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An Overview of Crowdfunding in the Indian Setting

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Abstract: *Crowdfunding is the raising of small amounts of capital from large amounts of people over the internet Crowdfunding has emerged as an exciting alternative to the conventional financial market. In particular startups all over the world are being drawn by the low cost of raising capital.*
In this paper we will examine whether crowdfunding can work in an Indian context. In particular it will focus on whether India has the proper legal framework to enable and support crowdfunding.

1. Introduction

Crowdfunding is a financing method mainly used by start-ups and small businesses according to J.W Parsont a professor at Columbia Law School. Crowdfunding works by having a small amount of capital being raised by a large number of people over the internet. Crowdfunding is typically held to be cheaper than traditional forms of raising capital for small businesses[i].

A standard crowdfunding arrangement typically has three parties. The websites which host crowdfunding applications are typically called portals. The businesses posting on these portals seeking money are normally called issuers. Finally there are the investors who put money into the actual project. There are variations from this standard formula however.

Crowdsourcing is a new internet phenomena. People come together through a virtual forum to achieve some common purposes. A very good example of this phenomenon can be seen in Wikipedia. Crowdfunding is a type of crowdsourcing where people use these same principles to generate financial resources for a business[ii].

Crowdfunding is primarily done through websites called crowdfunding portals. These portals put together those seeking funding with consumers. A person posts a profile of their needs and if the consumers are interested they can invest money into the project. The returns on the promised project vary from according to the project[iii]. These crowdfunding portals do not fall into the conventional financial legislations.

The lack of regulation and comparative ease of raising capital make crowdfunding an attractive alternative to conventional forms of raising capital. Let us say for example a person wishes to start a small sized private company. Under the Indian Companies Act they are required to have (quote figure here) for capital. If the company wished to get money from a bank they would be charged with a high rate of interest and have to put up security. Similarly listing on the stock exchange would entail sharing information and a potential loss of control of the company. Crowdfunding by contrast offers a much simpler alternative to raising the money required.

The ease of raising capital has led to astounding growth in capital being raised by crowdfunding. According to the FTC in the United States crowdfunding generated 5 billion dollars of funding for businesses in 2013. (FTC complaint) as opposed to 2.5 billion in 2015.

The growth in crowdfunding is especially surprising given the fact the hit many financial systems took in the wake of the 2008 recession. If it continues to grow at this trajectory crowdfunding could become a major part of the financial market.

This growth has necessitated the need to have a proper regulatory framework for crowdfunding. The need for this regulation is twofold. The first priority is to protect consumers who might be cheated out of money. Crowdfunding can in theory reach a fair wider audience of people than a traditional forms of raising money. Many of these people may well be vulnerable to being cheated.

Secondly by regularising the process it would also help crowdfunding portals themselves. In countries where no legislations exist crowdfunding is in a sort of legal vacuum. In India for example a person would not know under which laws their investments are protected. This means there are no i

Internationally various legislations have been enacted to meet these challenges. In the United States crowdfunding has been recognised under the Jumpstart Our Business Start-up (JOBS) Act[iv]. Under the JOBS crowdfunding gets a tax exemption. However in return for this exemption there are quite strict regulations about who can invest.(Rutlidge,Westlaw JOBS). Similar legislations have been implemented in quite a few countries (SEBI consultancy paper.

In India there is a growing need for such legislations as crowdfunding has taken root. There are currently quite a few crowdfunding portals in India itself. These portals are specifically designed to work with the Indian market. One of the main sectors that is attracting capital from crowdfunding is the creative sector.(internship report).

SEBI has taken note of this need and has issued a consultancy paper on this matter. The consultancy paper provides a framework for how any future crowdfunding legislation could work in India. The paper itself addresses the major issues of crowdfunding would face in India.(SEBI consultancy paper)

In this paper we will examine the following issues related to crowdfunding legislation in India:

2. Issues:

1. Whether crowd funding can accord benefits to India? If yes, how benefits can help in minimizing the costs of raising capital?
2. Are regulations the maiden efforts of SEBI and its impact in India and how stakeholders interests have been taken care of
3. What are the best international standards available in regulating crowd funding? Can India seek any benefits from the same?

