CROWD FUNDING PLATFORM DUE DILLIGENCE COMPRISES

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ABSTRACT

Crowd funding is the use of small amounts of capital from a large number of individual investors to finance a new business venture. Crowd funding makes use of the easy accessibility of huge networks of people through social media and crowd funding websites to bring creditors and entrepreneurs simultaneously, with the potential to increase entrepreneurship by expanding the pool of investors beyond the traditional circle of owners, relatives and venture capitalist. Due diligence is an audit done before entering into an agreement with another party regarding potential investment or product to confirm all facts, that might include the review of financial records. Due diligence comprises background research, site visits, credit verification, inspection, account monitoring, and middle person proof on project finance. We estimate the factors relevant with platforms' compliance expenses, and their due diligence applications. We find that due diligence is associated to legal requirements, platform size, and type or complicated of crowd funding drive. In addition, we find that platforms applying due diligence offer more services to project creditors and funders. Furthermore, due diligence is connected with higher percentage of successful campaigns, more fund contributors, and large amount of capital raised on platforms.

KEYWORDS: Crowd funding, Due diligence, Entrepreneur

INTRODUCTION

It is broadly recognized in highly repeated media releases that crowd funding has significantly changed the entrepreneurship and entrepreneurial financial ecosystem. Relative to the better studied traditional form of finance involving banks, venture capital, private equity, and Initial Public Offerings (IPOs). Crowd funding likely involves a more expressed democratization of capital, with the frequency and success of capital more equally distributed across gender and project types. Crowd funding pushes the creative process, permitting innovation and entrepreneurship at new level of strength not previously possible through traditional form of entrepreneurial finance, in recent years, the volume of crowd funding hat at least doubled annually around the world.

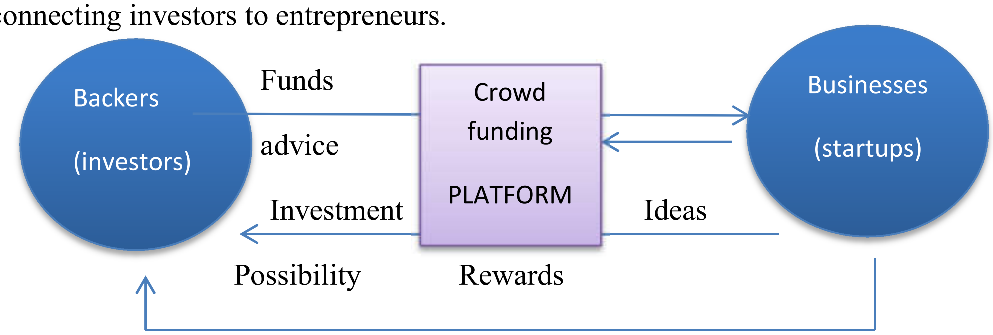
With the development in crowd funding markets around the world, numerous questions arise for which answers are not easily transferable from other types of entrepreneurial finance. One earlier unfamiliar is very essential: are all types of platforms, the same, purely providing comfort of association between individual funders and those who need capital? Or, do floors, in fact, vary, suggesting immense inequality for the projects success and capitalist returns given the huge information imbalance between venture capitalist with capital and entrepreneurs who need capital, outstanding to the insufficient or not contemporary expose requirements when an entrepreneurial enterprise is not publicly listed on a fund exchange, it becomes vital to apprehend what crowd funding platforms actually do and whether they affect entrepreneurial outcomes and funder returns. Similarly, as many international regions strive with enactment relevant to crowd funding, it is vital to know what role platforms can, should, and/or might play in the governance of crowd funding marketplaces.

In this paper, we address for two questions. First, what elements are combined with the operations of crowd funding due diligence? Second, is there a benefit linked with due diligence in terms of more successful crowd funding contest? We address these questions with data set associated from 93 Canadian crowd funding platforms. The data comprise a bulk of crowd funding marketplace in Canada, and were collected by a eminent sales person (The National crowd funding and Fintech Association of Canada, or NCFA Canada). The data facilitate the direct investigation of what crowd funding platform do. In particular, we check crowd funding due diligence, meaning the guarding of projects that explore listing on crowding platforms. We also check other value-added services provided by platforms that go above due diligence. Finally, we appraise the elements that effect the operations of due diligence and other services, as well as whether due diligence provided by platforms is combined with the success of project campaigns.

