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# A Theoretical and Regulatory Framework of Crowd Funding and P2P Lending in India

Addakatla Venu [1]
Dr. Kamatam Srinivas[2]

***Abstract:***
*Crowd funding makes an infant industry grow fast. It is simple as the name suggests "crowd "funds yours business. It provides new investment avenues and provides a new product for portfolio diversification of investors. Traditionally, P2P lending platforms have been charged with attracting borrowers that are unable to access credit from banks and other FIs. While this may be partly true, it by no means undermines the quality of borrowers attracted to the low-cost loan offerings from P2P lending platforms.*
*Peer to peer (P2P) lending is enable individuals to get loans directly from added individuals, cutting out the financial institution as the middleman. Popular P2P loan types are Personal Loans, Home Improvement Loans, Auto Loans, Student Loans, Medical Loans and Business Loans. This paper is focus on specific objectives of the present study are to study the crowd funding and P2P Lending in India, to examine the regulation and regulatory bodies in India and to suggest the COVID-19 pandemic its impact on P2P lending sector. The data was collected from secondary sources.*
*In India, the IPO marketplace has no longer been very energetic. SEBI, has been at the leading edge in facilitating fund elevating for SMEs to measures like SME section in stock Exchanges, category I- SME funds under AIF, Institutional Trading Platform, etc., on the other hand there is a need to encourage innovative way of fund raising to offer an impetus to SMEs/start-ups. It is useful to selecting and understanding the different alternative method of fund raising. In India peer to peer lending is at a standstill in initial stage only, hence SEBI should provide more awareness to investors about P2P ending. The P2P lending sector also affected negatively due to COVID -19, but it has no doubt quickly adjusted and adapted to the trials and problems of the COVID-19 pandemic.*

***Key Words:*** *Crowd Funding, P2p Lending, COVID-19, SEBI, SMEs, IPO, FIs*

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## I. Introduction:

Crowd funding is new go-to strategy for budding startups. It is the practice of pooling in of resources by numerous people, thus the term "crowd" to fund prospective projects. It is an alternative finance system where funds are raised through mediums like internet. The modern day crowd funding is the modified, internet model of the same old concept. The Web has made the entire process of floating an idea and raising funds for the same much easier and faster. Apart from getting access to funds, another major advantage is to getting validation of the idea or concept. Crowd funding has been used to fund a wide range of for-profit, entrepreneurial ventures such as artistic and creative projects, medical expenses, travel, or community-oriented social entrepreneurship projects. The process of applying P2P is submit an online application, assign your risk category, investors review your loan request; accept the loan and you make monthly payments. Popular P2P loan types are Personal Loans, Home Improvement Loans, Auto Loans, Student Loans, Medical Loans and Business Loans. One of the first instances of using internet to raise funds occurred in 1997 when the British rock group Marillion raised $60,000 from its fans to fund its North American tour. Artist Share was the first US-based company to establish the crowd funding website in 2001.

[1]**Mr. Venu Addakatla, Research Scholar, Department of commerce, Osmania University, Hyderabad, Telanagana.**

[2] **Dr. Kamatam Srinivas**, Assistant Professor and Addl. Controller of Examinations, Department of Commerce, Osmania University-500007,

## II. Literature Review

As the present study is concerned with the Crowd Funding and P2P Lending in India - Theoretical Study, an attempt is made to discuss in concise the earlier studies on Crowd Funding and P2P Lending so as to achieve a greater insight into the subject. As a matter of actuality, theoretical discussion of Crowd Funding and P2P Lending in India began to take place recently, then only few prominent writers, renowned scholars have examined in different guidelines, some of the pertinent studies which are alarmed to the present study are presented for a moment.

