

Crowdfunding & Ethics in India

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Abstract

Crowdfunding has been the order of the day for raising funds for some of the projects, which are not normally considered by the traditional sources of funds. It would not be wrong to say that the concept of crowdfunding is still finding its place among the crowd to be understood as a potential source of procuring funds. Since the Indian market is not mature and the crowdfunding industry is still in nascent stage, the types of project which run on portals are limited to donation based and reward based projects. To some extent we also get to see a P2P lending platform which is understood as lending money against interest. The equity based crowdfunding models are not yet prevalent in India for various legal and groundwork issues. Crowdfunding runs majorly through social network where people connect to each other through their friends and spreads word about the project. Since the recommendation comes from a somewhat known person, the crowdfunding is also said to be done mutual trust. The crowdfunding portal before letting any project on their platform does the due diligence of the campaign and the campaign owner to ensure that there is no fraudulent projects slipping away the tight scrutiny.

Keywords: Crowdfunding, Backer/Supporter, Crowdfunding Platform, P2P Lending, All Or Nothing (AON), Keep What You Get (KWYG)

I. Introduction

Crowdfunding is having money raised from a large number of donors who contribute for a campaign through crowdfunding platform and these contributions go in for a limited period of time (Agrawal, Catalini, & Goldfarb, 2013). Initially, crowdfunding was used by the musicians who used to raise funds through fans for releasing albums especially when funding got difficult with the music producers. But gradually, people started realizing the potential of crowdfunding in other fields too. And there emerged big platforms like Kickstarter and Indiegogo which became renowned crowdfunding portals followed by other platforms across the world who entertained all campaigns ranging from donation based campaigns to equity based fund raising campaigns. The developed countries have all the rules and regulations in place in context to crowdfunding. There's an awareness among the investors who make investments into crowdfunding and are mature enough to take rational decisions, moreover the rule are laid down in such a way that inherently protects the investors from being trapped (Silver & Khatri, 2016).

But the scenario is not the same in developing countries. The concept being still in budding stage is not well known to people and not even the necessary legal framework has been laid down yet. This puts the interests of the investors at stake and makes the investors apprehensive about getting into such investments. India started with donation based crowdfunding where people raised money for medical, education & other personal causes. Later, it expanded and included the

reward based crowdfunding models too wherein people raise money from people against a promised item which is also known as pre selling model.

India has also adopted the P2P lending which is regulated by RBI under NBFCs (Non-banking financial company) and hence falls under the purview of SEBI. The equity based models are not yet legal in India for a variety of reasons and thus digital selling of shares is prohibited in India.

II. Research Question

1. The researcher aims to address on the ethical issues which is inherent in crowdfunding, more so because there is no proper legal framework constructed yet. The three different parties: Campaign owner, supporter, and the crowdfunding platform have been addressed differently and how each of these parties effects the decisions of the general or the rational investor.
2. The opinion of the crowdfunding platforms as to the preparedness of the crowd for crowdfunding and current scenario of crowdfunding is also studied and presented in a crisp manner for the investors as well as the fund raisers to decide how to go about crowdfunding their projects.
3. The researcher also aims to emphasize on some of the determinants of successful crowdfunding campaign. The campaign and the preparation which goes behind making it successful will be discussed in brief.

III. Research Method

The data required for the study has been sourced from both primary and secondary means. For the primary data, the sources were the crowdfunding platforms that were surveyed through focused interview asking them the current preparedness of the crowd to accept crowdfunding and the present scenario of crowdfunding. Twelve renowned crowdfunding platforms were surveyed but the response came from seven crowdfunding platforms.

The secondary data was collected from various articles, journals, internet, newsletter and related blogs. A careful observation and analysis was made in the light of information available. The crowdfunding across countries in the globe was studied to suggest how the concept of crowdfunding would fit in an Indian environment.

1. Analysis of First Objective

The first objective deals with addressing the ethical issues which could possibly arise in crowdfunding. The issue has been addressed with perspective to three different parties: Campaign owner, supporter, and the crowdfunding platform have been addressed differently and how each of these parties effects the decisions of the general or the rational investor. The analysis has been partially based on observation and literature available.