2.1 Whether crowd funding can accord benefits to India? If yes, how benefits can help in minimizing the costs of raising capital?

1. In a layman word the practice of funding a project or venture by raising many small amounts of money from a large number of people, typically via the Internet. For example, "musicians, filmmakers, and artists have successfully raised funds and fostered awareness through crowdfunding"

INVESTOPEDIA EXPLAINS 'Crowdfunding'

In the United States, crowdfunding is restricted by regulations on who is allowed to fund a new business and how much they are allowed to contribute. Similar to the restrictions on hedge fund investing, these regulations are supposed to protect unsophisticated and/or non-wealthy investors from putting too much of their savings at risk. Because so many new businesses fail, their investors face a high risk of losing their principal[v].

The use of small amounts of capital from a large number of individuals to finance a new business venture. Crowdfunding makes use of the easy accessibility of vast networks of friends, family and colleagues through social media websites like Facebook, Twitter and LinkedIn to get the word out about a new business and attract investors. Crowdfunding has the potential to increase entrepreneurship by expanding the pool of investors from whom funds can be raised beyond the traditional circle of owners, relatives and venture capitalists.[vi]Crowd funding is an innovative way to provide modest amount of funding to young entrepreneurs and technology professionals needing early stage or seed capital for startup companies which may spur entrepreneurship and ultimately assist in boosting the growth of real economy. A company raising funds through online crowd funding platforms or websites offers equity or debt interests in its business to investors who make small contributions, through a crowdfunding platform or social media. In most of the cases funding is sought online on the basis of future projections rather than a viable business model in operation which increases the risk of failures and therefore loss to the investors. If the costs associated with regulatory provisions for investor protection are excessive, crowdfunding may not become a viable capital raising method. At the same time investors would be concerned about the risks of crowdfunding and may not be prepared to invest if there are no adequate safeguards in place. Therefore the approach seeks to strike a balance between retail investor protection and capital market access to such ventures by providing adequate investor safeguard without creating too many entry barriers or significant regulatory burdens on the one off issuers. … Pure Donation Based Crowdfunding (where issuers directly seek donation from the grantors), Reward Based Crowdfunding (where issuers directly offers rewards like movie tickets, new computer game, download of a book etc.) and Peer-to-Peer lending do not fall within the regulatory purview of SEBI, as they do not generally involve issuance of securities for financial return, and may require authorization from other regulators. For example, Peer-to-Peer lending may fall under the purview of RBI.[vii] Crowdfunding has become a serious source of capital to kick-start new ventures and is by far the most disruptive innovation of the 21st century. As an industry, crowdfunding has developed steadily into a primary tool for entrepreneurs and creative people to assess the potential for their ideas engage with specific people who would be interested in these ideas, and also attract the funding which is pivotal to the success of any project. With the industry that's growing at a compound annual growth rate of 74% year on year there are already more than 450 Crowdfunding Platforms worldwide, most in the US and Europe. At the moment India has about 12-15 crowdfunding platforms and the list is increasing day by day.

> '*We increasingly live in a frugal economy were now even small teams can develop and commercialized ideas that only large firms could do in the past. Crowdfunding is the crucial component of this frugal economy now starts-up with relatively few resources can access small amounts from large numbers of ordinary people to bring their ideas to life and to markets.*''[viii]

Pooling in money with contributions from ordinary people for a mission is not new to India. Looking back at the country's history, regular contributions to political, social and religious causes have been there forever. Indian businesses like the multi-million dollar Reliance Empire have been built with modest contributions from small time investors. *Crowd funding isn't just about taking money from a bunch of people, but also about listening to them, taking their feedback and co-creating the final product.*

Crowd Funding: Nature of its Financial Return:

FR crowd-funding globally has grown rapidly in the last 5 years, data suggests that the peer-to-peer lending market doubles each year. It accounts for approximately $6.4 billion outstanding globally.

