Policy Paper

Crowd-Funding in Microfinance in India: Issues, Challenges and Opportunities

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Background and Scope

Crowd funding is a relatively recent phenomenon whereby a large number of individuals pool their often relatively small financial resources to support efforts, projects or campaigns initiated by other people. The process of several individuals pooling their financial resources happens via an internet-based online "Crowd-Funding platform" (CFP).

The largest such platform in the international development field, Kiva.org, has channelled over US$ 427 million from about 1,300,000 micro-lenders through about 296 affiliated field partners (mainly microfinance institutions) in 85 countries to over a million micro-borrowers in developing countries.

Crowd funding exists for a variety of funding modalities including donations, in-kind rewards, lending and equity investments. The link between the individual crowd-funder and the recipient can be direct as Person-to-Person (P2P) or indirect, for instance through an investment/social fund. The motivation of the funders can range from purely philanthropic to purely financial, with the majority finding themselves in the middle and expecting a 'dual return' of social and financial benefits. Contributions of individual funders are typically too small to finance the entire project; hence a need to pool resource results in major value addition from CFP.

The massive demand for affordable microcredit across the country warrants a wide diversity of mechanisms and channels for mobilizing the huge amounts of funding required by the microfinance sector. Crowd funding is one such potential mechanism that needs to be further supported and nurtured in order for it to become a major source of funding for microloans in the country. Since the model is new, there is need for documented information and analysis drawn from the existing experiences in order to identify the potential and opportunities, the challenges to scaling up and the enabling factors required to overcome these.

This paper intends to plug this gap through a well-researched document on the status of crowd funding in microfinance in India, regulatory and other constraints and recommendations for scaling up.

More specifically, the paper will cover the following aspects:

- Study and present the existing models of crowd-funding in microfinance in India including sectors, products, processes, technology, marketing, management and leadership, strategic partnerships, innovations/USPs and business models and sustainability.
- Identify operational challenges faced at all levels of the value chain – investors, crowd funding institution, field partners and clients.
- Specifically understand the benefits and risks involved in the web-based lending process for investors
- Assess the existing regulatory framework for crowd-funding in India and recommend broad policy advocacy requirements for this channel
- Examine the technology and infrastructural investments required for the model
- Assess the future potential of the crowd funding model based on the experience so far
- Make recommendations for investments and support required for scaling up of crowd funding in microfinance in India, including areas in which the PSIG programme can support

The scope of this policy paper is to study existing business model in the web enabled loan based crowd funding for social sector. Other model of crowd funding namely, equity, grant or reward based model are not studies in this policy paper. In person discussions were carried out with senior representatives of 3 main crowd funding portal (CFPs), Milaap, Rang De and Micrograam. In order to gain MFI perspective, in-person discussions were held with two microfinance institutions (MFIs), Mahashakti Foundation and People's Foundation (Non-profit arm of Annapurna Microfinance).

Limitations of the paper

Detailed financial statements are not provided by CFPs therefore detailed sustainability and profitability analysis could not be carried out. Although Rang De has financial statements available on the website and efforts were made to understand some aspects of their business model some necessary information were not provided despite repeated request.

Business model related financial information provided by CFPs and MFIs could not be verified with documentary proof. Information on international CFP, Kiva.org is based on secondary sources as it could not be verified by any Kiva representative. Information on regulation and legal aspects of business are not verified with any competent authority on these subjects.

These issues require more in-depth analysis and could possibly be considered as follow-up study of the paper.

Structure of the paper

First section of this paper starts with brief introduction on ***Crowd-funding and different types of Crowd-funding models***. It also cites ***current status of global Crowd-funding*** and the ***status of Crowd-funding in India*** with an ***introduction of existing Crowd-funding platforms*** in the country.

In the second section of the paper, ***detailed information on three major CFPs*** engaged in social lending are provided. Paper further studies five critical aspects of Crowd-funding models in social lending/microfinance:

1. ***Business models and sustainability analysis***
2. ***Partnerships***
3. ***Fund raising***
4. ***Technology***
5. ***Regulations and challenges of transparency***

The third and last section of the paper identifies ***possible enablers to strengthen crowd funding based social lending in India*** and ***concludes*** with a possible way forward in this space.

Crowd-Funding

Crowd-funding is a phenomenon where money is solicited for an idea, business venture, creative composition, and product development and so on from individuals across the globe, falling under different demographics, geographies through public domain. The domain could be media, internet or social networking. The underlying motivation is individual willingness to support the idea by funding it in small or big way.