***Irma Borst, Et.al, (2018)*** in their study, examine the crowd funding includes raising small quantities of money from a large array of investors. They used through the internet and social networks for rising funds to a new project. Mission creators are searching to attract funding from greater distant/potential resources; in addition to current networks they examined usage of social media and the crowd funding platform. They analyzed 10 cultural initiatives hosted at the Dutch crowd funding platform theorizing on latent tie activation. This study concluded that demonstrating of social media messages and platform updates helps to increasing the crowd funding. ***Prinsha K. (2016)*** in her research studied the technique to commercial enterprise finance is largely the opposite of crowd funding. Traditionally, to initiate new product the entrepreneur has to do marketplace research. It helps for business plan and makes a trial product to confirm the concept and look for investors to aid the business financially. These resources of financing are including banks, angel buyers and assignment capital businesses. Which were really restricted the alternatives to more than one key player. This fundraising method may be seen as a cone-shaped tool, which area of play at the extensive quit and the investor target market at the closed give up. ***LoretaValančienė etall (2015)*** in his paper covered a listing of crowd funding agencies and their pursuits is furnished in addition to a top level view of crowd funding guidelines in the countries like USA, UK, Canada, Germany, France, Australia and Italy. He also recommended that even though all nations are developing legal frameworks, enlightening entrepreneurs and promoting a good crowd funding cases, different actions including selling a excellent label for crowd funding websites, educating investor and creating an overview of true crowd funding platforms done by few of the service providers. ***Ethan Mollick (2014)*** in this study analyzed crowd funding founders for-profit, artistic, and cultural ventures. Crowd funding is used to fund their efforts by drawing on relatively little contributions from a comparatively sizable amount of people using the internet, whereas no regulated monetary intermediaries. He realize that the overwhelming majority of founders appear to meet their obligations to funders, however that over 75% deliver merchandise later than expected, with the degree of delay foreseen by quantity and amount of funding a project receives.

The above studies revealed that they have not covered the in-depth study of crowd funding in India. Keeping in view the present study has been taken up to examine the crowd funding and P2P lending in India.

**Objective of the Study:**
The specific objectives of the present study are to study the crowd funding and P2P Lending in India, to examine the regulation and regulatory bodies in India and to suggest the COVID-19 pandemic its impact on P2P lending sector.

**Scope of the Study:**
The present study is confined to the crowd funding and P2P Lending in India. The study covers all important aspects of top fund rising plat forms, regulations and types of crowd funding and P2P lending.

**Methodology of the Study:**
For the Purpose of the study secondary data has been taken from the published articles in journal, news papers, magazines and websites. The data has been suitably arranged and analyzed to the requirements of the study.

**Limitations:**
The study is used the secondary data for examine the crowd funding and P2P lending in India, which were collected from the published research articles, books and websites. Therefore the accuracy of the data depends on the accuracy ensured in the data presented.

**Types of Crowd Funding:**
Crowd funding varies depending on the product or service you offer and your goals of growth and reimbursement. There are three primary types including donation-based, debt-based and equity crowd funding.

**Donation-based crowd funding:**

It is best way to raise the funds where the investors or contributors are promised no financial returns. People usually invest because they believe in the cause as these campaigns are mostly cause-based. Nevertheless, minor Tokens can be offered in order to express gratitude towards the investors. These include fundraising for disaster relief, medical bills, charities, and other non-profit ventures.

**Debt-Based Crowd funding:**

This type of crowd funding promises the contributors their money back with interest. It is also called "peer-to-peer (p2p)" lending and doesn't account for much involvement of traditional banking. Along with financial returns, the investors get the satisfaction of having contributed to the success of a prospective idea which speaks to them through micro financing. These campaigns usually include personal startup ventures.

**Equity Crowd funding:**

This type of funding is different from both the abovementioned ones as the contributors become part-owners of your company. They acquire equity shares in exchange for capital receiving return on their investment as well as a share of the profits. They are also entitled to a dividend. If the venture turns out to be successful, the share value goes up and if not, the value goes down. This type of funding is a sort of gamble which can go either way and is much more risky.

## CROWDFUNDING IN INDIA

Crowd funding is nothing new to India. Since centuries we have been donating "chanda" for some or the other socio-cultural cause, such as building of religious infrastructure. The online scene is a bit of a different matter though. Crowd funding, a concept originated in the West, much like most of other western ideas has started infiltrating the Indian masses. But, the crowd funding scene in India is rather new with not much awareness amongst people.

