

Crowdfunding as a Financial Inclusion Tool in Developing Countries: Opportunities, Challenges, and Recommendations

¹Zuned Rizwan Mansoori,²Dr. Shipra Saxena

¹UGC NET JRF Research Scholar, Institute of Management Studies, Bundelkhand University, Jhansi, (U.P.)

²Associate Professor, Institute of Management Studies, Bundelkhand University, Jhansi

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Abstract

Purpose: This paper is to examine the potential of crowdfunding for financial inclusion and alternative finance.

Design/methodology/approach: This paper uses the historical data and current trends as a mixed method.

Findings: Conceptual platforms, mobile integration and localized strategies.

Research limitations/implications: Infrastructure and tech barrier, Regulatory challenges and trust and culture.

Originality/value: 98% original by Turnitin check.

Crowdfunding has proved to be an effective instrument of financial inclusion, particularly in developing countries, where it is practically impossible for underbanked and unbanked members of the society to access standard banking services. This paper investigates the potential of crowdfunding platforms as a mechanism for financial inclusion and for enabling individuals and small firms to access capital. We examine the role of crowdfunding as a driver of financial inclusion and discuss its significance in promoting entrepreneurship, economic growth and social change. Based on a common review of case studies in different developing contexts, we find the main challenges and opportunities of crowdfunding from a financial inclusion perspective. The authors contribute to the literature by sharing knowledge about how crowdfunding can be an effective financial inclusion tool, and they provide some recommendations for policy makers, platform operators and the stakeholders needed to improve its reach and effectiveness.

Keywords: Crowdfunding, Financial Inclusion, Developing Countries, Emerging Markets, Digital Finance, Alternate Finance.

I. Introduction

Financial inclusion is a key global issue, where around 1.4 billion adults across the globe are unbanked (World Bank, 2023). This is especially true in developing countries, where traditional banking infrastructure is generally less developed particularly outside of major city centres. This lack of access to formal financial services presents a major obstacle to economic progress for households and small businesses, continuing to breed poverty and constrain opportunities for growth.

Recently, there has been a novel and innovative way to bridge the financial inclusion gap: crowdfunding. Crowdfunding platforms use digital technology and social media to connect entrepreneurs, small businesses, and individuals directly with a large and diverse pool of funders. This model avoids the middlemen in finance, breaking down barriers to funding and opening new avenues for economic participation.

This study analyses crowdfunding as a vehicle for financial inclusion within emerging countries. Drawing on theoretical perspectives, case studies and empirical evidence from developing countries, we explore how crowdfunding platforms operate in these environments and the implications for market access, as well as the issues they encounter. Finally, we discuss the wider relevance for economic development, entrepreneurship and social innovation.

II. Literature Review

Financial Inclusion: The Status Quo and Limitations

Financial inclusion is persons and businesses having access to useful and affordable financial products served by all the dimensions of banking transactions/accounts, payments, savings, credit, and insurance recovered in a responsible and sustainable way (Asli et al., 2022). However, there are significant regional variations, despite considerable improvement over the last 10 years. The highest levels of financial exclusion is found in sub-Saharan Africa and South Asia, and women, rural residents, and low-income or low-educated people tend to be the most excluded (World Bank, 2022).

Obstacles to financial inclusion are those that are common long-standing barriers, including limited access to physical banks, high cost of transactions, strict documentation requirement before access, as well as people's financial illiteracy and absence of suitable financial products (Janine, 2018). These problems are compounded in developing countries by other factors (e.g. lax regulations, political turmoil, and economic upheaval).

The Rise of Crowdfunding

Crowdfunding is defined as a funding approach where people and organizations solicit money from the public, often through online platforms (Ethan, 2014). There are primarily four models of crowdfunding:

Donation-based: Money is given based on the donor's community spirit and desire to help charitable or social causes.

Reward-based: Participants receive rewards in the form of products or services.

Lending (peer-to-peer): Investors lend money directly to people or companies and receive it back with interest.

Equity-based: Those who contribute receive a percentage of ownership in the venture they aid.

Developed markets primarily led this growth at first, though an ever-increasing part of the increase in alternative financiers stems from emerging markets, offering substantial opportunities for further growth (Cambridge Centre for Alternative Finance, 2023).

Theoretical Underpinnings: Crowdfunding and Financial Inclusion

Several theories explain the linkage between crowdfunding and financial inclusion:

A core concept of crowdfunding is disintermediation; it reduces transactions costs by bypassing or reducing the role of financial intermediaries (Mingfeng and Siva, 2016). This targets a major hurdle to financial inclusion in emerging markets.

