A Study on Crowdfunding as an Innovative way to Finance Startups

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Abstract
Crowdfunding is a budding concept that links entrepreneurs and investors. It helps raise funds for entrepreneurs for individual projects online with devoted sites. For the past few years, the crowdfunding industry has grown exponentially to raise billions of funds for individual art projects for start-ups. The crowdfunding model has the potential to increase the financial environment for small entrepreneurs to big business enterprises. This research article aims at providing insight into whatcrowdfunding is, its types, and how it is an innovative way to finance startups.

Keywords: Crowdfunding, Finance, Startups, Entrepreneurs, Innovative

Introduction

Crowdfunding is a way of raising money to finance projects and businesses. It enables fundraisers to collect money from a large number of people via online platforms. Crowdfunding is most often used by startup companies or growing businesses as a way of accessing alternative funds.

Crowdfunding has been around for a while now (the word was first used in 2006). It's fundamentally a pretty simple idea – raising money from multiple people towards one wider cause or project.

It is an upcoming trend for raising capital for individuals, who propose great ideas. It makes the use of internet or social networking sites such as Facebook or LinkedIn or Twitter or even some dedicated websites to provide funds.

Crowdfunding is a relatively new method of raising capital from a variety of networks, expanding the donor base to fund ideas and projects. It allows a large number of people to contribute and get behind the project, whether they're working on social causes, product development, research, and innovation, or myriad other worthy initiatives.

Crowdfunding allows projects to expand immensely to other passionate investors that would have otherwise been difficult to reach. Which in turn can make their project happen in a new innovative way.

For example, in 2015 a smartwatch company used crowdfunding to raise more than $20 million from 80,000 people. The potential of using crowdfunding is huge if a company/startup has got the right product and story.

Objectives

- To analyze the different methods of investment through crowdfunding
- To analyze how crowdfunding is an innovative way to finance start-ups

Research Statement

A study on crowdfunding as an innovative way to finance start-ups.

Literature Review

Prinsha K. (2016) The normal technique for commercial enterprise finance is largely the opposite of crowdfunding. Traditionally, to begin an enterprise or launch a new product the entrepreneur has to do marketplace research, put together a business plan, make a prototype to validate the concept and look for investors to aid the business financially. These resources of the financing included banks, angel buyers, and assignment capital businesses, which restricted the alternatives to more than one key player. This fundraising method may be seen as a funnel, which pitch at the extensive quit and the investor target market at the closed give up. This approach dramatically streamlines the traditional model, giving entrepreneurs a single platform for building, displaying, and sharing their capabilities.

Types of Crowdfunding

Equity-Based Crowdfunding

Stock crowdfunding is a novel approach to finance firms without taking on more debt. It's a type of fundraising that seeks to entice investors who are prepared to give money toward your company's objectives in exchange for a financial share in the enterprise.

The main idea behind equity crowdfunding is to raise smaller amounts of capital from a bigger pool of private investors. This method is distinct from attempting to obtain sizeable contributions from venture capital firms or angel investors—a business finance strategy that is out of reach for many startups and established small businesses alike.

Process of Equity-Based Crowdfunding

Due to federal government oversight, equity crowdfunding is also known as regulation crowdfunding. Your company still offers equity to investors in exchange for capital, even though you aren't selling shares on a stock exchange. As a result, there are more regulations involved in the process than there would be with a straightforward online fundraising effort on GoFundMe or Kickstarter.

Following the guidelines is essential if you want to use equity crowdfunding to raise money for your company. If not, you can experience some unpleasant repercussions. For instance, breaking the guidelines could result in you having to return any investments you have received. The U.S. Securities and Exchange Commission (SEC) may in some circumstances temporarily suspend your company's ability to offer shares to investors.

The Process to Sell Business Shares through an Online Crowdfunding Platform

- Process any investment transactions by working with an SEC-registered broker-dealer (also known as a funding gateway).
- Allow no more than $5 million a year in investments from crowdsourcing.
- Observe statutory restrictions on the sum you can receive from unaccredited, individual investors each year (amounts vary based on income).
- Depending on the amount of money your business receives, make any mandatory financial disclosures public.

If you want to engage the public and persuade people to invest in your firm, you'll need to create a captivating campaign in addition to addressing any legal issues.

- The amount of money do you need to raise?
- How do you plan to utilize the fund?
- Who are your target customers?
- And profit margin are all important factors that should be communicated to potential investors in a solid equity crowdfunding campaign.
- What makes your business different from competitors?
- Why investors should back you?

Reward-based Crowdfunding

This particular form of crowdfunding entails asking a lot of people to donate to a "campaign" that the developers of a new good, service, or company are starting in exchange for something.

A reward is promised to campaign backers in exchange for their financial support. These incentives frequently consist of the good or service that the fundraising campaign was intended to support, as well as marketing materials like branded t-shirts, bumper stickers, bobbleheads, and more.

Reward-based crowdfunding provides a venue for the producers to pre-sell their product, service, or creative work in situations where the rewards are centered around the good or service that
the campaign was made to raise money.

