

Role of ‘Crowd’ in Financing Start Ups in India

Hari Kumar. C¹ and Dr. B. Johnson²

¹Research Scholar, Department of Commerce and Management Studies, University of Calicut,

²Professor & Head, Department of Commerce and Management Studies, University of Calicut,

Abstract

Crowdfunding is an innovative, emerging fundraising method in which an open call for finance is made before the public essentially through an internet platform. It is an informal means for raising finance for startups, which unlike the other informal means has a wider reach. Crowdfunding presents not only financing but improves an entrepreneur's online presence, offers prospective end users, reduce production cost and many more. After creating headlines in USA, UK and many European countries, the concept is finding its space in developing countries too. From \$6.1 billion in 2013, the crowdfunding industry witnessed an accelerated growth about \$16.2 billion which shows a whopping 167% growth in 2014. Crowdfunding reports at the end of 2015 estimated a growth of \$34 billion in the industry. This research paper explores the concept of crowdfunding, the mechanism involved and its various models. It uses extensive literature analysis to define various models, parties involved in the process of crowdfunding. The paper contributes further by analyzing the risks of crowdfunding. India, with its abundant resources, youths, numerous NGO's can make use of this innovative method. A properly guided, regulated, investor protected crowdfunding environment can help India to grow rapidly in the world economy.

(Key Words: Crowdfunding, Crowdfunding Models, Innovation, SME's, Online Communities, Risks, Start – Ups)

¹Research Scholar, Department of Commerce and Management Studies, University of Calicut. harikc967@gmail.com

² Professor & Head, Department of Commerce and Management Studies, University of Calicut. bensavier01@gmail.com

1. Introduction

Collecting large amount of funds from the public for a cause is an old practice. It accumulate funds by drawing smaller contribution from a larger public. For decades society used this technique of funding for the purposes like charity, construction of public roads temples or churches. Crowdfunding is a modified version of this kind of fund collection. As the name implies, crowdfunding is an alternative tool of raising finance from ‘crowd’ or public. It uses internet for the collection of money. Modern finance world is highly volatile and competitive. Since economies are liberalized and are open, opportunities in such an atmosphere is much more than one can expect. One who is flexible and ultra-fast to sense the environment can only survive in this modern era because along with the opportunities, complexities are also out there. Financing is one of the most heated issues as far as an entrepreneur is concerned. Financing of projects can be done by using either formally or informally. Formal ways to raise finance is where an entrepreneur uses traditional monetary resources such as banks or other funding agencies like ‘angel investor’ or ‘venture capitalist’. Informally an entrepreneur can make use of his own money, his relatives, or friend’s assistance. Using the information from Global Entrepreneurship Monitor (2004) Lam says that informal financial funds cover 90% of new business ventures' capital.

Crowdfunding can be defined as an act of raising necessary finance from the crowd or public connected through an internet platform so as to materialize a business or creative projects. Crowdfunding uses online community to raise finance by asking them to make smaller contribution in return for tangible or intangible rewards. After making huge impacts in USA, UK, and other European nations, the concept is getting much more attention in developing countries like India, Brazil etc.

2. Crowdfunding: The Concept

Crowd funding can be viewed as an extension of the wider area of crowd sourcing. This involves outsourcing different business activities via an open call (Howe, 2006; Kleemann et. al 2008). Crowd sourcing enable a large networks of people to share information and user generated content through social networks. Social networking is another term closely related with crowdfunding. In social networking consumers would actively participate in discussions and thus share their information as well as suggestions about new brands. Crowdfunding is yet an improvised form of social networking wherein the consumers who are interconnected through internet are pushed for more active roles in product development and most importantly to support with finance. Belleflamme and Lambert define crowd funding as: “With crowd funding, an entrepreneur raises external financing from a large audience (the “crowd”), in which each individual provides a very small amount, instead of soliciting a small group of sophisticated investors” (Belleflamme, Lambert et al. 2013).

Emergence of crowd funding activities could be traced out from 17th centuries. Jonathan Swift had created Irish Loan Funds for low income families who had no credit facilities and little

collateral but could still be considered creditworthy. Thus, this fund was used by small businessmen and farmers to push up their business. In 1976, the Noble Prize winner, Dr. Mohammad Yunus, launched the well-known programme micro credit which offers banking opportunity for the low income residents in Bangladesh. Initial loan of \$27 to 42 women was given and in five years, program has 30,000 members. In 1983, the program was transformed to Grameen Bank. The bank has more than 8 million borrowers, with 97% of the money given to women operated business. Another major instance was that in 1997, the U.S. tours of the British rock band Marillion was funded by their US fan base by raising \$60,000 themselves online to give to the band.

