



## DIGITAL TRANSFORMATION - TRANSMUTATION OF CROWD FUNDING FOR INDIAN STARTUPS INTO A FINANCIAL REVOLUTION



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### Introduction

In this column of November 2020, a brief account of contemporary Indian startup ecosystem was presented with narratives on various initiative of Government of India for propagation of successful startups. Various schemes for crowd funding were briefly narrated as options for providing funds to young entrepreneurs for value generation by actualising their ‘innovative’ ideas. Platforms designed using blockchain technology was ideated for facilitating the

process of crowd funding with transparency and commitments by and between stakeholders under insightful oversight of a designated Regulator<sup>1</sup>.

Crowd funding symbolises the old axiom “Many a drops make an ocean,” It helps founders of new entities to approach hundreds of individuals to fund their entrepreneurial or social service activities. Often rewards are offered in return for products or equity when such funding is solicited by commercial ventures. Schwienebacher and Larralde (2010)<sup>2</sup> defined crowdfunding as

projects that “.... can range greatly in both goal and magnitude, from small artistic projects to entrepreneurs seeking hundreds of thousands of dollars in seed capital as an alternative to traditional venture capital investment..... the crowd fund small amounts of money to accumulate into an investment large enough to finance a project or a start-up company.”

Albeit structured information being not available, unconfirmed information suggest 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.”<sup>3</sup> Crowdfunding is now a web-based model of the same old concept. Separate platforms for specified projects are hosted by service providers against the charge of nominal fees.

## Objectives

In the said first volume the author called upon young corporate professionals and members of business families to allocate a small portion of their investible surplus by lending or participating in equity shares of those startups. Such contributors can collectively be called as an Angel Club orchestrated by a blockchain based platform. The call is also there for Indian business entities to extend support and derive benefits from various scheme-based reward options while funding startups, whose products and services can be used by them as inputs in course of time. Such a crowdfunding ecosystem would also provide opportunities to startups to become future ready by validating their concepts and products. Many such facilities are already available in the USA and European countries. Time is here and now for India to also implement this before being too late.

Objective of this article is to deal with certain preparatory initiative, which are to be actioned upon by startups, for achieving a state of readiness before launching their campaign for funds through a crowdfunding platform. Those would help



Figure: Options for Crowdfunding Schemes

Startups need to go through a drill of preparatory action steps, with their agile thinking cap on, for achieving a state of readiness before launching any campaign for crowdfunding. This should be

started after they are ready with proof of concepts and receiving some tractions resulting into sales and value realisations from a few legitimate users of prospective customer groups. The following steps are essential for achieving that state of readiness:

- 1. Goals:** Identification of the goals in terms of validations to be achieved for products / services, and quantum of funds to be raised from a defined set of target investors and / or future stakeholders?
- 2. Talk to experienced people:** Gathering experiential learning points from stories of ‘stratupians’ who have run similar campaigns before is important. Objectives would be to replicate and fortify the keynotes of their success, or learn from the reasons of their failures as appropriate. Straight imitation may not be right as products and services being offered may have many differences.
- 3. Tell the story:** Spend the needful time to make sure that reasonable number of people of the target audience group know the products and / services being offered by the startup. Upcoming bloggers / influencers in social media may be requested to write about those items. The objective would be to create a certain degree of awareness outside the known network of entrepreneurs.
- 4. Platform selection:** Identify and evaluate options for campaign platforms, and selection of the one which can help best achieving the desired objectives against affordable charges for hosting the campaign. The selected platform should also facilitate online transactions for collection from contributors and any other services that may have to be taken with due compliance of legal and regulatory provisions in this regard.
- 5. Create contents:** Contents are to be created for the selected platform to host and run the campaign. Such contents must ensure sharing information on a need to know basis with the target audience. The predominant objective should be to enhance credibility of products and services being offered. Every single image, video, infographic, illustrations, and even the story of the product should be created to familiarise future users with all unique features and benefits of the product.  
The author urges upon readers to please watch amazing videos of successful crowdfunding campaigns by two startups in the USA for products called ‘Think Board’<sup>4</sup> and ‘Coolest Cooler’.<sup>5</sup>  
The ultimate objective of such campaigns is also to create a large base of potential customers and convince contributors that there are potentials for the venture turning into a huge success in its journey to become an Unicorn and then a MNC. Such story telling should also create differentiation from the similar products / services if available in market. Yet at the same time, fundamental technology and secrets behind the product are not to be revealed to avoid risks of immediate replication.
- 6. Activate inner-circle network:** Start campaigning in social media about the products and services with minimum contents out to those in point 5 above. Objective would be to keep the inner-circle network of family, friends, mentors, well-wishers, and other acquaintances alerted about the crowd funding campaign to be launched, and receive help in case raising of funds from external sources falls short of target.