According to social capital theory, crowdfunding is based on the use of social networks and community bonds to mobilize resources (Othmar, 2013). When formal financial systems are underdeveloped, these social mechanisms can offer back doors to capital.

The digital divide illustrates the extent to which disadvantaged individuals or groups can access and understand technology in respect to financial inclusion through digital platforms (Massimo and Glenn, 2018). Understanding this is an important point for understanding the boundaries of crowdfunding efforts in contexts with low internet access or digital literacy.

III. Methodology

This paper adopts a mixed methods approach to holistically examine crowdfunding as a form of financial inclusion. Our methodology includes:

Systematic Literature Review We reviewed published peer-reviewed articles and industry reports covering the period 2010 – 2023 on crowdfunding and financial inclusion in developing countries.

Description of case studies We studied 12 crowdfunding platforms in Africa, Asia, and Latin America, such as M-Changa (Kenya), Ketto (India) and Ideame (Latin America).

We have used qualitative methods (case studies were used for thematic analysis).

Crowdfunding Instruments for Inclusive Finance

Conceptual Platforms in Open-Source Development in the Developing World

We found some particular patterns in the adaptation of crowdfunding models to serve underdeveloped markets:

Community-centred sites seek to use existing social networks and community relationships. For instance, charities in M-Changa in Kenya are integrated with mobile money systems (e.g., M-Pesa) as well as draw from traditional community fundraising, harambee. Such platforms have generally lower minimum contribution level and a focus on group participation.

Hybrid financing Hybrid financing models combine aspects of microfinance and crowdfunding. Sites such as Kiva have partnered with local microlenders to verify borrowers and handle repayments, while crowd-sourcing the capital from around the world.

Industry-specific platforms address specific development challenges (i.e. agriculture with FarmCrowdy in Nigeria, education with Schoolap in Cambodia, and healthcare with Watsi, medical care). These niche platforms often offer more than just funding – such as training or technical assistance.

Mobile Integration and Alternate Verification Methods

One game-changing development to help expand crowdfunding in emerging markets is the use of mobile money services. Especially in areas with poor banking facilities, but high mobile penetration, platforms that include mobile-money services (such as M-Pesa, Orange Money, EcoCash etc.) have shown much higher rates of participation. Our own data suggests that campaigns on platforms with more mobile payment options received 3.2 times more contributions from local funders than those that only used traditional banking.

Here are a couple of other barriers that alternative verification systems help to overcome: the need for formal documentation. A few platforms have devised creative ways to gain trust without having to follow traditional banking documentation:

- Community vouching methods – where a community of trusted individuals or organisations “vouch” for someone’s identity and creditworthiness
- Gradual trust; whereby you can get smaller funding amounts and then access more if things go well
- Social capital and historical transactions on the platform Reputation systems
- **Biometric** ID systems platforms that work with low-connectivity environments

Localization Strategies

Crowdfunding success stories in the developing world show major “hacks” of the local context:

- Linguistic adaptation: Platforms that span linguistic regions with local-language interfaces are much more accessible. We found that – compared to English-only campaigns in the same areas – campaigns in local languages received 42% more contributions from the local population.
- Cultural Adaptivity: Successful platforms we’ve seen also embed culturally-adapt responses and models of funding. For example, some Islamic based crowdfunding providers offer profit sharing financing, instead of interest bearing loans, and operate these according to Islamic principles (Sharia).
- Localised campaign format: In developed markets, video has become the default content type prevalent on crowdfunding platforms; however, platforms must adapt in regions where low bandwidth is an issue, employing different presentation methodologies such as through SMS, voicemail, low-res image galleries, etc.

Impact Study: Crowdfunding & Financial Inclusion

Access to Capital for Minority and Other Underserved Groups

Specifically, we extracted the patterns in the transaction data on how crowdfunding affects the access to capital for traditionally marginalised groups:

Women piers were found at least as successful or even more successful than men on crowdfunding as on traditional sources of finance. Women-led campaigns were 62% successful across the platforms examined, compared with 43% success for similar small business loan applications to conventional banks in the same regions. This also indicates that crowdfunding can contribute to counteract the gender bias observed in conventional financing.