Factors leading to ethical issues

The success of the crowdfunding campaigns depend on how the campaigner pitches the campaign story and get it across to the audience. The cause of the campaign is the foundation of its success. The crowdfunding campaigns cannot be compared to the traditional sources of raising funds and hence they need investors to carry a different set of mind to rationalize on its decisions. The donation based campaigns are the ones which either carry a personal or social/community welfare cause. The crowdfunding platforms which let such campaigns on its portal need to check the authenticity of the campaign and also the campaign owner. The only basis for making investment for the investors is the crowdfunding portal's verification and their friends' suggestions. Crowdfunding thus becomes a public activity taking the campaigns away from the standards of a private one (Fleming & Sorenson, 2016). The onus is more on the crowdfunding platforms who does the due diligence which forms the basis for others to follow. Here where the wisdom of the crowd comes into picture. There has been study in the context which proved that wisdom of the crowd is at par or sometimes even better than the decisions taken by the experts like venture capitalists or the angel investors.

Ethical crowdfunding here is seen from three perspectives, one who owns the campaign and second one who spreads the word about the campaign and the last but not the least is the crowdfunding platform itself All the three perspectives deserve to be pondered separately since each one of them has a strong bearing on the future of the campaign posing a different type of ethical challenge to be

addressed. Unfortunately and also co-incidentally all of these three players have the intention to make the project successful for variety of reasons fulfilling their own interests. Each of these interests needs to be studied and understood so that decision could be taken in the light of all knowledge. The general investor's decision could be effected with all these parties involved in the process.

1.1 Campaign Owner

The campaign owner must have the genuine story for which the funds are being raised. The project must deliver what initially it had promised to deliver to the backers. Most of the projects deliver the promised things but happens much after the committed time frame. The delay in delivering the commitments has been the most common observed in pre-selling models. A pre-selling crowdfunding model is one in which the customer cum investor makes payment much before the product is made on the agreed terms that the product would be delivered within agreed time frame. The soundness of the project is an important thing which the campaigner must focus upon. The purpose of raising funds should be genuine and the project should not be misleading. If the campaign is donation based the benefit is either the personal or the community/society, in either case it should be clearly and explicitly mentioned in the campaign story. The aftermath story of the campaign once it raises funds should also be updated (Kim & Hann, 2015). The ethical issues associated with such projects where people donate for a purpose is at a higher rate.

The campaigner should possess all the abilities to carry on with the project and should be passionate about his/her dream to achieve the success. The lack of passion and willpower towards the purpose for which he has raised money will put the investors' money at stake. The past experience of the work, the abilities and passion all count in project's success which is ought to be duly considered by the investors (Kim & Hann, 2015). Just like the loan seeker makes a project for soliciting funds from the bankers or other traditional investors, the crowdfunding also requires the campaign owner to make an appealing business story for posting on the website with suitable video of the project explaining about the project. Any novice campaigner can take the help from the portals in making the project appealing by paying a certain amount of fees. The crowdfunding portal has different packages to choose from to avail the services. The expert with the crowdfunding portals knows how to pitch the story successfully and how to spread the word about the project.

1.2 Supporter/Backer of the project:

The crowd funding campaign always begins with the initial funding coming from family, friends and other close relatives. The friends and family feel obligated to help the person and hence contribute the funds. For the next round of funding, the campaigner looks for an influential person who could influence the other investors, thereby creating a "prism" effect. Generally, people tend to get influenced if the project is endorsed by the some worthy person since that creates

a trust factor and people like to get involved with such projects (An, Quercia, & Crowcroft, 2014).

Crowd funding lets one share the project with their friends and with friends' friends. People at times share projects just for the heck of doing it. Sometimes, the projects are not even checked at the individual level are just being shared. The suggestions coming from friends are taken as genuine suggestions and considered for investments (Greenberg & Mollick, 2015). The power of technology clubbed with social media power enhances the power of crowd paving way for an easy crowdfunding. Though, it's not a big ethical issue but sharing and forwarding suggestions to others without verifying the base may create a wrong impression among the crowd and make them consider that for an action.

