS OF CROWDFUNDING

There are three models of CrowdFunding to comprehend its concept, these are:

- 1. Donation and Reward based:** The platform accepts a donation from many donors for projects. In most cases, the return is in the form of incentives whether it is in tangible or intangible form. Hence the return includes finished goods like the “pebble watch” or a signed DVD of the movie received by the crowd. Sites like Ketto do this kind of crowd sourcing in India. In India, this form of model is basically a NGO type model where the donor donates to done for a charitable or benevolent purpose and in return the donor receives hardly incentives.
- 2. Lending Based CrowdFunding:** These borrowers take money with a promise to return it with certain interests from different people (lenders) and facilitate loans or microfinance to the needy. This model is used where the Campaigner approaches Lenders through Website Plat formers and borrow the money. In return, the Campaigner paybacks the borrowed amount with certain rate of interests as specified by the Lenders. Thus, Milaap is an example of such crowd sourcing in India.
- 3. Equity Based CrowdFunding:** This mode of crowdfunding, where investors take a share of equity in the project or startup, is not legal in India yet. In this model, the Entrepreneur (the Project Campaigner) approaches the Investors through Website Plat formers to invest in the project and in return they can hold certain shares of equity in that project or startup.

CROWDFUNDING: INDIAN SCENARIO

Interestingly, it can be said that India has seen a massive crowdfunding success story many years before the term was coined: the story of the Reliance Industries founder Dhirubhai Ambani. His small yet growing textile business was crowdfunded by communities across the Indian state of Gujarat. Today's India with its huge market and human capital has become a popular destination for global business and other investments that have identified opportunities. In the next six months or so, many crowdfunding platforms are expected to be in India. Worldwide, nearly a thousand such platforms will be launched. Recently, platforms such as Wishberry and Ignite Intent have been launched in the country. There have been attempts at crowdfunding for events like the Goa Project and campaigns like Teach for India. Crowdfunding is slowly becoming an alternative funding channel for the film industry. Film Director Pawan Kumar from Karnataka recently raised Rs 51 lakh using Facebook and other platforms. The three based models of crowdfunding are Donation and Reward Based Crowdfunding; Lending based Crowdfunding; and Equity based Crowdfunding. Out of them, only Donation and Reward based Crowdfunding; and Lending based Crowdfunding are very popular in India whereas Equity based Crowdfunding is not legalized in India as of now.

CROWDFUNDING WEBSITES: INDIA

These are list of Crowdfunding websites based in India is:

- **Ignite Intent**
- **PikAVenture.com**
- **start51.com**
- **YourSeva**
- **RangDe**
- **WeFunder**
- **Ketto**
- **LetsVenture**
- **WishBerry**
- **Catapooolt**

WHAT IS THE ROLE OF CROWD IN CROWDFUNDING?

An individual who takes part in crowdfunding initiatives tends to reveal innovative orientation for interaction, social identification with the content, cause or project selected for funding as a part of the initiative, (monetary) exploitation, which motivates the individual to participate by expecting a payoff.

- The inputs of the individuals in the crowd will trigger the crowdfunding process and influence the ultimate value of the offerings or outcomes of the process.
- Each individual acts as an agent of the offering, selecting and promoting the projects in which they believe.
- They will sometimes play a donor role oriented towards providing help on social projects. In some cases they will become shareholders and contribute to the development and growth of the offering.
- Each individual disseminates information about projects they support in their online communities, generating further support (promoters).

HOW CAN A PROJECT CAMPAIGNER GET HIS CROWDFUND PROJECT?

Many projects fail because their product prototype isn't impressive and hence is unable to attract backers. Here are a few points that One (Borrower; Invitees; Donees) should consider before launching One's crowdfunding drive:

- Choose a platform or to create an online profile
- Get your content ready and explain your project
- Create Interest for fund raising goals
- Get payments right
- Share the same with public at large, including your peers, relatives, friends of friends, and so forth.
- Use social media to reach out more people and keep them up-to-date on the project with the same enthusiasm as it started throughout the fundraising process.

CROWDFUNDING SCAMS: HOW MUCH FAR?

A Recent study commissioned by the World Bank that addressed the issue of crowdfunding scam in detail did not cite a single case. As published by the Economic Times. The \$1.5 million worth of reported scams are less than 1 per cent of the total money raised by Kickstarter for projects in last five years. An example of Crowdfunding scam where someone copied Ken Lowery and Robert Wilson IV's Kickstarter campaign for Like a Virus, including the video, and made it into an IndieGoGo campaign, presumably planning to pocket the money and run.