The data examined reveal that crowd funding platform due diligence comprises background checks, site visits, credit checks, and middle person proof. The data indicate that due diligence is more prominent for larger crowding platforms and for equity and lending crowding platforms. In addition, the crowd funding enactment modernize creates a perfect impact on platform due diligence application. We further find that due diligence operations not only helps fund raising campaigns but also helps to increase number of shareholders and total amount of fund raised on a platform. We contend that due diligence application benefits the crowd funding process by screening lower quality or fake projects and reducing information inequalities between project issuers and funds.

Our paper is combined to a growing number of studies on cost-based crowd funding, capital crowd funding, and crowd funding legislation. A familiar quality of these papers, however, is that the differences across platforms are not analytically studied, as the data commonly come from just one platform. Our paper is difference in analyzing variations across platforms on due diligence application using proprietary data on platform applications. Our paper is, likewise, related to other forms of entrepreneurial finance, such as work on investor effort; most directly, our paper relates to work on the importance of due diligence, investor value added, and venture capital and private equity reputation. There is evidence of massive heterogeneity across private equity funds in the extent of due diligence carried out prior to investment, and a positive correlation, and even a causal connection between the extent of due diligence and the investor firm's subsequent performance, consistent with theory. Inspired by these related studies, our analysis examines the presence and impact of due diligence on fund raising campaigns in the relatively new field of crowd funding

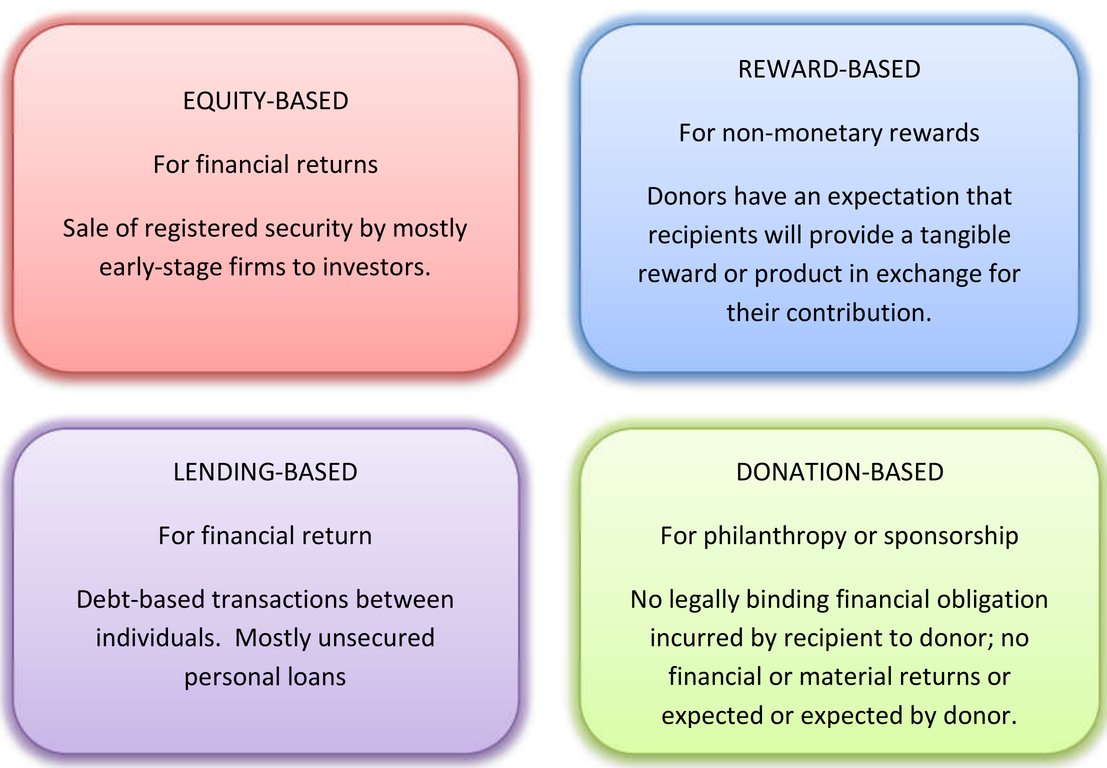
Investors (backers) are the members of the crowd funding community who decide to commit their financial resources to the project. Intermediaries are web sites, which aims at connecting investors to entrepreneurs.



