



## CROWDFUNDING

Ms P Deepika

Department of commerce

Kathir College of Arts and Science

Coimbatore-62

### ABSTRACT

Crowdfunding is getting a lot of press lately and it should. It's turning into an accepted process to raise money for an idea, product, or entire business. Entrepreneurs now have crowdfunding as a finance option when they're thinking about financing their business. Crowdfunding can be a complement or substitute for traditional forms of financing, like angel investing, venture capital, and bank loans.

But with different flavors of crowdfunding to choose from, which is the right one for an entrepreneur to choose. That's the subject we'll explore in this article.

It's important to understand that there are various kinds of crowdfunding and each comes with its own strengths. We'll look at each type of crowdfunding, define how it works, and see if it's a good match for your business.

**Key words** -Entrepreneurs Equity Debt-based Litigation.

### INTRODUCTION:

Crowdfunding is the practice of funding a project or venture by raising small amounts of money from a large number of people, typically via the Internet. Crowdfunding is a form of crowdsourcing and alternative finance. In 2015, over US\$34 billion was raised worldwide by crowdfunding. Although similar concepts can also be executed through mail-order subscriptions, benefit events, and other methods, the term crowdfunding refers to Internet-mediated registries. This modern crowdfunding model is generally based on three types of actors: the project initiator who proposes the idea or project to be funded, individuals or groups

who support the idea, and a moderating organization (the "platform") that brings the parties together to launch the idea.

Crowdfunding has been used to fund a wide range of for-profit, entrepreneurial ventures such as artistic and creative projects, medical expenses, travel, and community-oriented social entrepreneurship projects. Its use has also been criticised for funding quackery, especially costly and fraudulent cancer treatments. Crowdfunding has a long history with several roots. Books have been crowdfunded for centuries: authors and publishers would advertise book projects in praenumeration or subscription schemes. The book would be written and published if enough subscribers signaled their readiness to buy the book once it was out. The subscription business model is not exactly crowdfunding, since the actual flow of money only begins with the arrival of the product. The list of subscribers has, though, the power to create the necessary confidence among investors that is needed to risk the publication.

War bonds are theoretically a form of crowdfunding military conflicts. London's mercantile community saved the Bank of England in the 1730s when customers demanded their pounds to be converted into gold - they supported the currency until confidence in the pound was restored, thus crowdfunded their own money. A clearer case of modern crowdfunding is Auguste Comte's scheme to issue notes for the public support of his further work as a philosopher. The "Première Circulaire Annuelle addressée par l'auteur du Système de Philosophie Positive" was published on 14 March 1850, and several of these notes, blank and with sums have survived. The cooperative movement of the 19th and 20th centuries is a broader precursor. It generated collective groups, such as community or interest-based groups, pooling subscribed funds to develop new concepts, products, and means of distribution and production, particularly in rural areas of Western Europe and North America. In 1885, when government sources failed to provide funding to build a monumental base for the Statue of Liberty, a newspaper-led campaign attracted small donations from 160,000 donors.

Crowdfunding on the internet first gained popular and mainstream use in the arts and music communities. The first noteworthy instance of online crowdfunding in the music industry was in 1997, when fans underwrote an entire U.S. tour for the British rock band Marillion, raising US\$60,000 in donations by means of a fan-based Internet campaign. They subsequently used this method to fund their studio albums.

This built on the success of crowdfunding via magazines, such as the 1992 campaign by the Vegan Society that crowdfunded the production of the "Truth or Dairy" video documentary. In the film industry, independent writerdirector Mark Tapiokines designed a website in 1997 for his then-unfinished first feature film Foreign Correspondents. By early 1999, he had raised more than US\$125,000 on the Internet from at least 25 fans, providing him with the funds to complete his film. In 2002, the "Free Blender" campaign was an early software crowdfunding precursor. The campaign aimed for open-sourcing the Blender 3D computer graphics software by collecting €100,000 from the community while offering additional benefits for donating members.

The first company to engage in this business model was the U.S. website ArtistShare (2001). As the model matured, more crowdfunding sites started to appear on the web such as Kiva (2005), IndieGoGo (2008), Kickstarter (2009), GoFundMe (2010), Microventures (2010), and YouCaring (2011).

The phenomenon of crowdfunding is older than the term "crowdfunding". According to wordspy.com, the earliest recorded use of the word was in August 2006.

## **TYPES**

The Crowdfunding Centre's May 2014 report identified two primary types of crowdfunding:

### **Rewards crowdfunding:**

Entrepreneurs presell a product or service to launch a business concept without incurring debt or sacrificing equityshares. Equity crowdfunding: the backer receives shares of a company, usually in its early stages, in exchange for the money pledged. Reward-based crowdfunding has been used for a wide range of purposes, including motion picture promotion, free software development, inventions development, scientific research, and civic projects. Many characteristics of rewards-based crowdfunding, also called non-equity crowdfunding, have been identified by research studies. In rewards-based crowdfunding, funding does not rely on location. The distance between creators and investors on Sellaband was about 3,000 miles when the platform introduced royalty sharing. The funding for these projects is distributed unevenly, with a few projects accounting for the majority of overall funding. Additionally, funding increases as a project nears its goal, encouraging what is called "herding behaviour". Research also shows that friends and family account for a large, or even majority, portion of early fundraising. This capital may encourage subsequent funders to invest in the project. While funding does not depend on location, observation shows that funding is largely tied to the locations of traditional financing options. In reward-based crowdfunding, funders are often too hopeful about project returns and must revise expectations when returns are not met.