The crowd funding platforms in India are still desirable and have a long way to go till they reach the status claimed by foreign crowd funding giants like Kickstarter, Indiegogo, etc. Due to the restrictive admission policy of most of these foreign platforms, they are mostly unapproachable to budding Indian startups. In the later part of 2016, over 20 crowd funding platforms were deemed „illegal‟ by SEBI. Reward-based and Donorbased platforms still operate, while equity based crowd funding has seen a lot of scrutiny from SEBI. SEBI announced that it is taking a fresh look at crowd funding regulations, including perhaps, even a legal framework allowing equity crowd funding. The following are the top crowd funding platforms in India.

**Top Crowd funding Platforms in India**

| Crowdfunding Platform | Key Areas | Pricing | Features |
|---|---|---|---|
| **Impactguru** | *Medical causes and NGOs* | 5% | • Incubated at Harvard Innovation Lab<br>• Only Indian platform to offer a free crowdfunding Android app<br>• Fastest funds raised for medical causes<br>• Additional marketing and content support provided |
| **Ketto** | Celebrity charity, NGOs and Medical causes | 5% | • Offers multiple payment methods<br>• Has a large social media following |
| **Millap** | Rural projects, Debt-based crowdfunding and Medical Causes | 5% | • Top platform for Microfinance<br>• Expert in rural projects<br>• Free sign up |
| **Wishberry** | Creative Projects | 10% | • For creative projects only<br>• 70% success rate<br>• All or nothing policy |
| **Bitgiving** | Startups & Student Projects | 7% | • Partners with schools to make a social impact<br>• Allows pre-sales for startups<br>• Supports both Keep-What-You-Get and All-or-Nothing models |
| **Fuel A Dream** | Startups | 10% | • Provides rewards-based programs for startups<br>• Selects projects based on certain criteria<br>• Provides access to investors |
| **Catapooolt** | Personal Causes | 5% | • No upfront fees<br>• No verification guarantee on fundraisers |

| | | | |
|---|---|---|---|
| | | | • Allows rewards-based campaigns |
| **Funds Dreams India** | Technology & Creative ideas | NA | • Project must reach its goal in 51 days<br>• Contributions to unsuccessful projects are refunded<br>• Supports creative ideas only |
| Source: https://www.crowdfundingindia.org/ | | | |

**SEBI Regulations on Crowd Funding:**

Crowd funding, presently in a pubescent stage, has to face a lot of problems in India. Firstly, there is no proper legal regulation setting up rules regarding and specifying the same. But the lawmakers noticed the need to regulate this business model. Thus, Securities and Exchange Board of India (SEBI) released a consultation paper on crowd funding released in 2014 acknowledging the need for the same.

It provides that only an 'Accredited Investor' can invest money in a crowd funding project, where qualifications of an 'Accredited Investor' have been prescribed thereof as under:

I. Companies incorporated under the Companies Act, with a minimum net worth of Rs.20 crore.
II. HNIs with a minimum net worth of Rs.2 crore.
III. ERIs who fulfil the prescribed criteria.

The SEBI Consultation Paper proposes to place restrictions on the kind of companies that can raise funds through Security based crowd funding, some of which are as follows:

IV. The company intending to raise capital NOT exceeding Rs. 10 Crore in a period of 12 months.
V. A company which is not promoted sponsored or related to an industrial group which has a turnover in excess of Rs. 25 Crores.
VI. A company which is not listed on any exchange.
VII. A company which is not more than 4 years old.
VIII. A company which is not engaged in real estate and activities which are not permitted under industrial policy of Government of India.

Also, it is proposed that a crowd funding platform has to be necessarily recognized by the SEBI, and that it should fulfill the given integrity, experience and solvency requirements.[3] Peer-to-Peer Lending is regulated by the Non-Banking Financial Company– Peer-to-Peer Lending Platform (Reserve Bank) Directions, 2017 (The Directions).

The Directions define a "Non-banking financial company - Peer to Peer Lending Platform"[4] (NBFC-P2P) as a non-banking institution which carries on the business of a Peer-to-Peer Lending Platform. Peer-to-Peer Lending Platform[5] has been defined as an intermediary providing the services of loan facilitation via online medium or otherwise, to the participants[6] (a person who has entered into an arrangement with an NBFC-P2P to lend on it or to avail of loan facilitation services provided by it). Non-banking institutions other than companies have been prohibited from undertaking the business of Peer-to-Peer Lending platform.[7] The Directions provide the scope of activities, prudential norms (the aggregate loans taken by a borrower at any point of time, across all P2Ps, is subject to a cap of Rs.10,00,000/-), operational guidelines, *inter alia* other regulations.