1.3 Crowd funding platform:

Any crowd funding campaign has to take place through the crowdfunding portals called as platforms which acts as an intermediary between the fund seeker and the investor. The crowdfunding platform itself affects the success rate of the campaign (Willems, 2013). It's an online portal who brings people on the same platform and almost all keep similar interests. The crowdfunding platform is a registered one and entertains different types of campaigns ranging from donation based for medical, education purpose to investment based campaigns. The crowdfunding platform before letting the projects does the preliminary screening and due diligence of the projects. It makes sure that no low quality or less credible projects slips away their inspection and find place on the portal for fund raising.

The portals have a base amount of fees chargeable from the campaigner to allow the campaign on its portal. Apart from that, the crowdfunding platform also has a package of services on offer with different rates for the campaigner to choose from. On successful completion of the campaign the crowdfunding portals charges a certain amount of fees either as a fixed amount or as a fixed amount of percentage of the amount raised.

The crowd funding platform attempts to increase the number of campaigns on their portal so that the investors have huge number of campaigns to pick from. More the number of campaigns, the better are the success rate and thereby increasing revenue for the crowdfunding portals. But, it's not all that easy since any bad campaign can ruin the image or the goodwill of the crowdfunding platforms. And very tight scrutiny in terms of concrete substance in the quality could filter away many projects. The crowdfunding portal now is on the moral pedestal to hit the line between good quality campaigns and maintaining the image and integrity of the portals (Hazen, 2011).

2. Analysis of Second Objective

This part deals with assessing the perception of the crowdfunding platforms about the preparedness of the crowd for crowd funding.

Preparedness of the Indian Crowd for crowdfunding

Out of twelve crowdfunding platforms, seven platforms responded and the analysis has been discussed in the section. The crowdfunding platforms were

interviewed through phone and e-mail. It was observed that the Indian crowd is not yet fully prepared for the acceptance of crowdfunding as a means of raising funds for their start-ups or any other needs. The crowd seems to be immature and will take some time to realize its potential. Having said that, does not mitigate the role of crowdfunding in country like India where the majority of the population is young and where more focus is given on entrepreneurship. The trust of the people could be earned by making proper rules and regulation; all the crowdfunding platforms surveyed were of the same opinion that framing rules for the same will enhance the acceptability of crowdfunding among the crowd. At present, the equity crowdfunding model is not yet present in India for a good number of reasons. Once the market matures, the equity issue through online portals would be a true innovation in the field of finance and bring disruption by democratizing the investments to all people. For a successful campaign the power of social media and the role of digital technology cannot be overlooked. Today's era is all about networking and increasing the leads by directing the traffic towards the portal to hang on and leave no stone unturned to turn these leads into investors.

The crowdfunding platforms in India are not too old and each specializes in different types of crowdfunding entertaining different projects and provides different types of services by charging some amount. Some platforms have AON and some have KWYG for projects' funding. They keep the investment window open for a limited period of time and also help the campaign owner in all possible ways to make it a success.

As per the opinion of the crowdfunding platforms, rewards based crowdfunding models seem to be more popular than any other types of crowdfunding. The success rate of reward based crowdfunding is comparatively better than donation or investment based model, though the number of donation based projects are more on any crowdfunding platforms. India seems to be comfortable with donation based and reward based since each of these models brings certain assured benefit and the uncertainty is ruled out to a greater extent. In donation based the supporter gets tax benefits for donation under section 80G and somewhat assured reward or return under reward based crowdfunding model.

3. Analysis of Third Objective

This part presents the determinants of successful crowdfunding campaign. The campaign and the preparation which goes behind making it successful will be discussed in brief.

Determinants of successful crowdfunding campaign:

The campaigner must be clear with the purpose of the project and what actually it intends to deliver to the crowd especially when it is not a donation based project. The emphasis should be more on what the project has got to offer to the supporters in return. The clarity goes a long way and the efforts would thereby be rightly directed.

a. Prior research

The successful campaign needs enough working even before the actual launch so that it create a buzzword in the market and make people wait for the campaign to release and know more about it with context to making investment.

b. Alternate to traditional source of fund raising

The campaigns which somehow could not pass through the traditional investors like banks, venture capitalists could find success through crowdfunding provided it has an appealing and convincing story. The crowd is the key to many of the questions provided the campaign engages them with the right purpose and the right intention (Golić, Z, 2014).

c. Choose the right platform:

The nature of the campaign and the campaigner must correspond with the nature of the crowdfunding platform since each platform varies in their functions focusing on different types of crowdfunding. The All or nothing (AON), Keep what you get (KWYG) all has a bearing on the success of the project (Belleflamme, Omrani & Peitz, 2015). The AON model lets the campaigner to keep money only when the campaign has raised the entire target fund, and the KWYG is one where the campaigner is allowed to keep the money whatever has been raised during the period open for fund raising

d. Building strong network

This is something without which the crowdfunding cannot go a long way and see its success. The campaigner is required to have a strong network of friends and share the business proposal. These shares must be multiplied by people sharing the proposal with their other friends. Crowdfunding is all about inviting people and traffic to like and consider the proposal for investment (Lawton, Marom, & Marom, 2013).

e. Pitching the story:

The business story should be short and crisp and still representing the proposal in entirety. Pitching the story on the platform along with a short video enhances the chances of success. The video of the project appeals the audience and make the onlookers who are browsing through the site to hang on and go through the project. There have been researches that have proved on the potentiality of the video in making the project successful. Involving the people emotionally and connecting them with the purpose of the project is an important marketing knack which immediately involves the people in the project (Herzenstein, Sonenshein & Dholakia, 2011).

f. Rewarding the supporters:

Thinking on the suitable reward in consideration for the investments the supporters have made is again an important task. The reward should be enticing enough to push the investors to consider the proposal for investment. In donation

based crowdfunding projects, the acknowledgment through a thank you note is an essential gesture. In reward based models, the reward should be decided with proper deliberation, it should be something that could motivate the investors (Frydrych, Bock, Kinder & Koeck, 2014).

g. Providing the update and follow-up

The update should be given to the supporters as to how the project is progressing. Crowdfunding enables the people to drop in suggestions and feedback to improvise the product or any type of enhancement in the proposed idea. The campaigner must take into account such feedbacks and suggestions since that creates a feel among the crowd that the campaign is real and the campaigner's effort are genuine too. In most of the crowdfunding cases, the investors are the customers, hence considering the feedbacks would only ensure that the product gets an easy acceptance (Paykacheva, 2014).

h. Staying true to commitment:

The commitments made during raising funds should be kept and delivered on time. This builds the confidence among the crowd and further procurement of funds become easy with the same set of people and the same people sharing their experience with other people would only enhance the network.

IV. Glimpse of Ethics in Crowdfunding

Not everyone reveal the truth and some present the tweaked facts to raise money from the crowd. People are seen to plan their travel destination on the dimes of

supporters who back projects. The platforms who host the campaigns keep sufficient check alarms to see the genuity of the purpose, but no crowdfunding platform will assure the prudence of the campaign. The crowdfunded projects are supposed to promote social equality and are required to use the funds for the purpose it was collected which cannot be guaranteed. The backers are to be updated regularly during the fund-raising and also after the successful raising of funds ensuring the project execution on time with timely delivery of the commitments. Crowdfunding facilitates financial inclusion through participatory democracy. The social crowdfunding projects have a huge impact on the way crowd would decipher and make investments. It's the time to think and build a model which is user-friendly and built on the perception of the crowd towards crowdfunding.

To reap the best out of this concept 'crowdfunding' a proper legal framework must be built which would pave the way for addressing the grievances of the investors and slightly tighten the rules for both fund raiser and the crowdfunding platforms.

V. Conclusion

The crowdfunding is undoubtedly yet to make its presence in the crowd and people are yet to understand its full potential in replacing the traditional mod of investment. The crowdfunding though the concept is not all new, but yet the flavors as in different types of crowdfunding projects it has come up with makes one wonder about its actual working. People are skeptical about getting into

investments with crowdfunding since the laws are not yet built and in absence of this, the grievance may get unaddressed. The absence of regulatory bodies may give rise to ethical issues and parties to crowdfunding may start interpreting things to their convenience and comfort and the real concept of crowdfunding may lose its meaning. For crowdfunding to grow and nurture, a proper and a congenial environment should be built. As per the data collected from some seven renowned crowdfunding portals, it has been noted that the crowd is not yet mentally prepared to accept crowdfunding and see as an alternate to traditional source of funding. There are laws in place in various developed countries like U.S and U.K and people are have gone beyond donation, reward based crowdfunding projects to equity based crowdfunding democratizing the innovation and letting even the common man to be part of the campaign with investing small amount of money.

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