There are following models of crowd funding -

Donation Based Crowd-funding - This is a concept where donors come together for common cause, for example arranging a community event, relief for victims hit by natural calamities, funding education for a school operating for economically weaker sections etc. Such kind of crowd funding does not have a return motive attached to it. Donors donate amounts if they believe in the idea and are ready to support the cause without expecting returns for their donation. **Examples of websites operating on this model: Kickstarter, Crowdrise, Globalgiving.org**

Reward Based Crowd-funding - Reward based Crowd-funding is a method where an individual or a group solicits funding on the public domain to fund their idea, innovation, development etc. The funder in return of his/her funding receives a token or reward from the solicitor. The reward could be anything from a pre-released signed copy of music album, or a preview invitation to the film launch or a prototype of the invention. Reward-based Crowd-funding has been used for a wide range of purposes, including film creations, music video creation and release; book publishing, free software development, inventions development, scientific research, and civic projects.
Examples of websites operating on this model: Kickstarter, Quirky, Tilt, Indiegogo

Debt Based Crowd-funding - Debt based Crowd-funding also known as peer to peer lending (P2P) or marketplace lending is a process where and individual or a startup business firm solicits fund from investors in return for interest based repayment. This is a parallel process of lending in a non- banking sector where the interest rates varies from low to high depending on the scale of risk involved in the project.
Examples of P2P Crowd-funding Platforms: Lending Club, Zopa, Prosper, India based faircent.com, i-lend.in

Equity Based Crowd-funding - Equity Crowd-funding is a concept where a group or crowd of investors invests in a business venture or a startup in return for equity in the business. Investors invest their money in return for a stake in the business; the stake on the business being directly proportional to the size of investment. If the business or the startup succeeds then the value of the stake or the shareholding goes up and vice versa.
Equity Crowd-funding generally is subjected to securities laws, because it deals with securities and investments.

Examples of Equity based Crowd-funding Platforms: Onevest, CircleUp, AngelList, and Crowdcube

Current Status of Global Crowd-funding

As per Massolutions Report 2015[1] on crowd-funding, global crowd-funding experienced accelerated growth in 2014, expanding by 167 per cent to reach $16.2 billion raised, up from $6.1 billion in 2013. In 2015, the industry is set to more than double once again, on its way to raising $34.4 billion.

The strong growth in 2014 was due in part to the rise of Asia as a major crowd-funding region. Asian crowd-funding volumes grew by 320 per cent, to $3.4 billion raised. That puts the region slightly ahead of Europe ($3.26 billion) as the second-biggest region by crowd-funding volume. North America continued to lead the world in crowd-funding volumes, growing by 145 per cent and raising a total of $9.46 billion.

Table – 1

Growth Rates by Region in 2014	Growth Rates By Models in 2014	Most Active Categories in 2014
A. North America: Volume grew by 145% to $9.46 billion B. Asia: Volume grew by 320% to $3.4 billion C. Europe: Volume grew by 141% to $3.26 billion South America, Oceania and Africa: Volume grew by 167%, 59% and 101%, respectively	A. Lending-based Crowd-funding grew 223% to $11.08 billion B. Equity-based Crowd-funding grew 182% to $1.1 billion C. Hybrid-based Crowd-funding grew 290% to $487 million D. Royalty-based Crowd-funding grew 336% to $273 million Donation- and Reward-based Crowd-funding grew 45% and 84% respectively	A. Business & Entrepreneurship at 41.3% / $6.7bn B. Social Causes 18.9% / $3.06bn C. Films & Performing Arts 12.13% / $1.97bn D. Real Estate 6.25% / $1.01bn Music and Recording Arts 4.54%/ $736m

While rewards- and equity-based campaigns typically get the most headlines, it is lending-based crowd-funding that dominates the industry: in 2014, it raised $11.08 billion dollars. Part of that, according to Massolution Founder and CEO Carl Esposti, is explained by the strong growth of crowd-based lending in Asia, stemming largely from the Chinese market.

Business and entrepreneurship remained as the most popular Crowd-funding category, collecting $6.7 billion in 2014, which represents 41.3 percent of total Crowd-funding volume. Social causes ($3.06 billion), films and performing arts ($1.97), real estate ($1.01 billion), and music and recording arts ($736 million) rounded out the top five categories.

The Indian Perspective

Crowd-funding in India is still in a nascent stage. The models currently in operation are the Donation based Crowd-funding and Reward based Crowd-funding. Major crowd funding platforms in India are following.

Rang De.org - Rang De began its operations on 26 January 2008. The inspiration for starting Rang De was the thought that the peer-to-peer lending model could be transformed to lower the cost of micro-credit. Rang De is a non-profit organisation. They earn a nominal commission of on all the loans repaid by the borrowers.

[1] http://reports.crowdsourcing.org/?route=product/product&product_id=54

Milaap.org - Milaap was formed in June 2010. The founding members of Milaap shared a common vision i.e. to change people's concept of giving and make it a personal, transparent and sustainable process. It does not charge any commission from the funds you lend on Milaap. Instead, Milaap charges its field partners a 5% fee for the funds raised.

Micrograam.com – Micrograam was formed in 2009-10 by Dr. Rangan Vardan and Sekhar Sarukkai. Its focus is to connect social investors with individual borrowers in need of loans for income generating activities, microenterprises and employment training programs. Micrograam is a for profit model where Micrograam charges 2% fees for fund raising and 7.5% APR as transaction processing fees.

Ketto.org - Ketto was launched on 15 August 2012. It is the brain child of Varun Sheth, Kunal Kapoor and Zaheer Adenwala. Ketto provides a platform where you can provide support for the causes you think are important. It was launched with the idea to bring a positive change in the society. Its partners and supporters include- Google Grants, KWAN, CAP India, DASRA social Impacts.