In 2000, the first documented crowdfunding site for music ‘aristShare’ was launched. From 2005 onwards, ‘Kiva’ presented an opportunity before individuals to provide small loans to entrepreneurs in poor areas. In the year 2006, Prosper, the first peer to peer lending platform was launched.

Origin of the term crowd funding can be found in crowd sourcing. In 2006, a publication of Howe and Robinson in the Wire launched this marketing term *crowd sourcing* worldwide. Howe defines crowd sourcing as the power of the many that can be leveraged to realize feats that were once considered as the responsibility of a specialized few (Howe 2006). The main element in crowd sourcing is the outsourcing of labour to external parties (Howe 2006, Schenk 2011, ter Kuile 2011, Belleflamme, Lambert et al. 2013). This can take place in different phases in the production process and it gives the firms access to a great pool of labour. In 2006, Michael Sullivan, founder of ‘FundVlog’, coined the term ‘crowdfunding’.

Unlike in crowd sourcing, it is about raising capital in crowdfunding: the funding of a phase or phases of a production process. Where crowd funding started as a way to support politicians and charities, at the end of 2011 about 200 crowd funding platforms could be found only in Europe, active in a wide range of businesses and business models. According to ‘Massolution crowdfunding report 2015’, the global crowdfunding industry matured immensely in 2014 — expanded about a whopping 167% to reach \$16.2 billion, raised from a mere \$6.1 billion in 2013. The industry has raised more than double once again and reached to \$34.4 billion, in 2015. Further, Massolution adds that the Asian crowdfunding volumes grew by 320%, to \$3.4 billion raised from various projects³

3. Crowdfunding: The Mechanism

Crowdfunding involves a number of steps commencing from idea generation to the completion of project. The mechanism of crowdfunding is given in the following exhibit. For the purpose of easy understanding the whole mechanism is divided into four stages.

³ <https://crowdfundingpr.wordpress.com/category/country/india/>



Figure 1: Crowdfunding Mechanism

3.1 Crowdfunding Models

Different sources define different types and categories of crowd funding. According to The Crowd funding Industry Report (2013) prepared by Massolution based on a profound and explicit qualitative research of more than 452 crowd funding platforms active worldwide, four major models are recognized: donation, equity, lending and reward-based.

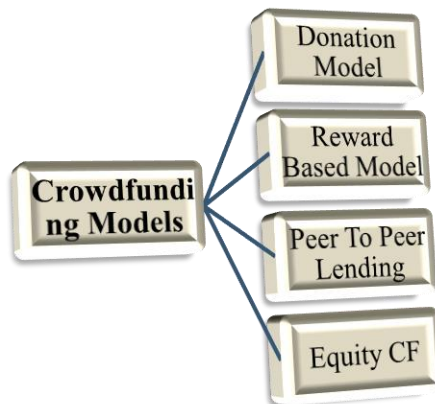


Figure 2: Crowdfunding Models

3.2 Crowdfunding: Parties Involved

The crowdfunding process involves at least three participants:

- Creators/Initiators or the Originators of the idea or project, who are in need of finance.
- Crowd/Funders or Contributors; they will decide on whether to offer financial support or not.
- Platform owner/ Intermediary, who facilitates the interconnection of the first two participant through an internet platform.
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4. Crowdfunding: Benefits

Some of the economic benefits associated with the crowdfunding are shown under two heads in the following exhibit.

