

“Crowdfunding in Emerging Markets: Prospects in India”

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ABSTRACT

Start-up firms these days are always seeking a means of acquiring funding to achieve their objectives and foster the growth of their enterprises. Over the last decade, new approaches to acquiring capital have emerged in the business sector. One option is crowdsourcing. Crowdfunding has rapidly become a popular method of financing in a short time. Crowdfunding is a concept that has significant importance. It contributes to the rapid growth of a new and emerging business, while also providing new investment opportunities and diversifying the portfolios of investors. Startups with unique and inventive ideas may be able to secure funding by advertising their concepts on social media platforms. These social media platforms facilitate the connection between entrepreneurs and those who support the cause or have a potential interest in creative concepts. Crowdfunding is still in its nascent stage of development in India. This study examines the use of crowdfunding in India as an alternative means of obtaining company capital compared to stock shares and other financial sources. The objective of this research has been to the challenges and complexities it entails, and its emphasis on Indian circumstances. The study focused on analysing the various forms of crowdfunding and the regulatory framework governing crowdfunding in India. The study asserts that crowdfunding initiatives have significant potential inside the Indian venture capitalist sector, provided that the uncertainty surrounding its laws and regulations is resolved. This concept was first used in the year 2000 and had been rapidly gaining popularity worldwide

Keywords: Crowdfunding, entrepreneur, capital, social media, business, investors.

INTRODUCTION:

“Crowdfunding is the act of requesting modest amounts of money from several investors using an online platform or social networking site for a particular project, commercial endeavour, or social cause.” - Securities and Exchange Board of India (SEBI)

Crowdfunding is an online method that enables companies or organizations to gather funds from many people, either via contributions or investments. This novel method of capital accumulation arose systematically during the 2008 financial crisis primarily due to the challenges encountered by craftsmen, innovators, and fledgling businesses in procuring financial resources. Due to the decreased willingness of conventional banks to provide loans, businesses began seeking other sources of funding (Krishna, 2015).

Crowdfunding originated as a digital expansion of conventional financing from acquaintances and relatives, where communities collectively contribute funds to support individuals with entrepreneurial ideas. In less than a decade, crowdfunding has quickly gained momentum in a number of developed nations, including the US, Australia, the UK, the Netherlands, Italy. This captivating phenomenon is spreading quickly throughout the developed world and is currently attracting a lot of interest in the developing world as well. Investing in projects through crowdfunding involves individuals providing small contributions in exchange for value, allowing the

project to be financed. An online transaction platform facilitates easy communication between investors and small business start-ups and projects, hence increasing investor involvement.

OBJECTIVES AND METHODOLOGY:

The focus of this study has been on providing an overview of crowd financing in India, including its emerging concepts. It also explores the advantages and dangers associated with this business. The secondary information and data have been collected from various sources such as magazines, media reports, government websites, and journals.

1. Exploring the various forms of crowdfunding.
2. Discovering the risk associated with crowdfunding in India
3. To analyze the regulatory landscape of crowdfunding in India.
4. To evaluate crowdfunding as the other sources of finance.
5. To analyze the thriving crowdfunding platforms in India

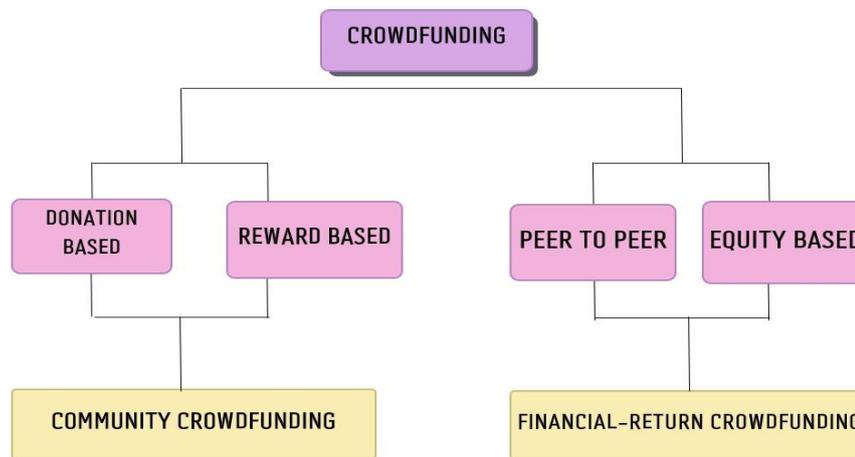
METHODOLOGY:

The study takes a descriptive and exploratory approach, utilizing secondary data gathered from various sources such as reports, books, websites, journals, previous research work relevant to crowdfunding. The paper examines the phenomenon of crowdfunding in India as a viable source of finance. The reports published by SEBI and the World Bank were analysed and were the major source of information.