FR crowd-funding market is worth over $1 billion in the USA, the UK and China, and is taking off in many other jurisdictions across the world. FR crowd-funding has three main business models: the client segregated account model, the notary model and the equity crowd-funding model. The major difference between the two peer-to-peer lending models, the client segregated account model and the notary model, is that in the latter a bank originates the loan unlike the former where the platform originates the loan. The third model, equity crowd-funding, is different from peer-to-peer lending as it allocates stock equity to investors, with the financial return coming in the form of dividends and/or capital growth[ix].

Key benefits of Crowdfunding:

- The primary benefit of FR crowd-funding to entrepreneurs seeking to raise funds as a form of market-based finance is the ability to raise capital, in most cases without giving up large parcels of equity interest.[x] FR crowd-funding spreads risk – the majority of investors are individuals (although some institutional investors are beginning to enter the market) with funding requests filled in much smaller amounts, another benefit is the crowd-funding provides a low cost alternative to channelling savings to the real economy, usually at rates lower than those attainable through traditional funding avenues. The venture and seed capital requests are difficult to access in the current economic environment. Crowd-funding alternatives provide an affordable and attainable option for raising capital:FR crowd-funding can help economic recovery by financing small and medium enterprises (SMEs) which are a key engine of economic growth. It helps those entities more efficiently to access capital for their development and expansion can contribute to job creation and economic recovery.

2.12. Crowdfunding: Key risks associated with:

- **Risk of default**: In equity crowd-funding the risk of default/investment failure is estimated to be around 50%. In peer-to-peer lending there has been a concerted effort by the industry to reduce default rates, which reached a high of 30% in 2009. While there has been some success in reducing the default rate, the actual rate of default in many cases is unknown as many of the platforms have only opened in the last three years and the loans originated by them have only recently started to mature.
- **Risk of platform closure/failure**: Despite the short life of crowd-funding, there has already been a case of a peer-to-peer lending platform closing leaving no data on contracts behind and resulting in 100% investment loss. Investors bear a higher risk than in many other types of investments.
- **Risk of fraud**: This is compounded in both peer-to-peer lending and equity crowd-funding by the anonymity created by the online aspect of these industries. This refers for both the lender/investor and borrower/issuer parties, whereby the opportunity to defraud is an ever present reality.

- **Risk of illiquidity**: Investors cannot sell their participations as there doesn´t exist a secondary market. This lack of liquidity in FR crowd-funding could be a risk for investors if they are not aware of this.
- **Risk of cyber-attack**: As there is a high risk of cyber-attack, the online nature of FR crowd-funding makes FR-crowd funding vulnerable to the risk of cyber-attacks. Lack of transparency and disclosure of risks: Risks tend not to be disclosed until a lender/investor becomes a member of the platform.[xi]

2.13. The evolving trend in India: The Response of Indian Capital Market:

India having given a decisive mandate to its new leadership, the country is poised to not just bring its economy back on track but also explore new ways to solve some of its challenges. It is here where creative concepts like crowdfunding could play a major role, here are some reasons which can benefit India:

1. **More Jobs for Young India.** 9 million Indians enter the job market each year, and this rising number will require the government to prioritize job creation plans, especially if they want the young and restless to be engaged and productive.as there is large number of students graduating each year government has to plan for the jobs so that a developing country can become a develop country. How better to create jobs than to encourage entrepreneurship! Crowdfunding makes it easier for entrepreneurs to access the early capital they need for their business.

2. **Global VCs Track Indian Start-ups. In** Stats like 3 out of 4 VC-backed start-ups fail and do little to increase investor confidence in start-ups; added to that the fact that most global investors, many US-based, tend to focus on start-ups in their vicinity. Therefore for Indian start-ups to grab attention of global VCs(venture capitals) they will need to do much more.in India A successful crowdfunding campaign with some good traction can go a long way in helping investors buy into a start-up's offering.

3. **Customer Demand Leads Production**. The notion that crowdfunding revolves only around funds can be misleading. While receiving funds may be the ultimate goal, it is the engagement opportunity with potential customers that is one of the biggest value-adds of running a crowdfunding campaign. With the delivery time established in the campaign, the product manufacturers can plan their product as per demand. There are many start-ups that have successfully planned and sold products with the help of a crowdfunding campaign. Crowdfunding helps maintain a good inventory turnover.

