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# MICROFINANCE AND CROWD FUNDING: ALTERNATIVE APPROACHES FOR ENTREPRENEURSHIP DEVELOPMENT

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**Abstract**

As the studies say, most of the entrepreneurs fail to get external finance for their start-ups and ventures due to inaccessibility of traditional finance in the form of banks, VC funds and angel investors. This paper examined the new trends of alternative finance such as microfinance and crowdfunding. Microfinance is not a new option of financing but a new approach for raising funds for microenterprises. Crowdfunding is a technology based online platform for financing a project, business ventures or social cause by a group of individuals. Crowdfunding platforms are not only offering donation and reward based financing, but it also offers equity based funds. This paper analysed the role of microfinancing and crowdfunding as the alternative form of financing for entrepreneurship development.

**Keywords: Microfinance, Crowdfunding, Entrepreneurship Development, Alternative Finance.**

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## Introduction

The Micro, Small, and Medium Enterprises (MSME) sector is the backbone of the economy of any country. It is the principal contributor to manufacturing, exports and employment. It is agreed that the entrepreneurs are behind the MSME sector who play an important role in economic growth, creation of employments and alleviating poverty. Entrepreneurship

development is a systematic and organized development of a person to an entrepreneur. The development of entrepreneurs refers to inculcate the entrepreneurial skills into common persons, providing the needed knowledge, building the entrepreneurial attitudes, and developing the technical, financial, marketing and managerial skills. The government policies and institutions focus on the development of entrepreneurship, not only for pushing individuals from job seekers to job creators, but it also helps in country's economic growth. There are number of government schemes around the globe to support the entrepreneurship development and to eradicate the hurdles such as access to finance, lack of labour force, poor infrastructure etc. As the studies say, most of the entrepreneurs fail to get external finance for their start-ups. The traditional finance is not available to all, just open to well established ventures having low level of risks. Nowadays, the young entrepreneurs and microenterprises are searching the alternatives of traditional finance. Microfinance and crowdfunding are attracting the budding entrepreneurs, as the alternative approaches for accessing external finance for their start-ups and ventures.

## Financial Constraints to Entrepreneurship

Beck, T., & Demirguc-Kunt, A. (2006) present recent studies on access to finance by small and medium enterprises (SMEs) and conclude empirical research which shows that the access to finance is most important constraint for small and medium-size enterprises (SMEs). The financial and legal institutions play an important role in reducing this constraint. There is also a suggestion that innovative financing instruments can help and facilitate SMEs' access to finance even in the absence of well developed institutions. SMEs are more constrained by different hurdles and limited access to finance is one of important of these. Kerr, W., & Nanda, R. (2009) reviews two major streams for examining the relevance of financing constraints for entrepreneurship. The first stream is the impact of financial market development and the second one is the variations across individuals. The researchers highlight the financing constraints is one of the important areas for future policy and research. Beck, T. (2007, April) summarizes recent empirical evidences on SMEs' financing patterns and constraints. The transaction costs and asymmetrical information between lender and borrower are the two factors explaining the limited access to external finance by SMEs in both developed and developing countries. Panda, S., & Dash, S. (2014) research on constraints faced by entrepreneurs in developing countries. The researchers rank different constraints from an entrepreneurs' perspective and observed that financial constraint is most important constraints. According to Andersen, S., & Nielsen, K. M. (2012), the financial constraints are the main obstacles to entrepreneurship due to lower entrepreneurial ability. The entrepreneurial ability can be enhanced by a well-functioning capital market by funding to able entrepreneurs. Maksimovic, V., Demirgüç-Kunt, A., & Ayyagari, M. (2006) find that the finance is one of the binding constraints which has direct association with the firm's growth. The impact of financing obstacle on firm's growth is strong to different samples of countries. Frid, C. J., Wyman and et al (2016) find the relationship between low-wealth business founders and external start-up funding in the USA. The findings suggest that the start-ups by low-wealth founders may be undercapitalised. The low-wealth founders are not getting external funds from formal sources. The business founders having low wealth face significant hurdles to acquire funds during start-up. Hashi, I., & Toçi, V. Z. (2010) assess the obstacles faced by firms in South East Europe (SEE) region due to determinants of financing constraints, credit rationing and financing. They assess based on some indicators and find that the small firms are facing relatively more constraints than the larger firms. The main obstacles are finance, relatively high interest rates and high collateral requirements for the operations and the growth of small firms.