**P2P Lending:**

While the toll on humanity is unprecedented, its economic impact is uncertain. The bottom is still awaited, making it difficult to forecast the future. While the government and regulators do their best to bring relief to the economy, we are closely monitoring and evaluating the impact on the P2P lending sector from both the demand and supply chain perspective.

**Demand Side:**

Traditionally, P2P lending platforms have been charged with attracting borrowers that are unable to access credit from banks and other FIs. While this may be partly true, it by no means undermines the quality of borrowers attracted to the low-cost loan offerings from P2P lending platforms.

However, lockdown across nations has meant restricted movements and little to no access to banking infrastructure. While most traditional FIs boast of an online loan application system, not many have made the effort to develop systems that enable online verification and processing of such loan requests. As a result, while borrowers may be able to apply for loans online, not many traditional FIs are able to disburse.

Here online lending platforms have an edge invested considerable amount of time and resources to develop an online infrastructure that covers the whole process from application to disbursal. From a simple online application process to signing a legally binding loan agreement to financial transactions between the lenders and borrowers through a third-party escrow fund, P2P lending platforms offers a smooth online experience for both the borrower and the lenders. Platforms like ours has also quickly adjusted to the changing environment and moved its physical verification of borrowers at their residence and office to e-verification (using location mapping through geo-tagging and video interviews). Collection of NACH mandate has been shifted to the RBI and NPCI backed e-mandate.

**Supply Side**

At a time, when economic activity is coming to a standstill, global markets are crashing, mutual funds like Franklin Templeton are winding up their fixed income schemes, the already shaky real estate has further nose-dived and the interest rates on savings and deposits are falling, the question that is quickly becoming crucial to most investors is where to invest.

Diversification is the key not just for the lenders but also for the platforms. Spreading your portfolio offerings across short-term (daily/weekend), working capital finance, personal, consumer and education loans is the key. This can work to your advantage as different products and borrowers perform differently during an economic crisis. Though returns on investments have taken a hit across most asset-class, investments in P2P lending, continue to hold ground. Our education and consumer loans products have delivered high returns even during the lockdown months of March and April.

Smart investors who understood the power of diversification are today, sleeping better. Those who built a diversified portfolio over the years across various investment opportunities are more assured of tiding over the crisis. Small ticket-size investments spread across a large number of loans and loan products and lenders who built diversified portfolio hold a better chance of earning stable returns.

**The Platforms**

This is the time when the P2P lending industry will prove that direct money lending is a very solid investment, providing stable results compared to the stock market, shared more fairly between participants."
The P2P lending sector has no doubt quickly adjusted and adapted to the trials and tribulations of the COVID-19 pandemic and all P2P lending platforms fare equally well in these challenging times. Platforms that are compliant with the regulations, have a sensible underwriting mechanism, established business practices, sound and secure tech-stack and an efficient workforce will surely emerge stronger on the other side of this ordeal.

## III. Conclusion

Crowd funding is developing in recognition, as bank liquidity is reduced and new regulatory requirements make getting loans for small and medium companies and individuals hard. In India, the IPO marketplace has no longer been very energetic. SEBI, has been at the leading edge in facilitating fund elevating for SMEs to measures like SME section in stock Exchanges, category I- SME funds under AIF, Institutional Trading Platform, etc., on the other hand there is a need to encourage innovative way of fund raising to offer an impetus to SMEs/start-ups. It is useful to selecting and understanding the different alternative method of fund raising. In India peer to peer lending is at a standstill in initial stage only, hence SEBI should provide more awareness to investors about P2P ending. The P2P lending sector also affected negatively due to COVID-19, but it has no doubt quickly adjusted and adapted to the trials and problems of the COVID-19 pandemic.

**Future Research Directions:**

This paper has analyzed peer to peer lending is at a standstill in initial stage only, hence SEBI should provide more awareness to investors and provide more research. Further focus on the performance of top plat forms in India and do the research on COVID its impact on P2P lending and crowd funding.

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