IgniteIntent.com - Ignite Intent was formed in April 2012. It is a platform where people can showcase their talents and tell the world about their idea and subsequently get funded. IgniteIntent enables artists, teachers, filmmakers, business start-ups, musicians, designers, housewives, sports persons, journalists, researchers, writers, explorers, dancers, curators, performers and others to transform their dreams into a reality.

Wishberry.in - Wishberry.in began its operations in the year 2012. It is a Crowd-funding platform for anything creative and out of the box. Their 8 defined categories are: Arts, Performing Arts, Events, Design, Technology, Publishing, Film and video and Food.

Foreign Crowd-funding platforms like Kiva also have operations in India in partnership with local partners.

Profile of Prominent CFPs engaged in social lending/microfinance in India

Rang De (www.rangde.org) - Rang De is a Bangalore based non-profit charitable trust with focus on income generation and education loans but mostly serving to all needs of low income households of select set of field partners. Rang De has tax exemption approval under section 12A of Income Tax Act, 1961 and is also approved by section 80G for tax benefits. Rang De has FCRA registration to receive foreign grants.

Rang De is promoted by husband–wife duo, Smita Ramakrishna and Ramakrishna NK. Smita serves as the Managing Trustee on the organisation's board. She has a Master's Degree in Social Work and comes with a rich experience of working for non-profits and social initiatives in India as well as the United Kingdom. Ram is the Chief Executive Officer of Rang De. He was slected for the Ashoka Fellowship in 2012. Prior to starting Rang De, Ram worked as Principal Consultant for Vignette Europe Limited and has consulted for some of the world's best companies.

Rang De was set up in 2007-08 with support from ICICI Foundation. ICICI Foundation provided grant support to Rang De for its operations and for facilitating low-cost loans to beneficiaries across India. Rang De's corporate partners provided revolving funds for on-lending to MFIs. These partners include ICICI venture, Zoho Corps, Trafigua Foundation, Freshdesk, Spark Capital, Muthoot Papacchan Group, Vernalis System, Sagtaur, Aura, Cosmic Circuits, Fairmacs Group, Neev Technologies, Assystem, smartclues.com, Hyjiya.com, Snuvik, Wisdom times. Rang De has received grant funds from World Bank through the Development Marketplace (DM) to scale up its operations and to deliver low-cost financial support to the most underserved low-income groups in Madhya Pradesh.

Rang De is governed by a formal board of trustees who oversee the operations of the organization and also support the management team. Ran De trustees include Prof. P Sudarshan and Mr. A Ramanathan. Prof. Sudarshan is former Professor of Entrepreneurship at Great Lakes Institute of Management and was founder president of ICICI ventures Ltd. Mr. Ramanathan has held several posts at NABARD during his tenure, including one in the financial inclusion department.

Rang De is also supported by an experienced team of directors, which include Mekin Maheshwari (Chief People Officer at Flipkart), Shobha Punukollu (alumnus of NIT Karnataka and IIM Calcutta, working on a voluntary basis for a Singapore-based humanitarian organization), Manoj Kumar (An alumnus of Harvard Business School, works independently as a board advisor, strategy consultant and investor) and Harish Hande (co-founder of SELCO-India).

Micrograam (www.micrograam.com) - MicroGraam Marketplace (MicroGraam) is a Bangalore-based crowd-funding lending platform that aims to promote development and growth throughout India by providing underserved populations with access to formal loan financing. Micrograam was incorporated in Nov 2009 with the objective of creating a marketplace for microfinance and to play the role of a facilitator to increase the availability of micro finance to rural Indians who would not otherwise have access to financial services.

75-80% portfolio of Micrograam is in **i**ncome generation / microenterprise sector. Remaining portfolio consists of education loan and micro-ventures focusing on essential services like water plants, water-sanitation, clean energy and handicrafts.

Micrograam has a non-profit Section 25 Company, *MicroGraam Social Development Foundation*, and a for profit entity, *MicroGraam Marketplace Pvt Ltd*. Micrograam positions itself as a for-profit crowd funding platform; however the relationship between these two companies and their respective functions is unclear.

Micrograam was founded by Dr. Rangan Vardan and Sekhar Sarukkai. Dr. Rangan was the Head, Banking and Capital Markets Domain Competency Group at Infosys Technologies. Sekhar Sarukkai is a successful entrepreneur; and his last two companies were acquired by Cisco Systems and Oracle. MicroGraam's Chairman is former Infosys CFO, V Balakrishnan. Micrograam has the backing of several tech entrepreneurs including Kris Gopalakrishnan, S D Shibulal, and Ranjan Pai of Manipal Group.

In March-2014, MicroGraam inked a strategic partnership with Kiva.org enabling people globally to fund low-income microfinance borrowers in MicroGraam's network of NGO partners in India. The partnership expands Kiva's ability to crowd fund microloans in India. Kiva committed to raise up to $2 million (Rs 12 crore) as the first tranche over two years under this partnership that comes under the purview of external commercial borrowing (ECB) as per guidelines set by the Reserve Bank of India (RBI). As per Kiva's website, in June-2015, Kiva has outstanding loan of $296,625 to Micrograam which is much less than what the partnership initially envisaged.