7. **Duration of campaign:** Decide how long the campaign should run. The questions to be answered are, whether the campaign should stop once the targeted amount of fund is received, or run for the number days agreed beforehand, and / or period to be extended if the target amount of fund to be raised is not received within the agreed number of days. Extension may also be considered if there are overwhelming responses and the startup would be able to make best use of the additional funds to be received.
8. **Have everything in place before calling for funds:** One or more of the schemes framed for crowd funding could be with commitments to give rewards by way of a committed quantity of products / services sold at a discounted price within a given time line, or pay-off the loan taken out of sales realisations or give free products as a reward unit against equity contributed. Therefore, the entrepreneurs should ensure that production can immediately be upscaled once funds start flowing into the entity.
9. **Allocate responsibilities:** Identify specific activities and related duties and responsibilities to be discharged in a structured manner for meeting commitments made in the campaign. Allocate such responsibilities to founders and other leadership team members to ensure that failures and gaps in performance are to the minimum if not nil.
10. **Fund withdrawal:** Keep understanding ready and agreed with the service provider that funds from the collected amount may have to be withdrawn even before closure of campaign depending upon the extent of achieving the pre-decided milestones.

Startups must maintain a high degree of ethical standards while orchestrating all these actions with a deep sense of frugality, discipline and respect for commitments being made to the prospective contributors. They must plan such actions following the concept of critical path method (CPM) so that valuable time is not wasted while maximising benefits from the first movers' advantages with their unique offerings.

## Domino Effect

Success is likely to be a sure shot if the product / service can solve a latent problem of society, or is the first of its kind like a robotic surgeon or electric vehicles, and / or have unique distinctions as opposed to those available in the market. If the above action steps are diligently executed with an agile thinking cap, there is every probability of receiving convincing validations about prospects and potentials of offerings. All these may result into a domino effect. Research findings indicate that successful crowd funding campaign may create a gold rush with destination being the startup. Such a domino effect should be managed with due care so that the startup can derive best advantages from success of the campaign by quickly scaling up product and / or service deliveries.

## Crowdfunding Enablers

Readers by now must have been convinced that Indian Startup are critically in need for professional services providers for launching and running crowd funding campaigns. Through research, albeit limited, the author could not be convinced that in India there is a community of professional service providers

who have clustered up with the predominant objective of communicating, collaborating and helping 'startupians' at an opportune point of time to launch crowdfunding campaigns. The following are essentially the enabling services that are required for this purpose:

## Campaign Platforms and Content Creators

The first set of such services should come from web-based campaign platforms creators for hosting and conducting campaigns at an affordable cost. There should also be a community of professional content creators with charges befitting the imperatives of frugality that startups must observe. Providers of both these services must collaborate with and complement efforts of 'startupians' for ensuring success from funding campaigns.

Campaign platform service providers, through a pre-audit, must ensure that all the norms and standards of the Advertising Standards Council of India<sup>6</sup> (ASCI) have been complied with before launching the campaign. They themselves also should function under vigilant oversight of ASCI. Members of the Council may consider promulgating a separate set of standards for conducting such crowdfunding campaigns by Startups in India.

## Blockchain Platform and Smart Contracts

The author has recommended Distributed Ledger Technology (DLT), i. e., Blockchain based platforms for entering into agreements and conducting financial transactions by and between startups and the contributors of funds. The essential pre-requisite for entering any transaction must be completion of the process of 'Know Your Participant or Customer' (KYP or KYC) in compliance with norms and standards to be recommended by a financial Regulator, preferably SEBI or RBI.

Smart Contracts (SCs), duly coded and whetted by eminent jurists, must digitally be embedded into such Blockchain platforms. These SCs must capture, inter alia, all the terms and conditions of different schemes that are being launched for funding. The entire drafting of different SCs should be done in compliance with all applicable laws, rules, and regulations. A digital library must be attached as an extended facility to the Blockchain platform for uploading and storage of documents by the concerned parties. This is required for any eventual requirement of retrieving and referencing such documents in future.

Introduction of such a Blockchain based platform will help resolving the inherent issues of 'Trust Deficit' as Blockchain technology has fundamental features and qualities for ensuring trust, safety, security and provides protections with almost zero probability of hacking.