LITERATURE REVIEW:

1. Crowdfunding is an innovative approach to funding various projects, allowing creators to seek financial support from individuals in exchange for some future products or equity in the business. Crowdfunding campaigns can range significantly in size and scope, from little creative endeavors to large-scale seed cash requests from entrepreneurs looking to bypass regular fundraising channels. (Schwienbacher and Larralde, 2010).
2. In a study conducted by Ethan Mollick (2013) titled "The Dynamics of Crowdfunding: An Exploratory Study," it was discovered that networks and project quality have an impact on the success of crowdfunding initiatives. Additionally, the study revealed that topography plays a role in the types of projects proposed and the ability to successfully raise funds.
3. Investors with a keen eye for success understand that financing is a critical factor in achieving favourable outcomes (Gompers and Lerner, 2004).
4. In their paper "Crowdfunding: Geography, Social Networks, And the Timing of Investment Decisions" (Agarwal, Catalini, and Goldfarb, 2015), it was found that a major obstacle faced by the crowdfunding industry is the disparity in information between investors and those seeking funding. Because of its ambiguity, the crowdfunding platform can be used in a variety of ways.
5. In their study, Meyskens & Bird's (2015) "*Crowdfunding and Value Creation*" investigated the impact of crowdfunding on the funding of social initiatives. They explored various crowdfunding, platforms, and the development of social value.

TYPES OF CROWDFUNDING



Donation Crowdfunding Raising money through crowdfunding is done for philanthropic, artistic, or social purposes. It can be utilized to raise funds for various important causes, such as disaster relief, education sponsorship for those in need, organizing free food camps, and covering medical bills for patients in need. In this type of crowdfunding, the donors do not receive any financial benefits in exchange. People contribute selflessly as an act of kindness. There are no restrictions on the amount that can be contributed. Although this form of crowd-funding may not appear to have significant risks, in India, SEBI has just introduced a '*Framework on Social Stock Exchange*'¹, which allows for donation-based crowdfunding inside a legal framework overseen by SEBI¹. It is therefore advised that the social stock exchange structure for donation-based crowdfunding include social firms.

Example: *Fuel a dream*, a crowdsourcing website with the goal of improving the lives of more than two billion Indians.

Reward-based crowdfunding is similar to donations, but it offers a nonfinancial reward in return. This reward can come in different forms, such as access to a museum, a t-shirt, or a positive message on Facebook. Major players in the industry, such as Kickstarter or Ulule, engage in this form of crowdfunding.

Example:

Fuel A Dream, based in Bengaluru, is a prime example of a successful reward-based crowdfunding platform. It aims to raise Rs 10 crore in a single day within the next five years.

Debit-Based Crowdfunding (P2P): "Crowdlending" operates on the loan principle. People have the opportunity to provide funding, with or without interest, for various projects, whether they are individual or corporate. Since 2016, mini-bonds have been made accessible in France to support small and medium enterprises (SMEs) in utilizing this form of financing through platforms like October or Bolden.

In India, only NBFCs licensed to operate as P2P Platforms are allowed to engage in this type of crowdfunding.

With **Equity-based crowdfunding**, investors have the opportunity to become shareholders in the company they are financing. Similar to a traditional equity investment, the potential return comes from dividends or capital gains on the value of the shares. For instance, the French Tudigo platform allows individuals to invest in local companies within their region through equity crowdfunding. Equity Crowdfunding is deemed as "unauthorized, unregulated, and illegal" by SEBI and is not permitted in India. The Securities and Exchange Board of India (SEBI) in their "Consultation Paper on Crowdfunding in India (SEBI Consultation Paper 2014)" has developed different type of crowdfunding called fund-based Crowdfunding (FBC).

Trends and Scenarios Across World

The United States

Overview of the US Situation the US Securities and Exchange Commission (SEC) has recently introduced a proposal for crowdfunding, outlining the key points as follows:

1. A company has the potential to raise \$1 million for equity through crowdfunding annually.
2. When a company raises over \$500,000, they are required to provide the SEC with more comprehensive information.
3. It is crucial for a company to offer comprehensive educational information to investors, ensuring that they are well informed about their investment and fully aware of the associated risks.
4. Investors who have a net annual income of less than \$100,000 would only be allowed to invest a maximum of \$2,000 or 5 percent of their annual income or net worth each year.
5. Investors who have a net income or annual income exceeding \$100,000 will have the opportunity to invest 10 percent of their income each year.
6. Securities can be purchased through online crowdfunding portals, which are a new class created by the SEC.
7. Securities acquired through portals must be held for a year before they can be sold (Krishna, 2015).