The minimum loan term from Kiva to MicroGraam is for three years as per RBI guidelines. Even if loan term to a borrower is for one year, MicroGraam will collect it back from borrower and is allowed to relend it. By partnering with Kiva, MicroGraam will be able to grow its loan portfolio and expand the impact in the Indian microfinance market. With the addition of Kiva capital and access to its large network of lenders, MicroGraam will be able to forge new partnerships with social organizations, connecting more rural areas with critical capital and bringing financial services to those who need them the most. For loans funded through Kiva, interest will only be paid to cover costs at MicroGraam and the partner organization. Interest will not be paid to the lender, as is the case with all Kiva loans. This mechanism empowers not only the borrower, but also MicroGraam and MicroGraam's partners. MicroGraam loans that are backed by Kiva lenders are provided to borrowers at 9.5% - 14.5%. Since Kiva loans are in US dollars, Micrograam needs to bear the cost of hedging forex risks.

Milaap (www.milaap.org) - Milaap is a for profit social enterprise that enables people around the world to provide loans to the working poor in India. Based in Bangalore and Singapore, it is the world's first and currently, the only online micro-lending platform that enables non-Indians and non-resident Indians (NRIs) to provide loans to working poor in India.

Milaap is co-founded by 3 young entrepreneurs (Anoj, Mayukh and Saurabh) who have experience in IT, microfinance and also in solar energy. Anoj graduated from National University of Singapore and is a founder member of the Microfinance Society in Singapore. In the past he has worked with SKS (part of the energy product pilot team) and D.Light (end-user consumer financing strategy). Mayukh is an electrical engineer from IIT Madras and a PGDM from IIM Lucknow. He has some interesting experience in building technology enabled financing models - working in consumer lending, distribution and sales network for solar-lanterns at D.light. Sourabh Sharma (currently not associated with Milaap) has a degree in Computer Science from University of Singapore (NUS). Before Milaap, he established a start-up and later successfully traded his mobile application to Onmobile.

Milaap facilitates lending in the areas of energy, education and training, enterprise development, sanitation and water. The organization seeks to fund loans that create permanent change in people's lives by providing basic needs, job guaranteeing skills, and working capital that helps small businesses grow. Milaap aims to establish portfolios for renewable energy (solar lanterns, microgrids), sanitation and vocational training as scalable asset class funded by banks and other mainstream financial institutions.

Milaap has been able to acquire the Reserve Bank of India (RBI) approval (ECB in June 2011) to source money to lend in India. It addresses the key constraints of capital and cost faced by MFIs while lending for unconventional products such as water and sanitation, energy and vocational training. It raises funds for on-lending both internationally and locally in India and subsequently disburses these funds though partner organizations in India. The turning point for Milaap was when they received the RBI approval for receiving foreign funds in India to lend to other MFIs. This has served as a game changer as it is much easier to raise 50 dollars from a non-Indian than raising Rs 2500 from an Indian. This has been confirmed as the average loan received by Milaap today from a non-Indian is Rs 5000 and from an Indian is Rs. 800. Also, the industry took notice of Milaap as a result of them getting this RBI approval.

Most of the funds mobilized by Milaap comes from HNIs and foundations. Retail online lending is speeding up. Penetrating the U.S. market – particularly the large and affluent diaspora or NRI population – has always been considered by Milaap's founders as a key to sustained growth. To continue to build their U.S. presence, Milaap hired a professional digital/social media promoter based in Washington D.C. Milaap has been able to solicit support of several business people and industry leaders to informally promote Milaap within the growing South Asian community in the Southwestern states, and in particular Texas.

Milaap coordinates with multiple authorities and associated rules and regulation both in India and abroad. In order to facilitate smooth operations Milaap has developed an innovative operational structure that involves four separate companies.

Legal structure -

A. Milaap Social Ventures (MSV): Private limited company in Singapore. This entity raises equity and owns the entire lender base and bears all technology and marketing costs of the platform
B. Milaap Social Ventures Pvt. Ltd. (India): Subsidiary of MSV Singapore which carries out operations on the ground in India
C. Inclusive Planet Technologies (IPT): Singapore based entity which receives all international money and lend foreign loans as an approved "External Commercial Borrowing" (ECB) lender to KVVS
D. Kashi Vishwanatha Vidye Samasthe (KVVS): Non-profit society, registered under the Societies Act 1860 in India. Society receives foreign capital via ECB from IPT and local Indian capital directly and subsequently lends the money to all field partners.

Milaap has a number of equity investors which includes individual investors (Jayesh Parekh, Rajiv Madhok and Vijay Shekar Sharma and Toivo Annus) and institutional investors (First Light Ventures, Jungle Ventures, Lionrock Capital, Toivo Annus, Unitus Seed Fund).