## Objective

The main objective of this paper is to introduce the alternative sources of finance for entrepreneurship development.

## Concept of Microfinance

Microfinance generally refers to micro savings, micro credit and insurance services extended to socio-economically marginalised segments of society. The term "microfinance" can be described as the entire range of financial services rendered to the poor and including upgradation of skills, entrepreneurship development that would enable them to overcome poverty. The important component of the microfinance is credit facilities. The microfinance enables borrowers to set up microenterprises. Microenterprises through microfinance has the potential to generate and raise earnings that ultimately reduce the poverty. Microfinance is an important alternative finance for microenterprises as most of the banks may not come forward to issue small loans. In most of the cases, the microenterprises start their businesses without any external or institutional help. They usually obtain the amount from his own saving or from friends and family. For the growth of business, these microentrepreneurs borrow additional capital from microfinance institutions (MFIs).

## Microfinance for Entrepreneurship

India is facing the high level of unemployment, poverty, and inequalities in the present time. One of the important need of the present time is to create employment. The employment can be created by generating wage employment and promoting self employment (entrepreneurship). Microfinance and entrepreneurship development are two important strategies for generating different types of self-employment in many under developing and developing countries.

### *Literatures on Microfinance for Entrepreneurship*

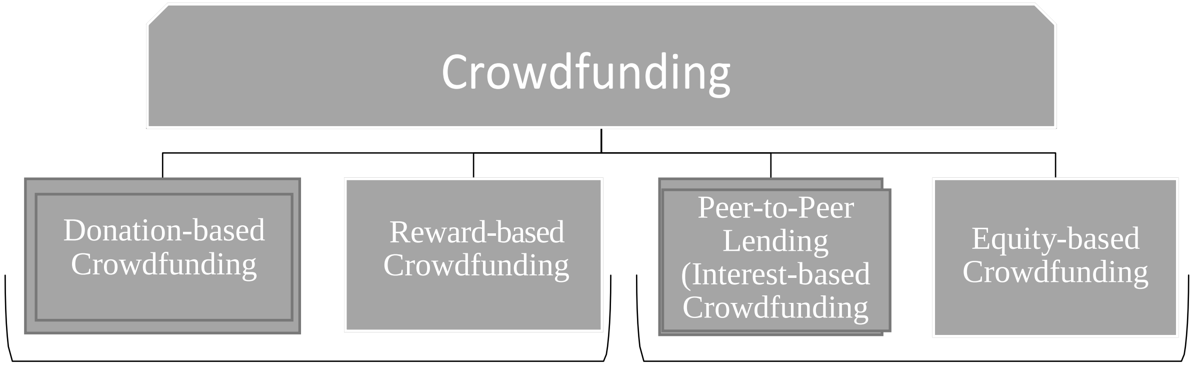
Samapti (2010) concludes that the Self Help Group Linkage Programme (SBLP) promoted by National Bank for Agriculture and Rural Development (NABARD) is the largest microfinance programme. The members of the SHGs have access to formal financial services for improving their livelihoods through entrepreneurship by setting up micro enterprises. It is also found that the micro borrowers of SHGs are graduating to become micro entrepreneurs. The microfinance institutions are evident tools for entrepreneurship development due to the various services they offer and the role they performs towards the development of the economy (Olu, 2009). Microfinance is the most popular form of entrepreneurial support offered to informal sector workers through different models including SHGs, group finance schemes, and social entrepreneurship (Warnecke, 2014). Suprabha, K. R. (2014) argues that the microfinance can be used for income generating microenterprises which alleviate poverty. The members of SHGs who are also the borrowers of microfinance belong to the weaker and marginalised sections of the society. The survival of SHGs depends on members' graduation towards income generating microenterprises for better standard of living. GHOSH, C., & GUHA, S. (2014) find that the micro entrepreneurs in declared and undeclared slums areas in Mumbai, India, also borrow money from micro financial institutes (MFIs). The borrowers from slums areas borrow from a MFI if the gain of investment is higher than the opportunity cost of borrowing. The advancing and nurturing the budding entrepreneurs may be derived from passing along entrepreneurial skills from one to another for long time and it may be also facilitated by providing small credit and entrepreneurial training and sharing (Pisani, 2015). The women entrepreneurs in online business using social networking websites also use microfinance to support their business (Azwadi, Nurasyikin, & Zatul, 2016).