Process of Reward-Based Crowdfunding

To raise capital, entrepreneurs usually display their objectives, business ideas, and projects on online crowdfunding platforms like Republic, Kickstarter, and Indiegogo. The fundraising process involves four steps:

- The entrepreneur lists a project or business to be funded on a crowdfunding platform. They mention the rewards, the timeline, and the deadline for the fundraiser.
- The entrepreneur markets the fundraiser on social media and other marketing channels. They usually target potential customers who could be triggered by FOMO and the scarcity principle to fund the business and try out the offering.
- Interested funders contribute to the project, and the amount is added to the fund after charging the platform's fees.
- The contributors are rewarded based on their con.

Donation-based crowdfunding

It is a method of raising money for a project that entails requesting a lot of donors to each give a tiny sum without expecting anything in return. The best uses of donation-based crowdfunding are to fund both local projects and individual needs. As a strategy to increase awareness and spur additional donations, you can promote your fundraising among your network and on social media. Natural catastrophes, disaster relief, charitable causes, and medical expenses are common projects for this type of support. In this scenario, a crowd is urged to contribute to a cause or organization in exchange for intangible benefits. Both concrete and intangible returns are possible. Contribution campaigns frequently last 1-3 months.

The tokens for donations may include pre-sales of an item that will be manufactured with the money received, a practice is known as incentives crowdfunding. Funders in this type of crowdfunding, which is based on donations, do not acquire any ownership or other interests in the project and do not turn into the project's creditors.

Process of Donation-based crowdfunding

In contrast to the conventional approach of borrowing money from banks, taking out private loans, or selling equity shares, crowdsourcing offers a fresh and cutting-edge option to generate money for a new product or service, assuming an entrepreneur or inventor has a brilliant concept for it. The business owner can pre-sell their product to a large number of supporters through donation-based crowdfunding and each contributes a relatively small amount to the project.

Debt-Based Crowdfunding

Debt-based Crowdfunding: It is undeniable that the modern fundraising procedure has its roots in the phenomenon of crowdsourcing. Debt-based crowdfunding, also known as peer-to-peer lending, minibonds, or crowd lending. Debt-based crowdfunding is quickly and ably replacing traditional borrowing channels. In exchange for a predetermined interest rate, each lender contributes a certain amount to the borrower's effort to realize their goal. The debt-based crowdfunding is further elaborated as:

1. **Peer to Peer (P2P)**: This debt-based crowdfunding business type seeks out potential investors who are willing to commit substantial sums of money in exchange for high returns.
2. **Microlending**: This form is similar to peer-to-peer lending, except here there is a smaller investment required and fewer risk-takers among potential investors.
3. **Mini-Bonds:** These have terms of three to five years, and borrowers are required to repay the principal amount as well as periodical interest payments to lenders at the end of the term.
4. **Invoice Financing**: This gives companies access to capital or a revolving line of credit based on the money that customers owe them.

The Process of Debt-based Crowdfunding Follows Different Stages

1. Determining the quantity needed for the project.
2. Examining the many sources of funding that are accessible.
3. It's imperative to adhere completely to all of the platform-specific laws andregulations before submitting the proposal.
4. The selected platform then spends some time reviewing the submitted idea.
5. Once the given idea is approved, it is then made publicly available on the platform for a predetermined period to raise the specified amount.

Data Analysis and Interpretation

The analysis based on the data is shown here:

1. Successful campaigns often raise more money than expected 78% of the time.
2. Campaigns with regular updates raised 126% more money than those without them.
3. In the days before the internet, crowdfunding was challenging since no one could trust another with their money. E-commerce, however, has transformed all of this. Via websites like Kickstarter, Indiegogo, and fundable, anyone may now fund any startup of their choice. Using these crowdfunding services, startups have made over $5 million. In just two months, 13,700 funders contributed $5.2 million to a project called "The Travel Line" on Kickstarter.

Findings and Suggestions

Although crowdfunding has only been around for a few years, its use and popularity have increased steadily, reaching practically every sector of society as a means of funding start-up businesses, charitable events, and diverse projects. This makes crowdfunding an important factor to take into account whenever money is being solicited.

Reasons why crowdfunding is a cutting-edge method for funding startups:

1. Crowdfunding is a creative method to finance startups because it enables them to test their concepts and products before going public, and they may use it to raise money when their ventures are just getting off the ground.
2. It is regarded as a low-risk procedure.
3. In contrast to conventional loan procedures, where the collateral is necessary, crowdfunding involves raising money from a large number of individuals and does not.
4. The process of crowdfunding for start-ups acts as a tool for marketing the product through the campaign, helps in building a client base, and enhances relationships with investors. The act of creating a community of individuals who support the product would offer useful feedback on the product, and would raise information about the campaignshould be viewed as the most crucial element of financing through crowdsourcing.

Conclusion

Crowdfunding is all things considered, a fantastic tool for entrepreneurs to raise money and cultivate a support network. It's also a wonderful opportunity for them to test the market for their business idea before committing entirely to it. We have examined the operation of crowdfunding, its different forms, actual businesses that have used it, and how it has affected startups' financial health. So, we can conclude that crowdfunding is a good choice for new businesses. If startups are seeking an alternative to conventional sources of finance, it is something to take into account.

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