Milaap has also partnered with Kiva in December 2014 and till June 2015 has lent around $80,000 in partnership. Milaap uses Kiva's crowd-sourced capital to reach people and places that are not covered by traditional MFIs. Milaap's loans on Kiva are from its field partner Prayas for Sustainable Development (Prayas). Milaap partners with Prayas to provide enterprise development loans to industrious rural women entrepreneurs in Gujarat and Madhya Pradesh, India. Madhya Pradesh and Gujarat have low levels of microfinance coverage. Prayas lends to clients that do not have loans from other sources.

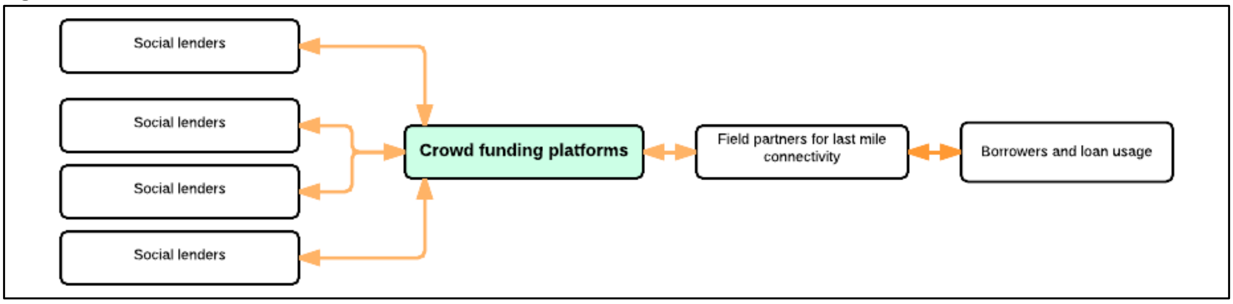
Kiva mentions in its website that "Although Milaap is arguably the most successful Crowd-funding platform in India, the demand for capital far exceeds the availability. Kiva funds help meet some of this demand. Kiva funds will specifically be used to fund borrowers that no one else is funding, products for which financing are not available, and geographies that are not covered by traditional microfinance capital. Currently, Milaap is also the only partner in India, able to overcome the 3 year lock-in period for lender repayments, and provide real-time updates on loan status and repayment."

Different structures for web enabled Crowd-funding for social lending

Crowd-funding for social lending is relatively a nascent industry. There have been many experiments some of which have been successful so far while some failed. There are primarily 3 underlying structures experimented in this space.

A. Person to fund model

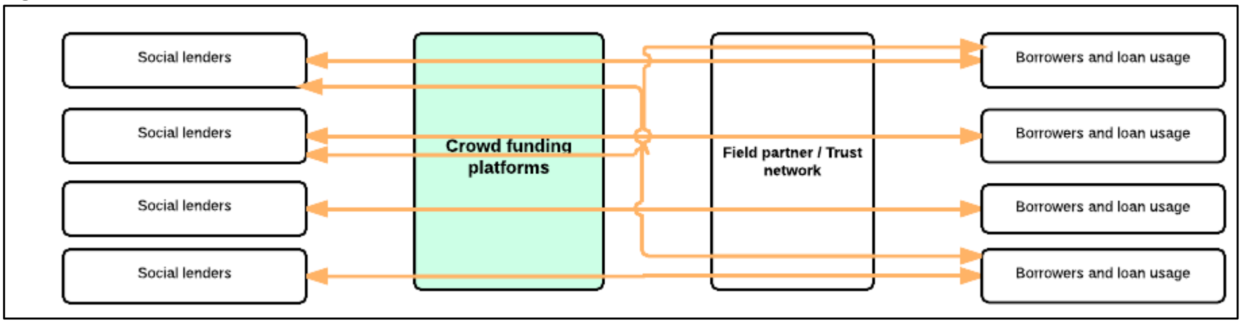
Figure - 1



In this structure, individual lender identifies the cause/person on the website of the CFP but money lent by the lender gets pooled at CFP level and CFP lends that money to the field partner, who in turn lends money to the borrower. Majority of CFPs including Kiva, Milaap, Rang De, and Micrograam works on this structure. This structure is adapted in both for profit and not for profit business model.

B. Person to person model

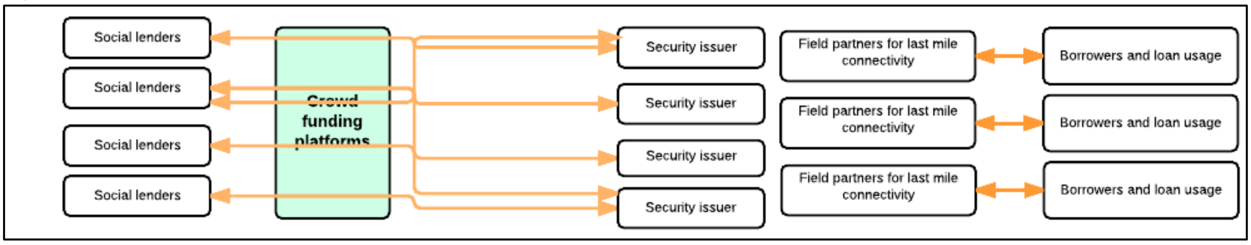
Figure - 2



In this structure, CFPs provide lending platform that connects individual lenders and microfinance borrowers without intermediaries. Loan relationship exists between individuals. CFPs and field partners act as facilitators for fees. Lenders can earn modest interest, at rates that are negotiated between individual lenders and borrowers. In India, there are some similar model emerging for mainstream P-2-P (www.faircent.com, www.i-lend.in) but there is no CFP which works on this model for social lending.