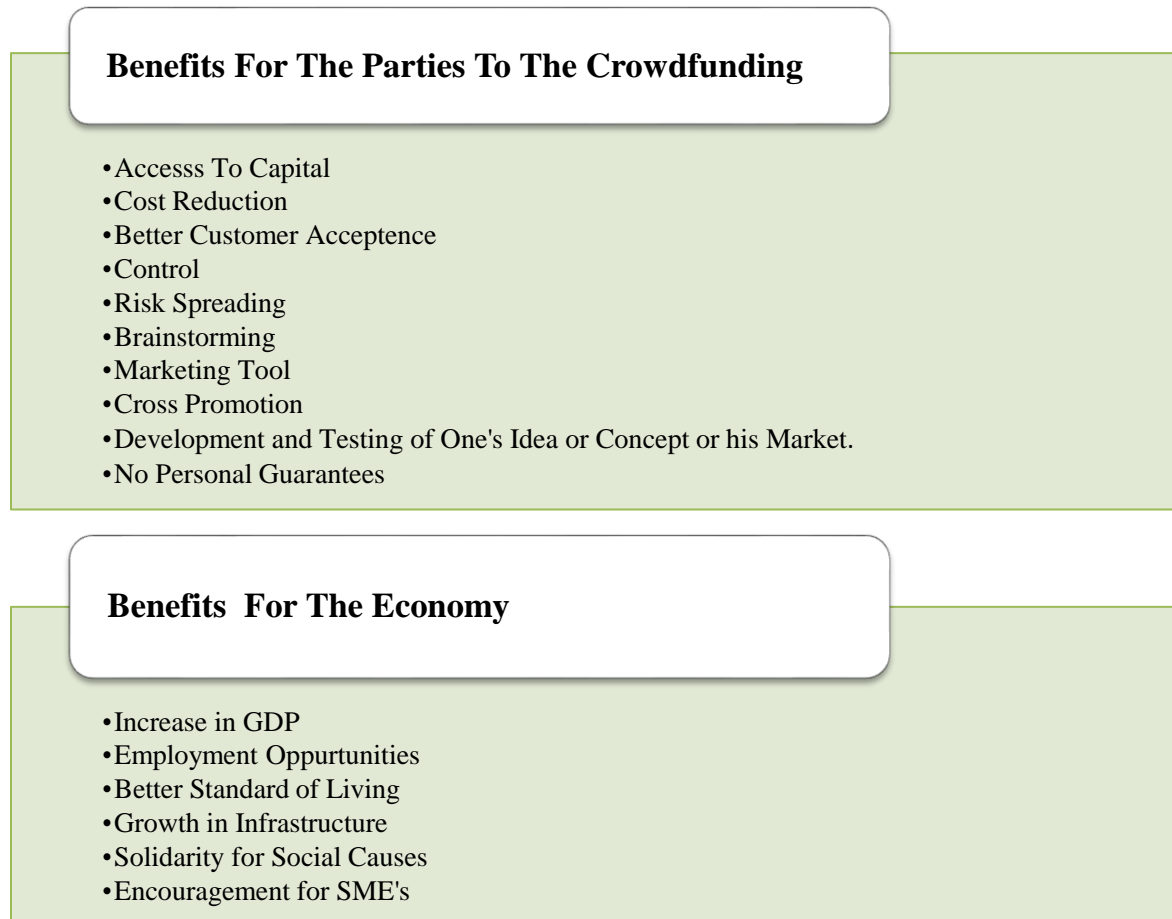


Figure 3: Crowdfunding: Benefits

5. Crowdfunding In India: An Overview

Crowdfunding in Indian context has an interesting twist. Many would think that the concept is new to the Indians. But it can say that Indians have witnessed the success of crowdfunding campaign even well before coining the term. Reliance Industries founder Dhirubhai Ambani's small yet growing textile business was crowd funded by communities across Gujarat. There are many instances in the past where the temples, roads, historical monuments etc. were built by collecting funds from the society. Today, India with its huge market and human capital has become a popular destination for global business. Recently, number of crowdfunding platforms have been launched in the country. There have been attempts at crowdfunding for events like the 'Goa Project' and campaigns like 'Teach for India'. It is a fact that Crowd funding is gradually becoming an alternative funding channel for the film industry. Many top players of the world crowdfunding market have started to establish its tie ups with the Indian crowdfunding market such as Kickstarter, indigego etc.