4. **Collaborative Teams, the New Mantra: some thought-**leaders have been regularly sharing various qualities needed for a start-up to succeed from founders' drive and passion to have the right team in place and a good working relationship among partners. A successful crowdfunding project also requires the various stakeholders to collaborate for the larger goal. For example a product manufacturing company will need its production, delivery, sales and marketing teams to collaborate seamlessly in order to become successful.

5. **Support beyond Family & Friends.** In some of the Western countries where government support is a way out in case of financial difficulties, in India it is the family and friends who tend to be more supportive than any other. With crowdfunding, entrepreneurs may not only have the support of family and friends but also an extended group of early investors who believed in the offering. The support of this larger group can go on to contribute to a start-up's success.

6. **Fund Innovations for Indian Challenges.** Most mature economies, India's challenges are unique and more diverse. Crowdfunding can help address some of the issues: such as supporting rural businesses through micro-financing, non-profits needing funds for causes like poverty alleviation, education, better health, scientific research and business growth.

7. **Policymakers & Businesses Get together.** It may be the case that the central government, various state governments and regulators have the biggest say in whether the benefits of crowdfunding can be realized. The biggest example is the lessons from other countries that have benefited by easing and flexible laws are out there to see, promoting crowdfunding in India may also set a good precedent of having lawmakers, financial regulators and the industry working closely on issues that affect the country's progress.

8. **SMEs Can Compete With Big Businesses.** With the ability to reach out to the masses through crowdfunding, the small

and medium enterprises (SMEs) have a good shot at competing with the bigger enterprises who have the money and resources. With the funding figured, these SMEs can now focus on quality of their products and services. It is widely believed that if India needs to compete with the global powers, it not only needs large corporations but also innovative start-ups to succeed.

9. **Fund Projects For & From the Community.** Most corporates as well as lawmakers spread across political affiliations agree on many of India's priorities, including more citizen's participation in governance and the need to improve infrastructure in the country. Successful crowdfunding projects like funds being raised by local residents to build a foot over-bridge as well as other initiatives that serve a much larger community interest can be a good learning and implemented across India.

10. **Compete Globally Based Out Of Anywhere.** Crowdfunding also helps companies go global. No more does the location of the manufacturing unit or the founders' office matter, not as much as the founders' background and the product itself. Reaching out to the world has become much easier through crowdfunding.[xii]

It will be possible for the entrepreneurship to boom in India via crowdfunding. Many children of families businesses get their entrepreneurship temperament early on in their lives, having had the opportunity to watch their family business from close quarters. **Now with crowdfunding, even youngsters from non-entrepreneurial families can get a headstart with entrepreneurship.** Crowdfunding as a game could be compelling for youngsters. The potential of what crowdfunding can achieve for a country like India, especially its overwhelming youth majority, is massive and outweighs current concerns around fraudulent projects, possible money laundering and other risks- all which with proper checks and balances can be addressed.

2.14. The Regulatory Need:

There are no specific regulations for crowdfunding in India and the current laws with respect to raising money from the public, a start-up cannot really opt for crowd funding, as the same will lead to violation of prohibition against soliciting investment from the public by private companies. There is a need of a set regulation for crowdfunding in India. However, using the Internet for raising funds can have its own issues. Clear laws need to be put in place on whether the Internet sites through which crowdfunding would be done should follow the regulations of SEBI. Whether SEBI guidelines will be acceptable by every website of crowdfunding? India has still not reached that advance stage where it can deal with internet security and awareness amongst people about how to deal with spam and fake web-portals. As the majority of the people are still unaware of the internet security and it's not possible without making people aware of the fake portals and frauds which happens in the internet as there should be advance security for minimizing the malpractices in the internet. The lawmakers, while framing the regulations, should keep in mind that what kind of security features and IT policies should be put in place to make the crowdfunding platform safe and secure from all sorts of cyber risks and hazards, so that it give a rise in capital and benefits the country and the stakeholders. Lack of regulations surrounding investments through crowdfunding, indeed, could leave the investors in a lurch if the companies are found to be badly governed. Regulator(s) need to consider what information about the business, the use of funds raised and the start-ups' founders should be disclosed to investors to guide them in their investment decisions. [xiii] There should be a proper planning before regulating the laws and there should not be that strict the SEBI laws to regulate crowdfunding before framing the laws it should see that there should be enough flexibility for the investors to rely upon crowdfunding. SEBI could also take some examples by looking to jobs Act of us and other European countries before making its laws. There should be a flexibility of that much so that the investor gets enough security for their amount investing upon the projects.