C. Person to intermediary model

Figure - 3



In this structure, CFP works with two layers of intermediaries—MFIs and third-party security issuers that have partnered with those MFIs. Online investors do not pick individual micro-entrepreneurs to lend to; rather, the online investor chooses a third party securities issuer, like Oikocredit or Calvert Foundation, to invest. The online investor then typically directs where his or her funding is to be placed among the intermediary MFIs profiled online by these securities issuers. Importantly, the credit risk of default is that of the securities issuer, not that of the intermediary MFI nor of its micro entrepreneur borrowers. This model was adopted by Microplace, an eBay owned company which started in 2007. However Microplace closed its operations in 2014 citing insufficient social impact as main reason.

Critical processes and components of Crowd-funding model

Though Crowd funding platforms are experimenting with different business models, underlying structures and key processes are same. In following section, five key aspects of CFPs are detailed. These are –

1. Business models and sustainability analysis
2. Fund raising activities deployed by CFPs
3. Key partnerships for CFPs
4. Technology aspect of crowd-funding
5. Regulations and challenges of transparency

Business models and sustainability analysis

Crowd-funding platforms studied for the purpose of this paper deploy *for-profit* and *not for profit* models. Though underlying processes and structures are similar, these two models are different in their approaches of raising funds to start business, achieving sustainability, fund raising and also attracting capital for expansion.

In not for profit model, initial fund for setting up of business is arranged by promoter's investment, and donation from foundations and individuals. Since organisation's legal form is not for profit, there is no equity subscription and no resultant expectation of subsequent equity fund raising. In case of Rang De, a non-profit CFP, ICICI Foundation grant helped in setting up of operations.

In for profit model, in addition to promoter's equity, private equity is raised from angel funds and HNIs with the expectation of subsequent fund raising rounds where initial set of investors can possibly exit with return.

Core functions of CFPs are to raise funds and on lend this fund to field partners. CFPs need funds for on-lending and also to manage their operational expenses (opex) and capital expenses (capex).

Funds for on-lending to field partners are raised via crowd-funding, institutional relationships and in some cases through borrowing from mainstream financial institutions. This category comprises of individual lenders, foundations, international development agencies, corporates (& its employees) and any other entity who is willing to provide loans to borrowers listed on CFPs.

Funds for opex and capex - CFPs business model requires initial capital and working capital as break-even is achieved only at certain level of funding generated and deployed in the field. However, to reach that level, CFPs need funds which can come from both equity investors or from donations. These funds are mobilised from revolving loan, grants, individual retail lender contribution, and equity investment.

In the process of raising funds and deploying it with field partners, CFPs incur expenses which cover salaries of IT staff (50%-60%), administrative expenses (15-20%), field partner and donor relationship management (10-15%), online and offline promotions (15-20%), financial cost (interest expenses, forex hedging expenses etc.;2-5%) and other expenses which include regulatory compliance (book keeping, audit and reporting), and technology cost (web hosting, server related expenses, payment gateway fees). Cost structure and extent of cost in both for-profit and non-profit models are approximately same. Based on information provided by CFPs, operational cost as a % of total fund raised and deployed varies a lot between CFPs and also in year or year. Additionally not all CFPs have achieved a steady level of business and it makes it difficult to measure different category of expenses as % of total portfolio.

For-profit and non-profit models differ in their approaches for generating revenues. Revenue streams of CFPs include the following -

- Service fees – CFPs charge service fees for raising capital from field partner
- Donations / grants – Includes online donation from individuals as well as institutional donations.
- Interest earning – CFPs also charge interest on fund lent to field partners.
- Investor contribution - At the time of making social investments, social investors have the option to donate their return on investment to CFPs. Such income is accounted for as investor contribution.
- Application fees and due diligence fees– CFPs charge nominal fees from organizations that apply for partnerships. This application fee is charged for the purpose of due diligence process to partly cover cost of travel and accommodation as well as time of management staff involved in the process.
- Float – Float is the fund that CFPs hold in the process of fund transfer between the lender and the field partner. Float exists because there is time gap between fund raising and transferring of fund to field partner and also between repayment from field partner and remitting it back to lenders. Since this float money is parked in bank account and sometime as short term investments, CFPs earn interest income from the float.
- Leveraging platform – Allowing individuals and other organization to leverage existing brand and web capabilities of CFPs to raise funds for their own causes. CFPs charge facilitation fees for fund raised by others on its platform

In non-profit model (refer Figure-4), CFPs rely mostly on investor contribution, donations/grants and float earnings. In for-profit CFPs, the major revenue source is the arrangement CFPs have with field partners which involve combination of service fees for raising funds and interest cost on the fund (refer Figure-5).