Crowdfunding is relatively a new concept in India and the usage of Internet for raising funds is even less. According to a World Bank report (2012), India has only 10 CFPs as against 344 in the US and 87 in the UK. These are the list of Crowd funding websites based in India:

- Wishberry
- Ketto
- Milaap
- Rangde
- Catapooolt
- Funds dream India
- Dream wallets
- Fuel a dream
- Bitgiving
- Impactguru

According to the estimates, the platforms in India have collected crores through their campaign, out of which 6 crores has been collected by wishberry alone. What is more interesting is that the crowdfunding in developing countries is set for an explosive growth period (Around 136% year on year). Moreover World Bank estimates that the crowdfunding in the developing countries could grow by up to 96 billion us dollar by the year 2025⁴. The top crowdfunding platforms in India are compared in terms of various categories:

5.1 Comparison of Various Crowdfunding Platforms in India

Indian crowdfunding platforms have performed significantly over their limited period of activity. Platforms such as *rangde*, *milaap*, *ketto* and *wishberry* have performed considerable well over the years. *Wishberry* claims a 70% success rate on their projects. Following table compare the top indian crowdfunding platforms:

Table 1 Comparison of Pricing Policy of Select Indian Crowdfunding Platforms

S.N	Platform	Area of operation	Mode of operation	Funds raised so far	Pricing policy
1	Ketto www.keeto.org	Domestic and international	Charity	+300 crore	<ul style="list-style-type: none"> • 5-6% +3% payment gateway charges+ 18% GST
2	Wishberry www.wishberry.in	Domestic and international	Reward based	11.6 crore	<ul style="list-style-type: none"> • Campaign consultation fee – 3500

⁴ Allied crowd report 2015

					<ul style="list-style-type: none"> • Social media marketing & PR – 11500 • Wishberry commission - 10% (inclusive of payment gateway charges)
3	Milaap www.milaap.org	Domestic	Charity	+332 crore	<ul style="list-style-type: none"> • 13.5%
4	Rang de www.rangde.com	Domestic	Peer to peer	+75.9 crore loans	<ul style="list-style-type: none"> • No processing fee • 2% all the loan repaid for meeting internal expenses
5	Impactguru www.impactguru.com	Domestic	Charity	+150 crore	<ul style="list-style-type: none"> • Self-driven – 5% • Collaborative -8% • Accelerate – 12% • 3% payment gateway charges • 18% GST on aggregate of transaction as well as platform fee
6	Fueladream www.fueladream.com	Domestic and international	Reward based / donations	NA	<ul style="list-style-type: none"> • Contract charge – 6% • Payment gateway charge – 3% • A one-time fixed, non-refundable processing charge of 3000 + service tax is charged from every fundraiser before the live pitching • 18% GST
7	Dream wallet www.dreamwallets.com	Domestic	Reward based	NA	<ul style="list-style-type: none"> • Listing fee – nil • Flat charge – 5% • Processing fee- 3.95% • 5% if you reach the target and 9% if you do not
8	Catapoolt www.catapoolt.com	Global with	Reward based	NA	<ul style="list-style-type: none"> • Pricing charge – 10% plus 18% GST

		focus on Asia and Domestic			<ul style="list-style-type: none"> Upfront fee - 1499
9	Fundsream india www.fundsreamindia.com	Domestic	Reward based / donations	NA	<ul style="list-style-type: none"> 6-8%
10	Bitgiving www.bitgiving.com	Domestic	Reward based	NA	<ul style="list-style-type: none"> 6-8%

Source: Compiled by Authors from Different Websites

From the websites of the various crowdfunding platforms and the limited literature, it is very clear that the platforms are entirely different in many ways. Among the selected platforms, ketto focuses upon the celebrity charity and NGO's, while Milaap and rangde give priority towards rural projects and debt financing. wishberry is reward based and it accepts creative projects. Catapoolt and fueladream has prioritized startups financing while the later has given importance to student's projects and has partnership with various students' community. Impactguru is specialized in medical causes and NGO's.

Table 2 Product/Service Policy of Select Indian Crowdfunding Platform

S.N	Platform	Payout policy	Funding duration	Key Services offered/ features
1	Ketto	Any time	Depends on projects	<ul style="list-style-type: none"> Personalized web app 24/7 support Fundraiser expert to guide Additional social media support
2	Wishberry	Only 15 days after the campaign	Maximum of 100 days	<ul style="list-style-type: none"> Personalized consultation Email marketing Global payment and trouble shooting Backer management tool Social media PR efforts
3	Milaap	Any time	NA	<ul style="list-style-type: none"> Free sign up
4	Rang de	-	-	<ul style="list-style-type: none">
5	Impactguru	3-10 days	Up to 365 days	<ul style="list-style-type: none"> Multiple donation Mobile friendly app Easy fund disbursal Real time donation notification Due diligence process Additional marketing support