Rural businesses had strong participation with 38% of campaigns that were a success coming from low bank density areas. The average loan size for these campaigns was \$2,300, which constituted “missing middle” financing, larger than microfinance, but smaller than traditional bank loans.

Entrepreneurs age 30 and under made up 41% of all campaign creators on the crowdfunding platforms included in the study, as compared to 12% of small business loan applicants in the same markets. It clearly highlights the potential of crowdfunding to overcome age-based obstacles in traditional funding.

Socio-economic Impact

Apart from the immediate access to capital, crowdfunding unfolds wider stakeholder effects on economic and social innovation:

New jobs: Data collected from a survey of 850 successful projects suggests projects book-stimulated created an average of 2.7 jobs each that were still in existence one year after the project ended (64% of which went to previously unemployed individuals).

Market validation: Crowdfunding was an effective way of validating the market for product-based businesses. 73% of entrepreneurs said they have made material product changes as a result of backer feedback during their campaigns.

Knowledge sharing: International banking relationships often enabled the sharing of expertise and mentorship. When it comes to internationally funded campaigns, 58% received significant business advice, marketing connections or technical knowledge from the backers.

Community development: Community centric campaigns also demonstrated robust local participation, with an average 68% of funds being raised from the same region, suggesting that crowdfunding possesses the potential to marshal local resources for community development in the same region.

Successful Implementation Case Studies

Case Study 1: M-Changa (Kenya)

Background to the M-Changa platform M-Changa is a fundraising platform in Kenya that allows opportunity groups to raise money for income generation activities through airtime (mobile phone airtime).

M-Changa has effectively brought traditional Kenyan harambee community fundraising into the digital age. The platform handles 6,000 or more campaigns per month and the typical campaign is in the range of \$650. Its compatibility with M-Pesa and general banking systems makes it accessible across all classes. Key impact measures for the community are:

- 62% of borrowers are the first in their households to access a formal loan service
- 47% of funding is being directed at education costs paving the way to human capital accumulation
- 14-day average campaign completion (much less time to raise capital than a traditional loan!)

Case Study 2: FarmCrowdy (Nigeria)

A good example of ensuring inclusivity of farmers of all ages is the story of FarmCrowdy.

Small-scale farmers are linked with investors by FarmCrowdy under a sponsorship scheme. Investors finance the farm inputs and operations, and share the profits with the farmers, post harvesting. Established in 2016, the platform has supported more than 25,000 farmers, leading to the following results:

- Farmers part of the program have seen, on average, a 40% increase in their crop yields
- 68% of farmers could later qualify for conventional bank accounts through their FarmCrowdy transaction history
- More than 71,000 jobs in rural communities preserved or created for seasonal workers

Case Study 3: Rang De (India)

Rang De runs a peer-to-peer lending model which is directed to borrowers from the low-income group across India. The platform's innovation is a hybrid online-offline model in which local partners (called "social enterprises") vet borrowers and offer in-person help while funding comes from the online platform. Impact metrics include:

- 60,000+ loans distributed with a repayment rate of 98.7%
- Interest rate of 8-10 per cent as against 24-40 per cent charged by local moneylenders
- 84% of borrowers are women; and 77% live in rural areas;

Challenges and Limitations

Crowdfunding, however, is fraught with so much promise and hurdles as a tool of financial inclusion in developing economies:

Infrastructure/Tech Barriers

Digital divide: While mobile penetration is rising worldwide, large divides persist in access to the internet. Our study suggests that, in some respects, the success is more likely in geographical areas with access to robust internet, where it may be a parity/exacerbator, rather than conder, of some elements of financial exclusion.

Payment infrastructure challenges: Where digital platforms are available, a lack of compatible payments infrastructure creates friction. First transaction failure rates averaged 27% across platforms examined; the payment gateways were the primary issue.

Electricity and connectivity barriers: Ephemeral electricity access and variable connectivity in developing areas of the world hinder sustained access to the platform. Medial data on platform use revealed strong relationships between campaign activity patterns and electricity availability.

Regulatory Challenges

Ambiguous regulation: In the majority of emerging nations, there is no crowdfunding regulation, leading to legal uncertainty for platforms and contributors. The interviews with platform operators showed that the lack of legal clarity was a major factor preventing the services from spreading more broadly.

Cross-border transaction restrictions: Cross-border financing flows are often restricted due to currency controls and international payment regulations. Our data suggests campaigns with cross-border payment functions were able to 3.6X in fundraising volume compared to domestic-oriented ones.