Though non-profit CFPs like Rang De charge fees from field partners for raising funds, generally this is less than that of for-profit CFPs.

Figure-4: Non-profit business models (Rang De.org and Kiva.org)

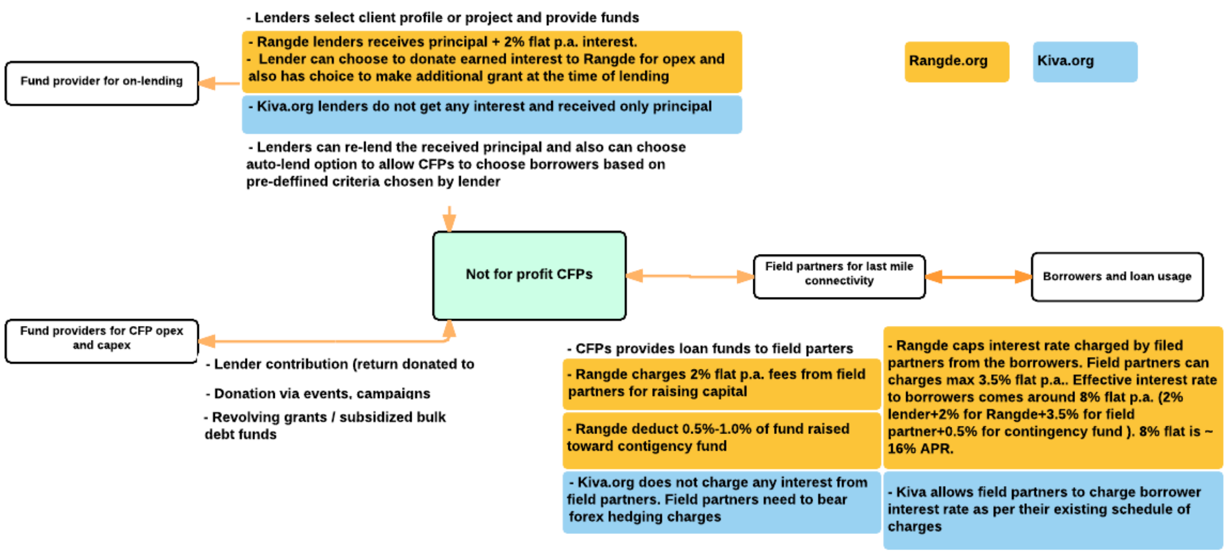
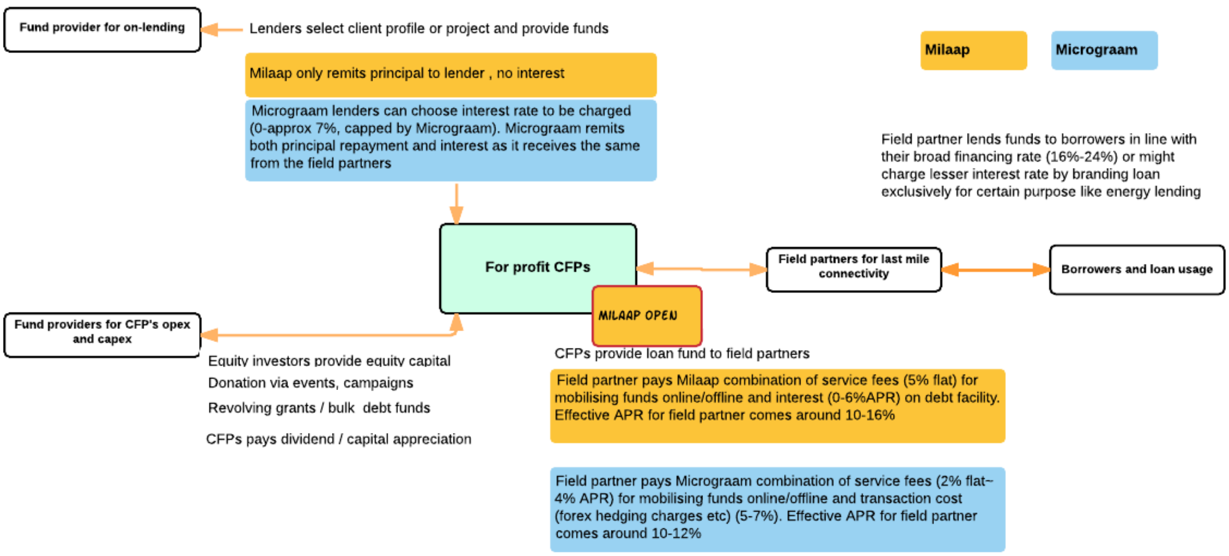


Figure -5: For profit business models (Milaap and Micrograam)



Sustainability analysis for Milaap

As on March 31, 2015, at portfolio outstanding of Rs.140 million and disbursement in FY 2014-15 at Rs.180 million, Milaap estimates for cost of acquisition of online lender is approx. Rs.350 while average loan made by online lender is Rs.2700. Though 98% of principal repayment from field partners is re-lent by Milaap lenders, Milaap's conservative business model assumption is an average of three times rotation of Rs.2700. Therefore for every Rs.350 invested in acquiring an online lender, Milaap is able to extend three loans of Rs.2700 totalling Rs.8100. Since Milaap does not pay any interest to lenders, this costing turns out to be 4.2%. Currently 60% of Milaap funds come from online social lenders.