## Integration of Campaign Platform and Blockchain Platform

Government of India is contemplating introduction of a Blockchain based platform for registration of Startups in India. This platform can be integrated in a three-way link with the aforesaid web-based Campaign Platform and the Blockchain Platform for crowd-sourced funding transactions. Such an integrated facility would help the fund provider to form an informed judgement and take decision about funding, having seen the contents, being convinced about the products / services, and terms and conditions of funding schemes.

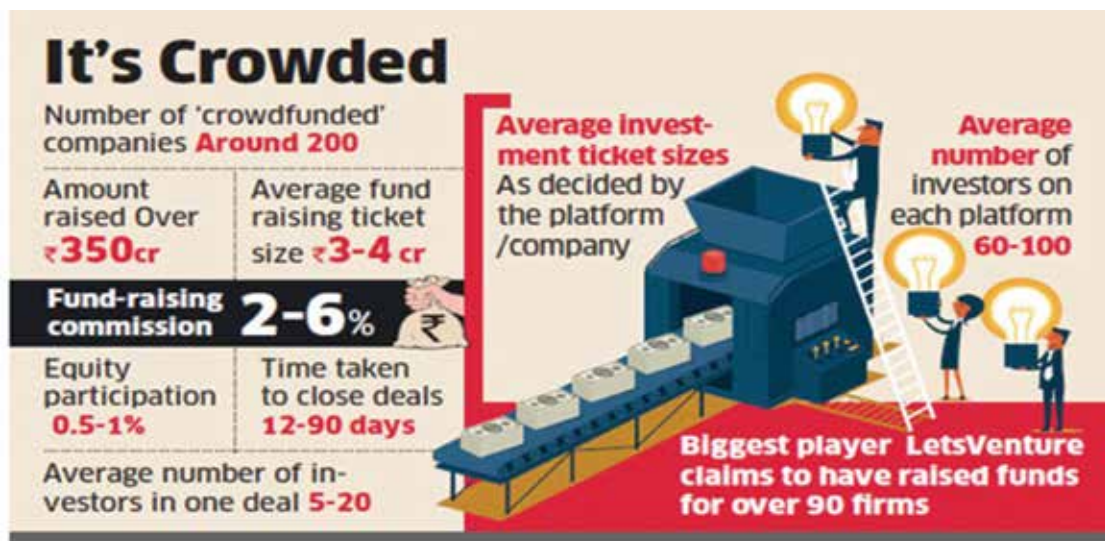
She / he can then conduct the funding transaction again using an integrated facility for conducting banking transaction. As and when the proposed Central Bank Digital Currency, christened as 'CBDR', is introduced by the Reserve Bank of India, funding transaction can be done without using INR as the fiat currency.

## Amendment of Laws and Regulation

The major scheme for any crowdfunding initiative would be equity-based. But the Indian Companies Act, 2013 does not permit allotment of equity shares to more than 200 persons in any given financial year through a private placement mode. Therefore, through crowdfund based campaign if a startup becomes successful to get equity-based funds from more than 200 people, the scheme would be construed to be a deemed public offer and would automatically attract the concerned

regulations of SEBI. It is reported that the startups in India have earlier resorted to equity funding from crowd sources as if the later are Angel Investors, which is a point of concern for SEBI.

The Economic Times reported on September 9, 2016<sup>7</sup> about a note from SEBI. It wrote that "The Sebi note, issued last week, has virtually pronounced over half-a-dozen digital equity crowdfunding platforms (ECP), including prominent ones like Grex, LetsVenture, Termsheet, Equity Crest and Tracxn, as unauthorised, unregulated and illegal. Sebi, more specifically, has also asked Grex Alternative Investments Market (Grex), a two-year old crowd-funding platform, to stop "onboarding" new investors or taking up fund raising mandates from startups, it is reliably learnt. The following picture contained in that report briefly provided an account of what happened in India four years back.



Source: Economic Times, September 9, 2016<sup>7</sup>

Since then not much actions are reported to have been taken by Indian Law Makers and Regulators to create an enabling environment and transforming crowdfunding of startups a movement in India. It would be of relevant to mention here how the USA has successfully handled such a contentious issue. The Securities Exchange Commission (SEC)<sup>8</sup> reported that "On April 5, 2012, the Jumpstart Our Business Startups (JOBS) Act was signed into law by President Barack Obama. The Act required the SEC to write rules and issue studies on capital formation, disclosure, and registration requirements." Some of the key features of the Act are:

- ⊙ Restrictions on the amount that can be borrowed via crowdfunding.
- ⊙ Compulsory audit by a Certified Public Accountant in some cases of crowdfunding.
- ⊙ Disclosures are mandatorily to be made by the company raising funds and utilising it.
- ⊙ The company needs to explain everything about its project for which it is raising funds.
- ⊙ The fund utilisation plan needs to be disclosed.