Indian view: *"Product-based projects are in huge demand but they are also the most risky as such projects have high chances of being fake,"* Due diligence is required before accepting such Projects said Rajat Das, founder of Delhi based crowdfunding platform , thehotstart.com.

"If you compare the scam rate in crowdfunding, it is much lower than even IPOs," said Ahmedabad based Ateet Bajaj, who founded crowdfunding platform start51.com .

WHAT ARE THE CHALLENGES RELATED TO CROWDFUNDING IN INDIA?

1. Low trust levels of doing the things online are also a challenge in India.
2. As long as the crowdfunding platforms on behalf of project campaigners or entrepreneurs are not making any financial promises to the contributors, they should not be safe to operate especially in case of Lending based model and Equity based model.
3. The crowdfunding industry is not so investor-friendly in India.
4. People are not ready for this concept as it is new one and online based, channelized through Internet.

WHAT ARE THE KEY POINTS INVOLVED IN CROWDFUNDING: INDIA

- 1. The crowd cannot get any shares or profits from the success of the company:** Firstly, crowdfunding in India is quite a misnomer. In the USA, if you are funding a company through a crowdfunding platform you can hope to get some shares in the company and profit from the success of the company. However, this is not possible in India. Here, capital markets law and regulators such as SEBI tightened the screws of the system, and it is practically impossible for a startup to raise money from the public until it becomes profitable and reaches a big scale. The company looking for crowdfunding has little to offer as incentives to the potential funders in India.
- 2. Offering incentives may be seen as offering return on investment:** It is an open legal question as to what can be offered to the crowdfunders as incentive - apart from the satisfaction of seeing the proposed idea coming to reality.
- 3. Who ensures that promises are kept? :** To get the money out of the crowd, the fund seekers make many sweet promises. What if those promises are not kept? What if he made promises knowing he will never be able to fulfill them? What if money has been raised as pre-orders, and the final product created turns out to be not of a reasonable or merchantable quality? What if a sweet talker makes a lot of promises, raises a hefty fund from the public, and then just run away with the money? The funding platforms reputation is in question, so they must act as a watchdog to a certain extent. However, creating a legal regime with respect to this is much necessary to keep such business in a lawful manner.
- 4. Auditing and accounting of the funds raised:** It is necessary that the funders should have a right to know how the funds raised have been used. Why else will they believe in the System if there is no transparency?
- 5. Role and liability of the funding platforms:** The funding platforms are going to be of great systemic importance to the entire crowdfunding ecosystem. We must ensure that they also follow a set of rules, maintains fairness in the proceedings, and are held to be accountable for wrong doing.

WHAT ARE THE LAWS FOR REGULATIONS OF CROWDFUNDING IN INDIA?

The passing of the JOBS (Jumpstart Our Business Startups) Bill has led to discussion over a similar Bill in India. There are no specific regulations for Crowd Funding in India as per now.

If the Crowd Funding laws like the U.S are passed in India then retail investors can fund the company using the Internet. Now the question arises, whether the Internet sites through which crowd funding would be done should follow the regulations of SEBI, whether the site through which Crowd Funding would be done needs to have a registration with the SEBI as the site is acting as an intermediary.

WHAT ARE THE LEGAL ISSUES RELATED TO CROWDFUNDING IN INDIA?

There are legal issues around crowdfunding in India, since equity-based online crowdfunding is not legalized in India yet. It was made legal in the US under Jumpstart Our Business Startups Act (JOBS) Act. Of the three crowdfunding models, donation-based crowd funding is the most pragmatic approach as of now. Lending-based microfinance platforms like KIVA need approvals from the central bank. The Reserve Bank of India in 2011 approved Milaap, a non-profit microfinance institution to crowdfund from the overseas.

However, it is not final, there is still ambiguity exists as to the regulation of crowdfunding as it differs from individual perspectives.

WHAT IS THE PRESENT REGULATORY ATMOSPHERE OF CROWDFUNDING IN INDIA?

Here in India, the concept is catching up fast and is posing a danger at the same time as many money laundering schemes might run in the name of crowdfunding via social media, pushing SEBI to set up a regulatory framework if it is found that such platforms involve large amounts of money or issuance of securities. A discussion is on to find a nodal agency for such activities following a talk with various stakeholders like banking regulator RBI, Finance Ministry and Corporate Affairs Ministry. An official from SEBI stated that apart from setting up new rules after discussions with the stakeholders, any crowdfunding involving sale of securities can be either regulated under SEBI's existing norms for Collective Investment Schemes or Alternative Investment Funds.