A possible structure which can be proposed in the draft regulations may be in a form where the offer is made through a web based recognized crowdfunding platform only to registered investors who have been given access to the platform. A crowdfunding platform must get itself registered with SEBI and fulfil all the requirements as specified by the regulator and for intermediaries. A company interested in raising funds must get itself registered with a crowdfunding platform by giving a copy of its business model or proposed business plan (in case of a start-up). A copy of the certificate of incorporation and other documents such are secured. The Memorandum of association and articles of association should also be submitted to the crowdfunding platform. This will help investors to know a company well before investing and will give an opportunity to the companies to present themselves and fetch more funds. The crowdfunding platform will also maintain a list of registered investors who will be given access to the platform to invest in the companies displayed on it. The registered investors will be allowed to register only after examination of KYC[xiv] compliances and fulfilment of other requirements like net worth or income, signing of Risk Acknowledgement, etc. Post registration, these investors will be given a Login ID and password to access the platform. Now, the main issue would be restricting the offering to a private placement and not crossing the lines to come under the scanner of public issue. For restricting the offering to a private placement, a company seeking to raise funds can approach each individual registered investor and give an invitation to subscribe the company's shares. Such invitation should be made to such number of investors not exceeding 50 in number, as per the requirement of section 42 of the Companies Act 2013. Further, a chat window should be provided on the crowdfunding website where the company can have a private pre-offering discussion with the investors, tell them about the business plan and ask them whether they are interested in investing. If an investor shows interest in investing, then an invitation to subscribe to the shares of that company can be sent to them. Amendment to the Companies Act is another way by which the offer can be restricted to a private placement.

2.2 Regulation: The Maiden Efforts of SEBI and its impact

In June, 2014, the Securities and Exchange Board of India (the 'SEBI') released a Consultation Paper on crowdfunding in India (the 'Consultation Paper')[xv] to provide a brief overview of crowdfunding and a step towards forming rules for regulating it in India. The Consultation Paper mentions the legal position of crowdfunding in different countries and the different types of crowdfunding. It also talks about the different components which Indian crowdfunding model might possibly have. The SEBI in the Consultation Paper has shown interest in introducing crowdfunding in India in form of equity, debt and fund-based crowdfunding. As SEBI has not shown interest in peer-to-peer based crowdfunding. Under the existing laws, crowdfunding schemes will be governed by the provisions of two legislations, viz., the Securities and Exchange Board of India Act, 1992 (the 'SEBI Act') and the Companies Act 2013. Under the SEBI Act, the significant issue is regarding jurisdiction of SEBI and intensity of its regulation. Under the Companies Act, the main issue is regarding private placement and public offer made by companies while issuing securities to investors.

Companies Act,

From the definition of crowdfunding as given by SEBI, as set out above, it is quite clear that crowdfunding is based upon the solicitation of funds from the public. Section 2(68) (iii) of the Companies Act prohibits a private company from making an invitation to the public to subscribe to securities of the company. So company or start-up which will be needing money from the investors should not be a private limited company whereas the main purpose of this funding scheme is to target small and new private limited companies. Here, the purpose of the scheme is hit by section 2(68) (iii) of the Companies Act. Further section 42(2) of the Companies Act requires that the invitation to subscribe to securities of a private limited company shall be made to such number of persons not exceeding 50. In case an offer or invitation is made to 50 or more persons for the issuance of securities, such an offer could fall within the purview of a 'public offer', requiring a prospectus and associated compliances, including listing of such securities on a recognized stock exchange, which could defeat the purpose and turn out to be very as well as expensive for a start-up.[xvi]