TYPES OF CROWD FUNDING MODELS

As per IOSCO Staff Working Paper - Crowd-funding: An Infant Industry Growing Fast, 2014 ('IOSCO Paper'), Crowd-funding can be divided into four categories: donation crowd funding, reward crowd funding, peer-to-peer lending and equity crowd funding.

What are different crowd funding models?



BENIFITS AND RISK OF CROWD FUNDING

The existing literature also explores the benefits and risks associated with crowd funding. This section covers the following aspects.

• Benefits of crowd funding, including those relating to the 'crowd' aspect of crowd funding—referred to as the 'wisdom of the crowd'

. • Project risk—in particular, the risk of default (borrowing) or failure (equity).

• Asymmetric information—in particular as it relates to investors lacking information about the risks and/or expected returns of their investments.

• Adverse selection resulting from ex ante (i.e. pre-investment) asymmetric information and giving rise to a risk of systematically low-quality investments.

• Moral hazard resulting from ex post (i.e. post-investment) asymmetric information and giving rise to a risk of funding being used for purposes other than those intended by investors. • Liquidity risk—in particular, the difficulty of exiting investments faced by investors due to liquid secondary markets.

• Risk associated with platform failure.

• Other risks.

• Investor experience and risk awareness.

• Platform measures to address various risks.

THE WISDOM OF THE CROWD, AND OTHER BENIFITS OF CROWD FUNDING

The benefits of crowd funding, some of which were mentioned above, include the increased scope for spreading risk (especially for small investors with small portfolios), potentially higher returns, and increased access to investment opportunities. In addition, as discussed above, by 'cutting out the middleman', crowd funding can reduce systemic risk and lower administrative costs. The latter is also achieved by replacing more thorough due diligence with quick project screening (but which also gives rise to potential risks, as discussed further below). There are a number of other benefits relating to the 'crowd' element of crowd funding. In particular, a potential benefit of crowd funding is its scope for pooling information and experience from a wide range of investors. To the extent that investors from the crowd are also potential consumers, successful crowd funding can be a form of market testing, allowing entrepreneurs to better understand consumer preferences and product demand.46 Investors from the crowd can also contribute their own ideas, allowing for 'user based innovation' as well as 'mass customization'. 47 However, the added value from investors from the crowd may be limited compared with business angels.

SWOT ANALYSIS OF CROWD FUNDING

Strength:

- Entrepreneurs maintain control over their company's decisions
- Capital is very accessible
- Opportunity to test idea marketability
- Benefits for communities both locally and internationally

Weakness:

- Administrative and accounting challenges
- Ideas and business models presented public can easily be stolen
- Weaker investor protection and potential for fraud
- Internet-based, so investors might lack detailed advice

Opportunities:

- Utilize the power of social networks for promotion, and connect with crowdsourcing
- Positive effects of crowd funding on economy
- Niche investment opportunity/way to raise capital

Threats:

- Current legal restrictions in some jurisdictions are not suitable for equity crowd funding
- Risky nature of small businesses

OBJECTIVES

- To study the model of crowd investment
- Investors perception on crowd investment

REVIEW LITERATURE

Crowd funding is an developing space of studying the broader range of entrepreneur ship. Since 2012, investigation undertakings are gradually evolving, assuming the keystone for a encouraging track of study. To fetch the evidence to this uneven field and to further proceed the scientific process, we conduct a systematic literature review of 113 journal contributions and gray papers, published between 2012 to 2017. Based on an broad evaluation of recognized publications, we define the landscape of the crowd funding region focused on two aspects. First, we conduct a detailed analysis of crowd funding analyze to depict the scientific development. Second, we classify relevant contributions into five different perspectives: capital market, entrepreneur, institutional, investor, and platform and perform a thematic analysis to reveal dominant motives and sub-motives within each prospect. Our analysis highlights several assuring supervision for supportive farther improvements in crowd funding analysis.

CONCLUSION

In this paper, we have estimated the aspects affecting the functions of due diligence, as well as whether due diligence by platforms is combined with project success. Our paper provides examination of empirical data on this topic, made possible by the innovative data collection efforts of NCFA Canada.

The data farther intimate that the functions of due diligence in general has a positive influence on the capital raising success rate, total amount of fund raised on the platform, and total number of creditors, controlling for platform service or project category. The positive association between due diligence and fund raising success shows the important value for Crowd funding platforms in limiting the number of lower quality projects they list through active due diligence.

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