Thus, it is not final whether the crowdfunding be regulated as per the Collective Investment Schemes or Alternative Funds under the SEBI.

OBSERAVTIONS AS TO THE STATUS OF CROWDFUNDING IN INDIA

Thus, there is a need of solid crowd funding law and good regulation will enable the Indian startups in a great way which ensures that the probability of committing a fraud is near to zero provided if some adequate steps are taken by SEBI to ensure protection. This is because as Crowd Funding is done through the use of Internet platform it allows investors to directly connect with the company. Thus it needs more transparency and democratize investment in startups. In the context of India, transparency and trust is more essential as there are always numerous complaints of small level businesses committing 'fraud' with the people on regular basis.

VARIOUS SAYINGS OF FOUNDERS'S OF CROWDFUNDING WEBSITES BASED IN INDIA

1. Varun Seth, the Founder & CEO of Ketto, a crowdfunding platform based in Mumbai, feels that there is still hope for crowdfunding as India is being the biggest countries for Non Government Organisations (NGOs), so crowdfunding stands a big chance. Section 135 of the new Companies Act, 2013 which mandates all companies to spend 2% of their average net profits on corporate social responsibility, will also help in gaining crowdfunding attraction.
2. Priyanka Agarwal, CEO of a crowd-funding Wishberry website said: If a Campaigner wasn't offering 'profits' for raising of funds for films from local and foreign contributors, then he wouldn't have faced any legal issue."
3. Priyanka Agarwal, CEO of a crowd-funding Wishberry website distinguished between Crowdfunding and Crowdinvesting. She said, Crowd-funding is when people fund a movie or gig or any creative project in exchange for tangible and intangible rewards and incentives, for example premier or VIP passes, name on credits, music lessons, autographed merchandise. Whereas, Crowd investing is when many investors come together to fund a venture in exchange for equity in that venture or profit sharing or loan payback with interest, basically a financial gain which is absent in Crowdfunding.

A BIG EXAMPLE SET- UP OF CROWDFUNDING IN FILM INDUSTRY

“Lucia” and “I am” films are the two great examples of success in relation to crowd funding for film industry. Lucia, an independent Kannada film made by an ex-IT professional, Pawan Kumar . It made on the total budget of Rs 71 lakhs and has been already sold to Udaya TV for about Rs 95 lakhs. The film has almost 600 producers approached through his crowdfunded campaigning link. Lucia is being the first ever crowdfunded regional film which managed to raise Rs 51 lakhs in a span of just 31 days!

This film is thus yet another ratification of crowdfunding, which is a \$6 Billion global phenomenon today. It is gradually firming up its presence and success in India. “I Am” fim directed by Onir which been financed through contributions by more than 400 persons, approached through Wishberry Site.

CERTAIN DATAS ON CROWDFUNDING IN INDIA: CATAPOOOLT

As per the Data Source Analysis of existing platforms and key crowdfunded projects done by team at Catapooolt, the various datas are as follow:

- i) Total number of projects crowdfunded so far: More than 150!
- ii) Total amount raised through crowd-funding in India: More than INR 300 Lakhs!
- iii) Highest amount crowdfunded for a single project: INR 84 Lakhs (Onir's film I AM)
- iv) Highest number of contributors for a single project: 610 (Pawan Kumar's film LUCIA)
- v) Crowdfunding Platforms: More than 3
- vi) Average contribution per project: Rs 2,800/-
- vii) Average number of contributors per project: 24
- viii) Most contributors are from cities Mumbai and Delhi. Almost 60% of current funders are coming from non-metros and international destinations.
- ix) Most crowdfunders are currently males aged between 25-40 years

CONCLUSION

Thus, conclusion can be drawn that there is no doubt that crowd funding is rapidly being looked as a serious way of raising funds for startups and new businesses in India. However, there are serious concerns which one needs to ponder upon as:

- 1) While on one hand, it perhaps bit derogatory to seek community help for their project; on the other, most of them still don't know what a crowd-funding campaign entails and wrongly perceive it to be some type of magic potion which can give instant results.
- 2) India, the prominent categories are still largely restricted to either NGO causes or entertainment projects. Why aren't these platforms looking at encouraging other categories onto this domain?

Therefore, to conclude by saying that one not only needs to focus on the grey legal areas but on the other said aspects so that crowdfunding platforms should be more trustable, transparent and democratic in nature with the fund raisers and project campaigners.