6	Fuel a dream	15 days after the campaign	14 – 90 days	
7	Fundsdream India	Any time	-	<ul style="list-style-type: none"> • Flexible funding • Allow pre- sales • Partner with schools
8	Catapoolt	15 days	Default 30 days; but there are no such deadlines	<ul style="list-style-type: none"> • Has ‘trusted mentor’ panel to guide the investors
9	Dream wallet	Upon the completion	30-90 days	<ul style="list-style-type: none"> • Personalized offline mentoring • Analytics for assessing target area • Automated email system • Robust Multiple layer payment system
10	Bitgiving	Upon completion	-	-

Source: Compiled by Authors from Different Websites

The table give an impression about the product policy and services offered by the various crowdfunding platforms in India. While the payout policy is different in majority of the cases. Milaap and ketto have a payout policy that allows the fundraiser to have his or her money at any time they want. While in wishberry, fueladream, catapoolt, the fundraiser will get the amount 15 days after the campaign period. Impactguru will transfer the amount within 3 to 10 days but platforms such as bitgiving and dream wallet pay out policy depend upon the completion of the project.

The duration of the campaign, again varies between the platforms. On an average the platforms has a funding period of 30 to 90 days. Most of the platforms offer a high secured, multiple layer payment options and are having excellent technical team to aid the stakeholders. Fully automated email notification, 24/7 services, perfect screening mechanism to select the projects are some of the standout services offered by these platforms. Platforms such as wishberry, catapoolt, and ketto etc are having separate project expert/mentor to guide and assist the project creators or the fundraiser to go on with the campaign.

5.2 Screening and Security

Most of the crowdfunding platforms have a well-functioning screening mechanism to select the genuine projects. Each and every crowdfunding platforms have a special team to review and verify the projects or idea to be placed in their platform. Important cases are given below:

- Ketto has a rigorous verification process for screening and the whole payment is secured via 128 bit encryption

- Wishberry will check the background – past experience, referrals will be considered. Wishberry will only allow work in progress projects; ideation stage projects are not allowed. Wishberry will give instant notification and each pledge will be reflected in the campaign page. Transactions are highly safe with wishberry.
- Impactguru has sophisticated algorithms to monitor data for fraud patterns; they have community reporting and a trust team to review all the data and customer feedback. it has ensured the safety of transaction by enabling highest level of encryption to the stakeholders
- Dreamwallets does not verify the bonafide and genuineness of the project. It cannot and does not verify specific data provided by seeking projects.

6. Crowdfunding: The Risks

Since the crowdfunding is relatively a new term, there is no time tested mechanism to regulate the process; there exists lack of a universally accepted construct definition. Crowdfunding is mostly associated with startups and is driven by the popularity of internet and its online community. Along with the benefits it provides, there are some risks too.

6.1 Risks to the Parties of Crowdfunding

1. Default Risk

The peculiar feature about crowdfunding is that the issuers or the creators are seeking finance for their projects or ideas which are not yet verified in terms of their technical and commercial soundness. Startups have an inherent risk of failure. The chances of failure of the project and ventures not yielding proposed returns are more in crowdfunding. This default risk is higher in crowdfunding when compared to the projects which use the traditional devices to raise their capital.

The risk may be multiplied as the investors are not very skilled and have expertise in drawing conclusions or making risk assessments about a project. There is no or limited follow up mechanism to verify the utilization of money invested and if the platforms are suddenly closed temporarily or permanently there is no mechanism to take back the money invested.

2. Substitution of Institutional Risk by Retail Risks

Usually the financing of startups and SME's are undertaken by a group of informed individuals through venture capital funds, private equity holders, banks and so on. In the case of crowdfunding the issuer draws funds in smaller amounts from a larger public who are basically uninformed and unsophisticated. These larger public do not have either the knowledge or risk bearing capacity of informed investors. Here, the risks of investment are shifted from informed, institutional risk takers to the retail risk takers. Retail risk taker's risk bearing capacity is very low and may be influenced by emotions. They often show herd mentality.

3. Responsibility Issue

The fundraiser uploads his or her campaign in a web – platform. This platform is not responsible for any fraud or other unethical practices of fundraiser. The platform only has a limited liability in crowdfunding. When investing in a crowdfunded project, contributors are reliant solely upon the representations of fundraisers and do not undertake a clear assessment of the company/projects that they are investing. Portals typically do not offer any certification as to the veracity of the claims of fundraising companies. They only act as an intermediary. There is no clear cut mechanism to check whether the funds collected are utilized for the intended work and not for taking the money and fading away.