China and The Asia-Pacific Region

Crowdfunding in China gained momentum starting in 2013. Since then, the industry has experienced exponential growth and has now become the leading market for crowdfunding globally.

Despite a decline in the amount of funds raised in 2018, China continues to dominate the crowdfunding market, holding a global market share of 70.7%. In 2018, the Asia-Pacific region, excluding China, saw a crowdfunding volume of \$6.12 billion, which made up 2.0% of the global market share. In 2018, the region experienced an impressive annual growth rate of 69.7% (Agarwal et al., 2011)

Latin America And the Caribbean

Latin American and Caribbean countries are witnessing a steady increase in growth rates. These countries - Brazil, Chile, Mexico, Colombia, and Peru - are known for their vibrant and rapidly evolving markets.

It was projected that transactions in the Brazilian crowdfunding segment would reach \$9.9 million in 2021. There is a wide array of successful platforms to consider. As an example, Broota, a prominent company in Chile, has successfully secured over 4.5 million reals (\$1.1 million) for 11 different companies. The funding amounts have varied, with each company receiving anywhere from \$30,000 to over \$300,000.

Brazil is projected to experience a steady annual growth rate in crowdfunding from 2021 to 2025, reaching a total estimated amount of \$10.6 million by 2025 (Agarwal et al., 2013).

Africa

Investment activity in this region experienced a significant decline of 42.8% in 2017, only to rebound impressively with a growth of 101.5% in 2018, reaching a total of \$209.1 million from \$103.8 million. It is worth mentioning that the majority of crowdfunding in Africa is currently dominated by platforms based outside the continent. However, there is a noticeable rise in the contribution of platforms based within Africa, particularly in Zambia, Kenya, and South Africa. Despite their funding volumes in 2018 of \$40m, \$35m, and \$27m

respectively, none of these three countries rank in the global Top 30. South Africa, for instance, is the proud host of Uprise. Africa is home to Thundafund and Lulalend, two prominent crowdfunding platforms where significant fundraising campaigns take place annually. Thundafund has successfully funded over 1,200 projects since its establishment in 2013, with a total value of approximately \$3 million. Looking at the bigger picture, transactions in South Africa are projected to reach \$0.5 million in 2021, with an annual growth rate of 1.52% from 2021 to 2025. By 2025, there would be a projected \$0.6 million (Alon & Shneor, 2017).

The Middle East

Israel stands out in this region as the sole thriving crowdfunding market. Aside from Israel, the Middle East has a relatively small impact on global crowdfunding volumes. Israel is projected to see a transaction value of \$2.3 million in the crowdfunding segment this year. The industry is expected to experience a steady annual growth rate of 2.56% from 2021 to 2025, resulting in a total amount raised of \$2.6 million by 2025 (Ahlers et al., 2015).

One of the main reasons why crowd funding has thrived in developed countries is due to

- The regulatory framework that capitalizes on the speed, size, and transparency provided by technological and internet advancements. This framework has greatly benefited early-stage funding marketplaces.
- Making use of social media's power and the internet to tap into demographic and technological trends, fostering collaboration and driving cultural shifts.
- A regulated online marketplace that prioritizes investor safety through education and training, while simultaneously focusing on financing formation.
- Collaborating closely with other entrepreneurial events and hubs, including universities, co-working spaces, incubators, accelerators, and business plan competitions, to create a network for coordination and cooperation.
- Establishing a culture of trust is essential for organizations, initiatives, and causes that primarily depend on web-based interactions to get support.

India

India is a massive, emerging nation with a booming economy. Given the massive population and the rapid growth of the middle class, it's only natural to anticipate the rise of crowd funding as a powerful tool for capital formation in this vibrant nation. Equity crowd funding has yet to be launched in India, but it is anticipated to make its way to the country in the foreseeable future.

India is likely to see the emergence of several crowd funding platforms in the coming six months. Across the globe, close to a thousand of these platforms are set to be launched. In the country, there have been recent launches of platforms like Wishberry and Ignite Intent. Due to the lower regulatory barriers associated with this specific model, many of them operate in the incentives and donations market. To raise money for projects like Teach for India and the Goa Project, a number of initiatives have been launched.