## **PLATFORMS:**

In 2012, there were over 450 crowdfunding platforms operating. In 2015, it was predicted that there would be over 2,000 crowdfunding sites to choose from in 2016. Fundamental differences exist in the services provided by many crowdfunding platforms. For instance, CrowdCube and Seedrs are Internet platforms which enable small companies to issue shares over the Internet and receive small investments from registered users in return. While CrowdCube is meant for users to invest small amounts and acquire shares directly in start-up companies, Seedrs pools the funds to invest in new businesses, as a nominated agent.

Curated crowdfunding platforms serve as "network orchestrators" by curating the offerings that are allowed on the platform. They create the necessary organizational systems and conditions for resource integration among other players to take place. Relational mediators act as an intermediary between supply and demand. They replace traditional intermediaries (such as traditional record companies, venture capitalists).

These platforms link new artists, designers, project initiators with committed supporters who believe in the persons behind the projects strongly enough to provide monetary support. [citation needed] Growth engines focus on the strong inclusion of investors. They "disintermediate" by eliminating the activity of a service provider previously involved in the network.

The platforms that use crowdfunding to seek stakes from a community of high net-worth private investors and match them directly with project initiators. [citation needed].

## BENEFITS AND RISKS:

### Benefits for the creator:

Crowdfunding campaigns provide producers with a number of benefits, beyond the strict financial gains. The following are non financial benefits of crowdfunding.

**Profile** – A compelling project can raise a producer's profile and provide a boost to their reputation.

**Marketing** – Project initiators can show there are an audience and market for their project. In the case of an unsuccessful campaign, it provides good market feedback.

**Audience engagement** – Crowdfunding creates a forum where project initiators can engage with their audiences. An audience can engage in the production process by the following progress through updates from the creators and sharing feedback via comment features on the project's crowdfunding page.

**Feedback** – Offering pre-release access to content or the opportunity to beta-test content to project backers as a part of the funding incentives provides the project initiators with instant access to good market testing feedback.

There are also financial benefits to the creator. For one, crowdfunding allows creators to attain low-cost capital. Traditionally, a creator would need to look at "personal savings, home equity loans, personal credit cards, friends and family members, angel investors, and venture capitalists." With crowdfunding, creators can find funders from around the world, sell both their product and equity, and benefit from increased information flow. Additionally, crowdfunding that supports pre-buying allows creators to obtain early feedback on the product. Another potential positive effect is the propensity of groups to "produce an accurate aggregate prediction" about market outcomes as identified by author James Surowiecki in his book *The Wisdom of Crowds*, thereby placing financial backing behind ventures likely to succeed.

Proponents also identify a potential outcome of crowdfunding as an exponential increase in available venture capital. One report claims that if every American family gave one percent of their investable assets to crowdfunding, \$300 billion (a 10X increase) would come into venture capital. Proponents also cite that a benefit for companies receiving crowdfunding support is that they retain control of their operations, as voting rights are not conveyed along with ownership when crowdfunding. As part of his response to the Amanda Palmer Kickstarter controversy, Albini expressed his supportive views of crowdfunding for musicians, explaining: "I've said many times that I think they're part of the new way bands and their audience interact and they can be a fantastic resource, enabling bands to do things essentially in cooperation with their audience." Albini described the concept of crowdfunding as "pretty amazing."

## RISKS AND BARRIERS FOR THE CREATOR:

Crowdfunding also comes with a number of potential risks or barriers. For the creator, as well as the investor, studies show that crowdfunding contains "high levels of risk, uncertainty, and information asymmetry."

**Reputation** – failure to meet campaign goals or to generate interest results in a public failure. Reaching financial goals and successfully gathering substantial public support but being unable to deliver on a project for some reason can severely negatively impact one's reputation.

**IP protection** – many Interactive Digital Media developers and content producers are reluctant to publicly announce the details of a project before production due to concerns about idea theft and protecting their IP from plagiarism. Creators who engage in crowdfunding are required to release their product to the public in early stages of funding and development, exposing themselves to the risk of copy by competitors.

**Donor exhaustion** – there is a risk that if the same network of supporters is reached out to multiple times, that network will eventually cease to supply necessary support.

## CONCLUSION:

In conclusion, there's a lot to be won by including crowdfunding into organisations' existing set of fundraising tools, both for individual organisations as well as for the development sector as a whole. Crowdfunding is already part and parcel to many organisations' and individuals' wish to make the world a better place and help people around the globe to improve their lives. Its obvious benefit is raising money. Crowdfunding is credited with overcoming financing barriers to small grassroots projects that don't have access to banks and large donors.

But pioneers of crowdfunding discovered quite early that the concept is not at all about the money and that "you can sometimes make much more than you ever intended, or asked for", as Scott Steinberg put it in his Crowdfunding Bible.

Crowdfunding not only provides money to organisations, it also boosts their man power as the crowd that funds them also puts their institutional structures on a broader footing. The supporters unwittingly become an additional marketing team by promoting the project they funded to their friends and networks.

Another side-product of crowdfunding therefor is testing the popularity and effectiveness of a project with very little means, often before the project has even started. “An unexpected benefit of crowdfunding campaigns is that you will often receive very useful advice – and even tangible offers of assistance – from backers, who, after all, want you to succeed and will do everything they can to help you get there,” said Dave Balzer in his interview with ikosom.

As an offshoot of crowdsourcing, which in turn has its roots in the open innovation movement, crowdfunding follows an “open” approach that applies the open source principles developed in the field of software development. Therefore it can significantly improve an organisation’s efficiency through open innovation processes. As crowdfunding opens up organisations and exposes their projects to a large community of supporters who provide feedback and ideas, it encourages organisations to rethink their own concepts off the beaten track of development work. Once an organisation has gained some experience in crowdfunding, it can also branch out into crowdsourcing activities more easily, e.g. by integrating external resources and concepts like E-Volunteering to support project work. Here, platforms like Volunteer Forever enter the picture, as they enable to financially support volunteers for going and working abroad.

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