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Crowd funding platforms and its Legal compliance



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Crowd Funding - A new way of connecting investor and startup. Technology intensive crowd funding platforms growing day by day to cater to the funding needs of startup businesses. Regulations and Legal compliances comes along with establishing a crowd funding platform. Read on to know more.

What is Crowd Funding

Crowd funding is a modern way of raising funds from large crowd say hundreds or could be thousands or lakhs of people for a new business idea, to fund existing business, to help someone in need (charity), to start a new project, etc. It is a new age platform, it is not similar to traditional ways of raising funds like approaching a bank or NBFC for loan. Crowd funding is intensely IT based, there exist a platform (website) which facilitates meeting of investors, donors, entrepreneurs.



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Business models for Crowd Funding Business

Crowd funding is IT intensive and it falls in the ambit of e-commerce as it is something relating to money exchanging hands electronically.

Like e-commerce websites, there are various models for Crowd funding:

First is the pure Investor and the Investee model: In this model investor or group of investors or donors join hands, pool large amount of money, come on board to website and pitch exciting business ideas or needy person. In this model investor advertise its website for attracting entrepreneurs to publish their creative business proposals. This type of model normally adopted by venture capitalists, Industrialists, high scale philanthropist. In this model investors evaluate various projects published by entrepreneur on their website, then few projects short-listed based on their future viability.

Second is the market-place model: In this model a third person create web based platform which helps to meet investor and entrepreneur. Third person earns commission out of every deal signed via its platform. In some cases, a small amount of registration fees also charged from investor and entrepreneur. Investor and entrepreneurs create their profiles on platform and if both sounds fit for each other things move on to close the deal.

Third is the hybrid model: This model is combination of above two models. Platform which work on investor and investee model as well as on market place model are classified as hybrid model of crowd funding.

Do your home work before closing the deal

Before registering yourself as an investor or entrepreneur on any crowd funding platform check it that it must be genuine, it should not be a sham or scam or a fraudulent platform.

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Check popularity, genuinity of platform. Do your homework properly before closing any deal as an investor specially, if it could be a fraud you end up loosing your hard earned money.

Legal compliances

In India a crowd funding platform needs to register themselves as (AIFs) alternative investment funds with SEBI. These flat forms must strictly follow provision as specified in Companies Act, 2013 for private placement. As an AIF, crowd funding platforms able to pool money only from those individuals (investors) who have a minimum liquid net worth of Rs. 2 crores and the minimum size of investment must be Rs. 1 crore. AIFs can only invest in those companies which falls under the definition of startup as prescribed by DIPP (Department of Industrial Policy and Promotion).

Crowd funding platforms often collect money from hundreds of investors but may not follow public placement norms. As per Companies Act, 2013, a company can allot securities to not more than 200 people in a FY through private placement. If the number crosses 200, it is treated as public offer and SEBI's fund raising norms must be followed.

Crowd funding platforms execute and facilitate transaction between two parties, it seems that there is a bid and offer for the amount of investment. It can be construed as equivalent to activities of stock exchange, if it is a pure market-place based model. In this case crowd funding plat forms shall meet all legal requirements as applicable on stock exchanges. For stock exchange minimum net worth of Rs. 100 crores is mandatory.

Set of rules for crowd sourcing firms in peer to peer lending released by Reserve Bank of India to monitor their activities and to maintain these in line with ethical lending practices.

Fresh arrival of Banning of Unregulated Deposit Scheme Ordinance, 2019 is now one more hit on operations and legality of crowd funding platforms. Crowd funding platforms collect money from large crowd which can be construed as a scheme of deposit, which is now prohibited under this ordinance if not regulated by SEBI, RBI and other regulators. If crowd

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funding platforms get their deposit schemes registered with SEBI, RBI as applicable then this ordinance would not attract and they can operate with ease.

Conclusion

Big amount of money exchange hands through crowd funding platforms, proper regulations over these platforms is mandatory to maintain healthy and robust economic environment. These platforms are also the source of seed capital for new and struggling startup businesses. By keeping this in view these funding platforms should not be over burdened with regulatory compliances. These platforms must also feels like ease in doing business. Excess compliances over these platforms may also shoot up cost of funds for startups.

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