**Concept of Crowdfunding**

According to SEBI, "Crowdfunding is solicitation of funds (small amount) from multiple investors through a web-based platform or social networking site for a specific project, business venture or social cause". Initially, the term "crowdfunding" was coined for charitable donations in a blog post by Michael Sullivan in 2006. Crowdfunding is a new technology-enabled innovative process to raise the funds. It is a novel method for funding different variety of ventures It is allowing individuals for cultural, for-profit or social cause to request funding from the crowd or mass (Mollick, 2014). Crowdfunding has become a valuable source of funding as an alternative finance for entrepreneurs. It allows individual entrepreneur to raise funds through an online crowdfunding platform or social media.

**Types of Crowdfunding**

Crowdfunding can be divided into two categories namely; Community Crowdfunding and Financial Return Crowdfunding and it is further divided into 4 categories; donation-based crowdfunding, reward-based crowdfunding, peer-to-peer lending (Interest-based crowdfunding) and equity-based crowdfunding.




**Source**: IOSCO Staff Working Paper (2014)

**How does crowdfunding work?**

Crowdfunding is an innovative alternative source for raising an external funds. The raising of funds through crowdfunding involves different stakeholders. The best way to understand the working ecosystem of crowdfunding is to identify the participants and their respective influence on the process. There are four major participants in the crowdfunding ecosystem (Beaulieu, Sarker, & Sarker, 2015).

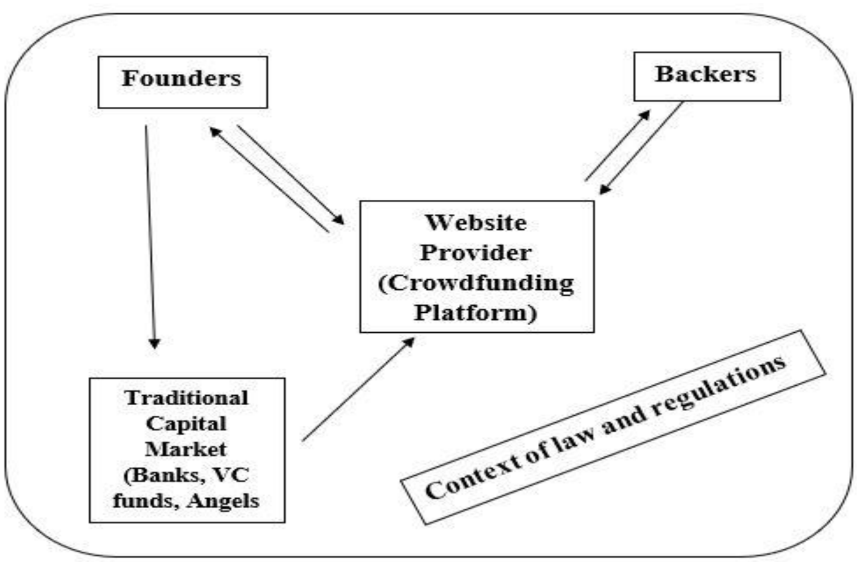



**Figure 1. Crowdfunding Ecosystem**[1]

**Source:** A Conceptual Framework for Understanding Crowdfunding, (Beaulieu et al., 2015).

[1] Figure 1- graphical representation of crowdfunding ecosystem

### Website Providers

As per the review, the crowdfunding is a technology based phenomena in which the online platforms are provided by the website providers. The online platforms allow founders to advertise their project to a large number of potential backers. The website providers also act as a communication channel between the founders and backers with social media sharing facilities. They facilitate the secure payment processing for both the founders and backers. The overall role of the website providers is to create and control the whole crowdfunding process and smooth operation (Beaulieu et al., 2015).

### Founders

The term 'founders' to represent those individuals or a group of individuals who initiate their idea on a crowdfunding platform to receive funding. There is a variety of terms used for founders such as borrower, creator, entrepreneur, firm, owner, and start-up. Apart from raising funds, founders may also use crowdfunding platform to gain exposure for future funding, to test market for an idea, to gain validation, and to build relationship and collaboration with backers (Beaulieu et al., 2015).