2.21. SEBI Act 1992

The issue raised alone brings our attention to the order passed by the securities Appellate Tribunal (the 'SAT') dated 18 October, 2011[xvii], with respect to the issue of securities by two unlisted Sahara group companies, to 30 million persons approximately.[xviii]SEBI, in its order dated 23 June, 2011[xix], had found that the companies had raised a huge amounts of money from the public without adhering to norms governing public issues in India in relation to disclosure and investor protection.[xx] One of the main findings of the SAT in its order was that a private placement is made to known persons whose number is less than 50 and therefore an issue to more than such a number is a public issue. The SAT observed that in the current case the companies had made a 'public issue' by approaching more than 30 million investors, but by avoiding the requirements of the law. SAT expressly stated in this regard, 'the fact that information memorandum was circulated to more than thirty million persons through ten lakh agents and more than 2,900 branch offices is nothing but advertisement to the public'.

Another important issue deliberated upon by the SAT which is also important in case of crowdfunding was whether the SEBI has jurisdiction to regulate unlisted companies? SAT held that SEBI has jurisdiction over unlisted companies too as long as they can be said to be 'persons associated with securities market'. The SAT also went on to state that when it comes to regulating the securities market and protecting the interests of investors in securities, the SEBI Act is a standalone enactment and SEBI's powers under it are not fettered by any other law including the Companies Act. Going by this order of the SAT, raising of funds by private companies through the internet using crowdfunding platform, where the number of persons to whom securities are being offered is 50 or more who are not specified, may be termed as a public offer and, hence, attract stringent and onerous compliance requirements including listing of such securities on a recognized stock exchange in India. It clearly states that there is a restriction on public offering other than the prospectus based offer and mandatory listing except for private placements of securities. Another issue that should be kept in mind while analysing the regulatory framework for crowdfunding is whether the internet websites on which in these securities are offered will require registration as intermediaries under the SEBI Act, and hence be subject to the SEBI (Intermediaries) Regulations, 2008 (the 'regulations'), and other securities regulations. Section 12(1) of the SEBI Act states that no intermediary who may be associated with securities market shall buy, sell or deal in securities, except in accordance with the conditions of the certificate of registration obtained from the SEBI as per the SEBI Act and the regulations. A crowdfunding platform shall come within the definition of intermediaries and will require mandatory registration provisions. Securities, as defined under section 2 (h) of the Securities Contract Regulation Act, 1956 (the 'SCRA'), include shares of any incorporated company. The preamble of the SEBI Act states that 'it is an Act to provide for the establishment of a Board to protect the interests of investors in securities…'. Under Chapter IV of the SEBI Act, the powers and functions of the Board have been discussed. Section 11 (1) states that '…it shall be the duty of the Board to protect the interests of investors in securities…'. Thus from the preamble as well as provisions contained in Chapter IV (section 11) of the SEBI Act, whenever there is an issue of securities by any company and the interest of an investor is on stake, the SEBI will have jurisdiction. The same was stated by the SAT in the Sahara matter which was later upheld by the Supreme Court.[xxi] if securities are being issued by a company, which is raising funds through the crowdfunding website, it is possible that, the website may be considered as an intermediary dealing in securities, which is bringing the fund raising company and the investors together and, hence, may require a certificate of registration from the SEBI. In addition, such intermediary shall be bound by the norms listed in the regulations including making regular disclosures, maintenance of books, accounts and records, ensuring redressal of investor grievances, appointment of a compliance office, abiding by a code of conduct specified in the regulations and being subject to scrutiny and inspection by the SEBI. From a reading of these related legislations and subordinate legislations, it seems like the website offering services to bring the crowd and the investee company together resulting in issuance of securities may be considered an intermediary and be subject to registration requirements and other ongoing compliances, which may or may not be acceptable to most such service providers. A possible structure of crowdfunding platform which can be proposed in the draft regulations may be in a form where the offer is made through a web based recognized crowdfunding platform only to registered investors who have been given access to the platform. A crowdfunding platform must get itself registered with SEBI and fulfil all the requirements as specified by the regulator and for intermediaries. Further, a company interested in raising funds must get itself registered with a crowdfunding platform by giving a copy of its business model or proposed business plan (in case of a start-up). A copy of the certificate of incorporation and other documents such are memorandum of association and articles of association should also be submitted to the crowdfunding platform. This will help investors know a company well before investing and will give an opportunity to the companies to present themselves and fetch more funds. Bring both accessibility and transparency.