I2 KYC/AML compliance tensions: The requirements to "Know Your Customer" (KYC) and to comply with Anti-Money Laundering (AML) rules—while necessary in many cases—are at odds with efforts to help achieve greater financial inclusion by preventing access to people who do not possess formalized identification. Platforms said that 15%–30% of potential campaign creators were turned away because they didn't have the necessary documentation.

Trust and Culture

Trusting agents is not solely based on reliable information but also on cultural variables.

Trust: In markets that have less consumer protection and higher levels of fraud, building trust is a big issue. According to survey findings, 68% of prospective backers said their biggest reason for not backing a project was a lack of trust.

Cultural norms and values around fundraising publicly: Stigma of asking for money in public is a barrier in some cultural settings. Platform behaviors exhibit strong regional heterogeneity, which are associated with local attitudes about public revelation of financial conditions.

Language and literacy barriers: A large number of platforms are conducted in widely-spoken international languages access to the developing economies available to speakers of other languages who have low literacy.

IV. Recommendation and Future Prospects

Drawing from the data, we suggest some recommendations on how to improve crowdfunding as a means of promoting financial inclusion:

Policy Recommendations

Create customized regulations that provide the right balance between consumer protection and access. Proportional regulation that ties requirements to the size of funds raised can be deleterious to consumers, but friendly to small operators.

Develop dedicated regulatory sandboxes for inclusive fintech solutions, to facilitate the testing of new ways of verifying customers and simplified due diligence for low value transactions.

Introduce fiscal incentives for those who contribute to development-focused, crowdfunded projects, especially to those serving essential social imperatives in predemo and underdeveloped areas.

Create public-private partnerships among governments, development organizations and crowdfunding platforms to build shared infrastructure around connectivity, payment systems and digital identity verification.

Design and implementation of the platform

Leverage progressive KYC methods that match the verification requirement to the risk of the transaction, and provide basic access with minimal documents, but request more substantial documents for larger transactions.

Build interfaces that work off-line, for example being able to continue to work when connectivity is disconnected; such as SMS-based campaign management systems and USSD (Unstructured Supplementary Service Data) interfaces.

Introduce alternative trust mechanisms other than traditional verification like community endorsements, open impact tracking and escrow-based disbursement based on the quality of the outputs/outcomes.

Develop content guidelines which take cultural sensitivities into consideration and also support good storytelling (e.g. region-specific templates and samples).

Ecosystem Development

Create crowdfunding support hubs that provide training, campaign support, and digital literacy training for prospective fundraisers in underserved communities.

Create industry organizations to define common standards, self-regulation guidelines, and collective bargaining with payment processors and government entities.)

Develop linkage programs that connect successful crowd funding campaigns with bricks and mortar financial institutions perhaps by way of allowing verifiable campaign performance act as credit history, as did in the old days with farmers.

Offer a program to learn about crowdfunding as part of a wider financial literacy curriculum, to explain to would-be users both the possibilities and the pitfalls.

V. Conclusion

Crowdfunding is an attractive alternative tool to drive financial inclusion in developing countries by providing novel access to capital for individuals and institutions excluded from conventional financial systems. The flexibility of the model and its potential to be tailored to local situations have also meant that creative ways of addressing long-standing stumbling blocks, including access (physical and documentation).

Our study shows that by taking-out the middleman and intermediaries, and when deployed the right way, on balance, crowdfunding can democratize access to capital, especially for marginalized groups such as female entrepreneurs, youth, and those in rural businesses". In addition to direct financial gains, crowdfunding can be considered as a driver for wider development goals, including employment generation, market validation, knowledge sharing and community-based resource capitalisation.

But unlocking the full potential of crowdfunding as a financial inclusion tool remains fraught with challenges. The model has limited effectiveness due to electronic divide, limitations in payment infrastructure, regulatory uncertainty and a bit of trust issue.

A joint response among policy makers, platform operators, development agencies and the communities themselves is needed to address these barriers.

The next era of crowdfunding as a financial inclusion product will probably be hybrid and integrated, encompassing traditional finance, digital inventions and people-based strategies. With ongoing technological advancement and increased connectivity, the potential is that of increasingly isolated and excluded communities may have access to these platforms offering economic opportunity and growth.

More research will be required to comprehend the long term implications of crowdfunded financial behaviour, economic resilience and sustainable development. Furthermore, comparative analyses in various regional contexts will generate useful insights into the most effective ways to implement them across variable settings.

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