Investing in The Future of Indian Crowdfunding Drivers

Given India's status as a major hub for Non-Government Organizations (NGOs), crowdfunding has a significant opportunity for success. There will be a plethora of new platforms emerging in the coming days. Students are encouraged by several universities and people to list causes on crowdfunding websites. The New Companies Act now implemented, requires all companies to allocate 2% of their profits towards corporate social responsibility. This will also contribute to the growing popularity of crowdfunding.

Obstacles/ Challenges in The Implementation of Crowdfunding in India:

1. Concept of crowdfunding is not new in India. Sites of worship, for instance, are rapidly constructed through a substantial influx of donations. Though, online crowdfunding is still relatively new in the nation.
2. The industry is not particularly welcoming to investors. It appears that individuals are still not prepared for this idea.
3. The lack of trust in online activities poses a significant challenge. India's e-commerce industry must undergo significant development before any meaningful progress can be made. For individuals to even consider supporting online projects, they must increase their online spending.
4. The concept of cash on delivery gave e-commerce in India a significant boost. Just like a savvy investor, crowdfunding will need to focus on establishing a physical presence to generate widespread awareness and attract more people to participate.

Potential Risks of Crowdfunding:

Here are some of the risks associated with Crowdfunding:

Shifting from institutional risk to retail risk: ¹

Currently, VCFs and PE Investors are the ones assuming the risk in financing Startups and SMEs. Startups often turn to crowdfunding as a way to secure funding from a wide range of investors, each contributing smaller amounts. As a result, the risk taken on by retail investors, who may have a much lower risk tolerance, replaces the risk typically shouldered by venture capital firms and private equity investors. Some investors may struggle to fully understand the risks involved in these investments and may not have the financial means to handle potential losses.

Investing in small and medium-sized enterprises (SMEs) and startups can carry more risk and may have less liquidity compared to other types of investments. They are often seen as bold and strategic investments with a focus on the long term. Investors in venture capital and private equity will enjoy the chance to secure better pricing and have a say in management decisions. This advantage is not present in crowdfunding, where the goal is to gather smaller contributions from a larger number of investors. Some investors, who lack knowledge and experience, may tend to blindly follow the crowd and base their decisions on the actions of others.

Investors may face challenges in seeking redress from the issuer in the event of default or fraud. The issuer does not explicitly ask for funds, nor does it create any offer document. The platform seeks funding and may or may not conduct extensive research on the issuer. Investors are left without any recourse if a platform is suddenly or permanently closed. Collateral is not present in peer-to-peer financing, just like with Corporate Bonds.

The likelihood of failure increases when participants without the necessary skills and experience to assess risk are involved in investments or lending, unlike Venture Capital Funds (VCF) or Private Equity (PE). Investors, banks, or other financial institutions that provide capital within the traditional business model.

Risk of fraud: There is a risk that some websites may be used by scammers who pretend to be project promoters, or that fraudulent websites may be created to deceive investors or trick consumers into sharing their credit card information, among other things. Therefore, there is a possibility of both misuse and the compromise of cyber-security and/or identity theft.

The Web's Responsibility: Issuers have the opportunity to offer their assets on a crowdfunding platform, an online market. Consequently, the Internet's central position and extensive reach would result in a larger number of people being impacted compared to traditional fundraising methods. There is a potential risk for younger investors due to its association with the Internet and social media.

Systemic Risk:

1. A real concern is the possibility of illiquidity, or the lack of a secondary market where investors can sell their shares and withdraw from the market.
2. There is a possibility of money laundering taking place.
3. Similar to how the subprime mortgage crisis exposed other financial sectors to the possibility of failure, these platforms may also represent the same danger. If the present rate of increase in peer-to-peer lending continues, these risks might potentially become widespread and ingrained in the system.
4. Online requests for money have cross-border repercussions due to variances.

Exploring the Legal Aspects of Crowdfunding:

Uncertainty in the legal context: Certainly, the crowdfunding approach is not fully authorized in India as Sebi has yet to approve equity-based internet crowdfunding in the country. Equity-based crowdfunding allows investors to receive a share of the project they are sponsoring. However, there is a notable risk involved as the recipient can suddenly disappear, leaving the investors puzzled. In India, crowdfunding initiatives can be classified into two main categories: donation/reward-based or lending-based. India's legislation and regulations for crowdfunding are not as effective as those in many other countries.

Preserving intellectual property: Crowdfunding sets itself apart from traditional fundraising methods by engaging a diverse group of individuals who bring valuable expertise and industry knowledge to the table. This allows the entrepreneur to share their innovative concepts with a wider audience, rather than being limited to a small group of investors. It has a negative impact because it enables other entrepreneurs to potentially copy ideas before the investors have a chance to see the concept. Therefore, before releasing their campaigns online, entrepreneurs need to ensure that their ideas are protected by the appropriate intellectual property laws.