2.3: International Comparisons

The need to regulate crowdfunding was also recognized by the U.S regulators with the passing of the Jumpstart our Businesses (JOBS) Act in 2012[xxii]. This act officially gives legal recognition for crowdfunding. The Act's main purpose is giving a tax exemption to the businesses who use crowdfunding to raise capital. The United States has had many successful crowdfunding campaigns and portals already such as Kickstarter.

SEBI's guidelines would likely be used by any future crowdfunding legislations in India and must measure up to similar standards elsewhere in the world. By comparing the SEBI guidelines to the JOBS Act it can be seen how these standards relate to world standards. We have chosen to use the

JOBS act as our benchmark for two reasons. The first is that the United States has one of the world's largest crowdsourcing portals so it follows their legislations would be more evolved to cope with this market. Secondly like India they also have a common law tradition derived from Britain. Therefore their laws should be more compatible with an Indian legal framework.

In addition to this by looking at the SEBI guidelines we can also see if there are any international solutions to problems in the act itself. This will not be restricted to merely the JOBS act but in general to other countries with compatible legal frameworks.

SEBI has in furtherance to it proposed that only accredited investors[xxiii] can invest in crowdfunding platforms. They also seek to restrict the size of businesses seeking to use crowdfunding to 10 crores. Any business that wishes to seek more than 10 crores would not be eligible and can list on the stock exchange or other forums provided by SEBI.

The JOBS act is similar in setting a limit for the amount of capital that can be raised by crowdfunding. The act holds any business that wants to apply for the exemption would have to be limited to capital of one million dollars or less. This amount would have to be set as a specific target which the business wishes to raise within a specified period of time. Crowdfunding of this type is quite common with websites like Kickstarter using it specifically[xxiv].

There is one area of contrast that should be mentioned here between the SEBI guidelines and the JOBS act concerning investors. As stated above the JOBS act primary purpose is to regulate a tax exemption to crowdfunding. As a result of this invest companies are forbidden from using this exemption. The act also has a lot more protection for investors by giving civil liability to issuers seeking crowdfunding[xxv]. This seems to suggest the act is protecting individuals investing. As opposed to this the SEBI guidelines explicitly state they are restricting those who can invest in crowdfunding to accredited investors. This includes firms and high-net worth individuals (having a gross income of 10 lakhs)[xxvi].

These two sets of legal limitations point to very different approaches towards crowdfunding. In the U.S crowdfunding is intended to ease businesses gaining capital. In particular this act makes it explicit it is targeting SMEs. This would seem to suggest it is targeted more at helping the actual issuers raising funds. The SEBI guidelines by contrast are more explicitly designed to protect the consumer investing money into the firm. This does reflect the attitude of many countries outside the United States who have much more restricted guidelines like Israel and Japan who have banned peer-to-peer crowdfunding[xxvii].

The SEBI guidelines should not restrict investment crowdfunding to only a certain section of the society and should follow the U.S model of allowing free investment. In these regulations SEBI has noted that they would restrict eligible retail investors to putting in only 60,000 rupees. This would dissuade firms from putting capital into such ventures.

India may be inspired by the JOBS act regarding freer investment. Under the Company Act there can only be a maximum of 200 people investing in a private company. SEBI is therefore forced to incorporate this guideline into their crowdfunding regulations[xxviii]. A crowdfunding company would also only be able to attract 200 investors. This would nullify one of the key benefits of crowdfunding which is the ability to reach more people than conventional channels. Also as stated above limitations of how much investment can be made are quite low.

One solution to this would be to amend the Companies Act 2013 to create an exemption. This suggestion has bene made by Debhansu Mukherjee a fellow at the Vidi Center for Legal Policy New Delhi[xxix]. This amendment would be similar to how the JOBS Act amended the older Securities act in America.