### Backers

The backers are those individuals or institutions who invest or contribute the funds as consumer, contributor, investors, crowd funders, funders or lenders. The role of backers, not only contributing funds but also act for testing the market and providing judgement towards an idea.

### Traditional Capital Market

Angel Investors, VC funds, and banks together formed a group, called traditional capital market. The traditional capital market fulfils the role of providing capital to funders. In crowdfunding ecosystem, the traditional capital market also acts as a validator for the existence of a market and explore different price points.

### Legal or Ethical Actors

It is also important to control ecosystem of crowdfunding, so it will be safe and fair to all participants according to accepted legal and ethical way.

## Crowdfunding for Entrepreneurship

The crowdfunding is an extraordinary way for individuals or group of individuals or firms to try new ideas without committing financial resource. The crowdfunding could be a screening mechanism for professional or larger investors. If the project has received funding through crowdfunding platforms, then the project can be approached by traditional investors such as VC funds, and angel investors. One of the important difference between traditional finance and crowdfunding is geographical access of funds. The crowdfunding is not dependent on local bank branch or face to face interaction. Hence, the dependency on traditional investors, investment manager or credit loan officers has been reduced. Now, the entrepreneurs in rural areas can also get the funds from thousands of potential creditors or investors without access to a physical infrastructure.

### *Literatures on Crowdfunding for Entrepreneurship*

Mitra, D. (2012) studies on the crowdfunding and finds that it is relatively new trend in alternative financing and one of the role of crowdfunding is to finance the start-ups. The donation and reward based crowdfunding are comparatively large in numbers than equity based platform. Silver, L., Berggren, B., & Fili, A. (2016) find that the crowdfunding is a way of true democratisation of the financial system as the entrepreneurial ventures can access the funds from the crowds. With the help of social media platforms in various forms, the crowdfunding opens up more options for the entrepreneurs in some industries. According to the pilot study done by Green, A., Tunstall, R. J., & Peisl, T. (2015, May), the crowdfunding overcomes the financial difficulties of the entrepreneurs. The study also reveals that the crowdfunding involves the crowd for acquiring additional funds by the entrepreneurs with maintaining ownership and control over business ventures. Busenitz, L. W., Townsend, D. M., & Anglin, A. (2017) find that the crowdfunding is an emerging form of equity based financing, where large number of online investors contribute small funds for the fraction of ownership in company. The equity crowdfunding has significant legal challenges, but it is experiencing rapid growth as legal obstacles are being relaxed in several countries. Mokhtarrudin, A., Masrurah, I. M. K., & Muhamad, S. C. R. (2017) highlight the crowdfunding process and initiative, which are in practice to provide new funding alternative for the start-ups by youth in Malaysia. The country has its own legal framework on crowdfunding and focuses on donation based and reward-based crowdfunding models. The budding entrepreneurs do not prefer equity based crowdfunding. The young people demand donation-based and reward-based crowdfunding finance to more easily pursue their start-ups.

## Conclusions

This paper has highlighted the financial constraints to entrepreneurship and the alternative approaches for filling the financial gaps for entrepreneurship development. The paper also examined the availability and accessibility of the microfinance and crowdfunding for acquiring the funds by entrepreneurs. The microfinance as an alternative approach, has significant availability from urban to rural areas and it has accessibility to microentrepreneurs and Self Help Groups (SHGs). The legal and regulatory frameworks are available for the operations of Micro Financial Institutions (MFIs). The study also revealed that the crowdfunding, as an alternative finance is a new trend, becoming popular and demanding to raise funds for the start-ups. The young entrepreneurs prefer crowdfunding for their ventures. The crowdfunding can easily accessible through online platforms, but it has limited availability. The crowdfunding is in the initial stage, providing funds to individuals or entrepreneurs through donation and reward based mechanism. The professionals have the advantage to use crowdfunding platform as a screening tool for testing the new ideas. As of date, there are very few regulatory frameworks for the crowdfunding and its operations. The study has a number of implications for future research such as whether crowdfunding does provide the benefits for SHGs as microfinance does. The researchers have the scope to study on a new business model in which micro and crowdfunding offer together for entrepreneurship development.

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