Investors would find reassurance in the requirement for all crowdfunding concerns to be channelled through a specific channel. Utilizing a crowdfunding platform that has received official recognition from SEBI. Enterprises have the potential to generate up to Rs. 10 crores in a year by utilizing entities under this framework. As per the proposal by SEBI, only individuals classified as 'accredited investors' will have the opportunity to participate in crowdfunding activities. These investors usually include individuals with significant wealth, large enterprises, institutional investors, and accredited retail investors who are recommended by portfolio managers or investment advisers. There is a suggestion to enable regular investors, who have submitted income tax returns for the past three financial years, to raise funds through crowdfunding. However, this would only be relevant for crowdfunding initiatives that are not associated with a company group generating revenue above Rs. 25 crores. Only entities with a pre-existing business listed on the stock exchange or with a minimum of four years of operation will be allowed.

Crowdfunding in India has the potential to be a secure method of generating finances in the country, although it is currently only considered safe in theory due to the absence of restrictions. India has become quite risky due to the lack of regulations. Therefore, it is crucial to prioritize trustworthiness on these crowdfunding platforms by enacting the required legislation.

Benefits of Crowdfunding:

It's a relatively new concept in India and there's still a lot of unfamiliarity surrounding its benefits. Investing in crowd funding has proven to be highly beneficial.

1. Insufficient funds can pose a challenge for individuals with great potential. With the help of crowd funding, dreams can be realized and obstacles can be overcome.

2. It welcomes individuals with potential and a dream. Crowd funding is beneficial to all types of people, including dancers, painters, writers, singers, photographers, scientists, musicians and planners of events.
3. It makes it easier and faster to raise the project's funding. Making your ambitions come true doesn't need you to wait years to save money or invest your entire life savings.
4. The fundraising procedure is streamlined via crowd funding, allowing entrepreneurs to focus more on their business instead of getting caught up in the tedious aspects of raising funds. Entrepreneurs with limited resources are no longer at a disadvantage when it comes to starting their own companies.
5. Anyone with a little spare cash and an interest can participate in financings. In the end, the industry moves towards a paradigm where intelligence and strategy are the key factors for success. Having a diverse investor base is beneficial for management as it allows them to gain insights from a wide range of perspectives, rather than being dependent on a limited number of parties.
6. Funding is often provided for complex, difficult, and niche ideas. Entrepreneurs who have the freedom to think beyond traditional payback windows can explore innovative models that foster creativity, encourage widespread invention, and impacts the society positively. Unconventional companies have the chance to establish themselves, attract talented individuals, and challenge conventional limits

Drawbacks of Crowdfunding

1. When entrepreneurs rely less on personal investment and no longer have direct interactions with investors, they miss out on the crucial opportunity to persuade others.
2. Information on crowdfunding is significantly imbalanced in terms of what venture capitalists and, to a lesser extent, angel investors acquire through their due diligence. Investors can be vulnerable to fraudulent schemes or simply inexperienced individuals.
3. Bold and unconventional ideas receive funding. Many ideas receive funding nowadays, but the success rate significantly drops with crowdfunding. A majority of crowd-funded investments are unlikely to generate profits, leaving investors at a disadvantage. Although small, fragmented investments help mitigate the risk for individual investors, an excessive number of failures could tarnish the reputation of crowdfunding and lead to stricter regulations.

The Current State of Organizations in India Operating Through Crowdfunding

In India The National Crowd Funding Association (NCFA) is dedicated to promoting crowdfunding in India. The NCFA gives its members the opportunity to shape the sector, learn about the market, and remain updated and innovative in this rapidly evolving profession.

Our goal at NCFA is to provide support, and education, and help establish a thriving crowdfunding market in India. NCFA India maintains an inclusive stance, welcoming individuals from various backgrounds and professions. Regardless of their preferred funding mechanism, anybody can join our membership, including educators, students, media professionals, regulators, lawyers, technologists, investors, entrepreneurs, and industry supporters.

CONCLUSION:

It is undeniable that crowd fundraising is gaining acceptance as a respectable way for start-ups and new enterprises to raise capital. The US and European agencies have begun enacting legislation to make this work. There are significant concerns that necessitate the regulation of this method within the legal framework. India is on the verge of implementing the necessary laws to strongly support this, as an effective crowd funding system has the potential to greatly accelerate the transformation of startup ideas into reality.

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