This amendment would need to be passed for another reason. Investors in a crowdfunding firm maintain a greater distance from the actual company than normal. For example an investor on Kickstarter would not have any direct say with the finished product or the running of the company. They do not fit in the conventional idea of a partner in a business. One route this amendment could take is to put them in the same category as the people who own debentures of a company. This would give the investors some protection but also not limit their numbers.

SEBI has set out to protect the investors when they give money to the crowdfunded companies. In particular they will have to give financial statements and progress reports on their businesses. These requirements are about the same as what other businesses are required to give under Indian law[xxx]. These guidelines roughly fall into line with what the JOBS act and other legislations say in regards to the requirements for disclosure.

There is one important legal difference that needs to be addressed regarding civil liability. The JOBS act lays out explicit guidelines as to who has liability and who does not. According to Forbes magazine these are even more than comparable liability for other investment platforms in America[xxxi]. SEBI surprisingly does not give a clear guideline in their paper how exactly a civil liability suit would proceed.

This does leave the law in a very odd position. Let us say if someone raises money for his new project using crowdfunding but doesn't produce it and instead uses the money for another purpose. Now if he did that to a normal investor there are fairly steps that can be taken. The investors could approach SEBI to take action, perhaps sue for not fulfilling the contract depending on the terms. However if he uses crowdfunding then there are several gaps in the law. For example does it count as a contract from the investors? In theory this would be the case but in practice who's purview does it fall under to help the investors? SEBI should address these issues more specifically.

SEBI has deliberated upon a mechanism in its consultation paper through which these sort of disputes could be monitored. SEBI mentions that all crowdfunding portals are to be approved by screening committees. These committees are to have a mix of personnel drawn from the industry itself[xxxii]. The guidelines used in forming these committees could be used to form a tribunal. This tribunal would function as a quasi-judicial authority specifically tasked with handling issues related to crowdfunding. These type of tribunals have been used in numerous places inside India. For example the Competition Commission of India.

Alternatively if SEBI wishes they could go wish with another model with looser guidelines with laws modelled from the United Kingdom. The United Kingdom like the United States also has a highly developed crowd funding market. The Financial authorities have a set of regulations governing the rules for arranging investments. These rules cover crowdfunding platforms as they do help in arranging the meeting between investors and investee[xxxiii]. It would be relatively easy to implement a streamlined version of this law in India given the common law shared background.

A further issue could be a possibility combining these two approaches into one. A quasi-judicial tribunal could be formed with a specific mandate passed into law. This type of model can be seen with the Information Technology act and the adjudication officer specially assigned to information technology matters. The immediate advantage is that it frees up the judiciary from having to deal with these issues. On the other hand this might take a longer time to pass the legislation due to the bigger changes made.

It is observed that, SEBI's paper is up to international standards. Aside of the issues of restricting investors and lack of liability it enables quite a vast set up of resolutions. SEBI should however not have such tight restrictions on who can and cannot be an investor. This defeats the very purpose of crowdfunding. In addition to this the SEBI guidelines should borrow from international standards and give a clear streamlined idea of how liability would work in crowdfunding.

3) Conclusion

The SEBI guidelines should be more flexible in allowing people to invest in crowdfunding as seen in the JOBS act 2012, of the USA. This will encourage economic development because it will allow the investor to raise capital while keeping costs to the investor lower.

We will finish this paper by noting the advice of Raghu ram Rajan current governor of the Reserve Bank of India. The governor was speaking about crowdfunding. He noted that most crowdfunding sites tend to not be as secure versus other investment mediums. He noted however Kickstarter was the world's top crowdfunding sties[xxxiv] due to its security[xxxv].

With this in mind we can commend SEBI's guidelines. They have taken steps to protect the customer in the guidelines. This would give security which leads to the investors having confidence enabling crowdfunding to grow, as observed by Mr. Rajan. The government should implement these guidelines but give freer investment as noted above.

We feel the government should emphasise crowdfunding more. It will help young entrepreneurs to raise capital and it would benefit the Indian economy. This would help in minimizing the unemployment rate in the country.

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