4. Liquidity Risks

There is no secondary market for crowdfunding. In the case of equity crowdfunding and peer to peer lending liquidity issue arises. There is no collateral as in the cases of corporate bonds. The investor protection schemes are also not there in crowdfunding.

5. Information Asymmetry

Those who are contributing to the project have to rely upon the soft information available in the web based platform or the social medias. The information other than soft information is hardly available. The issuer may not fully disclose his projects or he may give misinformation. As already mentioned there is no sound mechanism to track the flow of money. The transparency as well as reporting obligations for the project creators, platforms are not clarified yet.

6. Reputation

If the issuer is failed to collect the money targeted or failed to drag the attention of the crowd, can severely harm one's reputation. Often through crowdfunding, more than the funds collected, it is the validation of one's idea is bound to be important. So if one fails in that, it can harm his further proceedings.

7. Center Role of Internet

The crowdfunding uses the online communities, who are active in internet. In most cases young generations are often linked with these online communities. The issuer, funder and the platform, all the elements in the process must interact through internet if it is to be considered as a crowdfunding. There are significant risks in connection with the cyber security. There may be attempt to steal of identity, overloading the infrastructure of the intermediary, password theft etc.

8. Risks of Violation of IPR

One of the most important threats before the parties to the crowdfunding is that the idea or concept is put to a larger public, possibly millions. There may be an attempt of copying of ideas or concept. As the platforms are not providing any intellectual property rights, there may be instances that the concept can be copied while posting it to a platform. Creators are reluctant to disclose details fully before the completion of the project.

6.2 Risks to the Financial System

The first and most important problem in a crowdfunding process is that there are no clear cut regulations in the country as of now. It can severely harm the economy in many ways. The unskilled, inexperienced investors who are in larger number may not have the access to the utilization of their money or not able trace who the end users are. If there is no such mechanism, it will encourage the individuals or groups to place the fake projects through the platforms to amass finance. It may further lead to money laundering or hoarding. It can be even utilized for manipulating the stock markets. Sometimes these fake entrepreneurs can take the money and simply vanish in the air. These all are the results of lack of a well-organized, regulated framework. The cases of fraud can create further diffidence in the minds of the public.

7. Key findings

Key findings of the study are as follows:

- 7.1 Ketto is the premier crowdfunding platform, their target area is social causes and NGO's, and they have the largest social media followers.
- 7.2 Wishberry is one of the prominent reward based crowdfunding platforms in India, it claims a 70% success rate for their projects.
- 7.3 Milaap and rangde are the market leaders in peer to peer lending platforms in India.
- 7.4 Catapoolt exclusively focus upon the startups arena, they are the premier platform for startups in India. Fundsdreamindia has their focus on startups and students projects.
- 7.5 Dream wallet claims to be not responsible for the genuineness of the projects appearing on their platforms. Impactguru is focusing upon the medical causes and NGO's. They are the only platform which offers the US, UK and Indian tax benefits.
- 7.6 There exist number of risks in crowdfunding. Cyber theft; reputation, information asymmetry are some of the major risks for the parties to the crowdfunding whereas lack of a consistent regulation pegging back the growth of this most modern, volatile financial instrument.

8. Conclusion

There is no doubt that crowdfunding is the next big thing in the Indian financial market. Even in the developed countries, crowdfunding is going to take the driver seat surpassing the venture capital. It is true that compared to those well established markets, Indian crowdfunding is still in its tender stage. India with its abundant human capital, growing presence of youth in online communities, largest in terms of NGOs, can definitely make use of this most modern technique start up finance. Most of the crowdfunding platforms in india launched only after 2010, still the Indian crowdfunding platforms have been able to collect huge amount of funds. In reward based platforms only more than 10 crores have been collected. 'Wishberry', an Indian mirror for the US

crowdfunding platform ‘kickstarter’ has been able to draw huge interest among the public. It has more than 70% success rate and able to collect 6.6 crores across more than 11000 backers. ‘Milaap’, another crowdfunding platform was able to collect more than 55 crores for social causes alone. It shows that if well organized, Indian platforms can definitely make use of the large online community of the country. Considering the risks associated with the crowdfunding, a suitable regulatory frameworks are called for. If such an atmosphere is arranged for crowdfunding process, then the journey of the nation towards its sustained growth will be even faster.

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