SEC subsequently issued regulatory guidance for raising

funds against issuance of equity shares, salient features of which are as under:

- ⊙ The maximum limit is \$1 million for raising funds through issue of equity shares each year.
- ⊙ Detailed information must be filed with SEC if the amount raised exceeds USD 500,000.
- ⊙ Educational information must be provided to ensure that the investors are adequately informed about what they are subscribing for after due understanding of the risks being taken.
- ⊙ Investors can invest 5% of annual income or net worth in a year. Any person with a net income of less than USD 100,000 per annum can invest up to only USD 2,000.
- ⊙ Investors with net income of more than USD 100,000 per annum would be able to invest 10% of that every year.
- ⊙ Minimum lock in period for holding such securities purchased from crowdfunding portal is one year.
- ⊙ SEC created a new class of securities and transactions were permitted only through online crowdfunding portals.

Stakeholders in leading roles of startup ecosystem in India might have realised that first generation young entrepreneurs must have to be provided with the much-needed life blood called cash. They must also be allowed to make mistakes and burn cash without keeping any qualms about these, albeit with discipline and frugality. These two are essential for creating an enabling environment for innovation and proliferation successful startups in India. But the questions that remain to be answered are: Whether the present community of Angel Investors and initial stage VC Funds are good enough for this? How long a startup can bootstrap and young entrepreneurs can put their precious little savings and limited family assets at stake?

Keeping cues from the examples set by developed countries, Indian Law Makers and Regulators must have to come forward with concrete initiatives and enunciated actions so that crowdfunding of startups through equity-based schemes is given the due fillip it deserves. The author must hasten to add that financial Regulators of India have earned reputation for their resilience and financial wisdom during periods of crisis the world has faced in recent past. More of such are expected from them in this front living up to that expectation.

When both investors and investees are ready to collaborate and cooperate, nothing should stop enacting and promulgating enabling acts and regulations from broader perspective of public interests. There is no need to blindly follow western examples. India can introduce enabling provisions best befitting its own startup and business ecosystems. The author is of the view that enabling regulatory provisions should be announced for allowing at least crowdfunding transactions for three other C2S schemes based on reward, donation, and loan.

Again, if business entities find it commercially expedient to provide funds to startups, other than by way of equity, there is no need for colouring those transactions with any other ulterior commercial hue. Enabling provisions can follow thereafter for equity-based schemes. Blockchain based platforms can certainly help minimising trust deficits, if at all any felt to be there.

Due to shortage of space details are not being included in this article about various organisations who are providing services for hosing crowd funding campaigns by startups and enabling financial transactions. Readers can gather information from various sources about this, including from the report of Inc42.<sup>9</sup> a brief excerpt from which reads as follows:

*“In India, platforms such as Kickstarter, Wishberry, Ketto, Indiegogo, MesoTown, ImpactGuru, Catapooolt, FuelADream, Fundable and Dream Wallets have proven themselves as good options for startups ..... some are meant for creative products and services and operate on the reward-based model, others act as a marketplace.....Rang De, for example, is a leading based crowdfunding platform that provides microloans to rural entrepreneurs. Wishberry, on the other hand, is a reward-based platform for art and culture or creative projects while FuelADream and Catapooolt are similar kind of platforms that caters to political or charity projects and social causes as well.”*

## Conclusion

It would be far from facts to say that crowdfunding as a facility had not started in India and service providers for campaign platforms had sighed away from providing services to startups. People and business entities in general also had extended support. These are evident from the afore-quoted report of the Economic Times published about four years ago. Recently Government of India has also taken many initiatives for successful advancement of startup based business ecosystem in India with the ultimate objective of value additions to industry, trade, and commerce. Readers may know more about these from the immediate previous volume of this column.

What is left to be done is transmuting crowd funding into a financial revolution and structurally building it as a rallying ground for all to join, collaborate and cooperate for providing funds to startups. All concerned may pull their thoughts together and articulate suggestions for Law Makers and Regulators to provide enabling provisions. Federal level organisations like NITI Ayaog can rejuvenate such an initiative and bring momentum before India loses more precious time and ‘startups’ become more disheartened, if not frustrated. An optimist as always, the author is hopeful that days are not far for the sun to shine more light on Indian startups. **MA**

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