In order to meet fund requirement of field partners, Milaap occasionally borrows commercial capital from different sources. Additionally, Milaap has been able to also raise interest free revolving loan funds and grants from India based and international development organisations like Arc Finance. A significant chunk of Milaap funds are in foreign currency which results in associated hedging costs to be incurred. There is also cost of payment gateways in processing online loan made by individuals. Overall Milaap estimates its average cost of fund at 3-4%.

Milaap has following revenue model –

A. For raising this fund for field partners Milaap charges 5% upfront fees (approx. 10 APR) plus 0%-6% interest rate based on tenor of loan. This results in average return of 10-16% for Milaap.
B. Milaap allows individuals and institutions to host their projects on its website and raise funds. Milaap charges 5% of funds raised as service charge to cover marketing expenses incurred to distribute and promote their stories across online media channels, driving awareness and attracting supporters to the cause of the fund raiser

Based on the above mentioned cost of fund and revenue streams, Milaap's operating margin seems to be more than 5% of the fund raised and disbursed. Presently, this margin allows Milaap to cover a fraction of its operational costs as it works towards achieving self-sustainability. Till Milaap achieves scale and achieves operational break-even, Milaap is raising investment from individuals and institutions which share Milaap's vision.

Based on these estimates (though not verified by Milaap's financial statement) and traction Milaap is receiving from donors and field partners, its business model seems to be sustainable and Milaap is able to bring on-board established equity investors like Jungle Partners and Unitus Seed Fund in recent rounds of equity funding. However there are some challenges with respect to disclosures and transparency which are outlined in regulation section of this paper.

Milaap shared that as on March 31, 2015, it is operationally break-even and financial break-even is expected to be achieved outstanding portfolio level of Rs.300 million.

Sustainability analysis of MicroGraam

For raising funds for field partners, MicroGraam's charges flat 2% upfront fees (equalling 4% APR) plus 7.5% APR as transaction processing fees to cover foreign currency transfer and hedging cost. This adds to approximately 11.5% APR on portfolio deployed with field partners.

Based on financial statements provided for the FY 2013-14, Micrograam is still to achieve operational breakeven. For FY14, Micrograam revenues were Rs.0.78 million and expenses were Rs.3.18 million resulting into losses of Rs.2.41 million. Till March 31, 2014, accumulated losses of Micrograam stand at Rs.8.82 million. Majority of expenses is on staff salary (20%) and promotional activities (40%).

As on March 31, 2015 Micrograam has portfolio outstanding level of Rs.49.8 million and total disbursement till date of Rs.131.5 million. At this level of business Micrograam estimates 40% operational self-sufficiency.

To breakeven operationally, Micrograam will need to bring cost of fund raising (staff cost, administration cost, campaigns cost etc.) plus all related costs (foreign exchange fees, hedging charges, payment gateway fees etc.) below 11.5%. As per Micrograam business plan, operational breakeven will be at Rs.500 million portfolio outstanding which they plan to achieve in 1-2 years.

In the start of FY2014-15, Micrograam partnered with Kiva.org in order to increase size of operations and profitability. However data is not available for FY15 to comment on current status of revenues and expenses.

Sustainability analysis of Rang De

Rang De works on non-profit model, operational sustainability can be defined as % of cost covered by online donation provided by retail lender. As on FY13, Rang De has operational sustainability of only 36%. Kiva.org, international CFP which also works on similar business model as Rang De, as on December 2013, had operational self-sufficiency (defined as online donation/total expenses) of 72%

Rang De website has its financial statements from FY09 to FY13. Analysis of financial statements indicates major reliance on grants from foundations (mainly ICICI Foundation) and revolving funds from corporates. Since financial statements does not provide amount of fresh investments raised and deployed it is not possible to calculate cost of fund raising for Rang De for all the years. However its losses till 2013-14 add up to Rs.20.7 million. Rang De performance in raising funds has not been very consistent with irregular flow of grants to expand operations.

As on May 26, 2015, Rang De current portfolio outstanding is approx. Rs.70 million and total disbursement till date is Rs.297.6 million. If we assume that in 2014-15, Rang De expenses are same as 2013-14, its total expenses since inception would be approx. Rs.50 million. This indicates that since inception in 2000, for raising Rs.297.6 million, Rang De spent Rs.50 million with operational expense ratio (OER) of around 17%. Since Rs.297.6 million includes repeat lending and redeployment of grant money and revolving loan funds, OER for raising fresh investment would certainly be much higher than 17%. For the FY2013 Kiva has OER of 14%.

Particulars	2008-09 (Rs.)	2009-10(Rs.)	2010-11(Rs.)	2011-12(Rs.)	2012-13(Rs.)	2013-14(Rs.)
Total expenses	61,42,041	82,54,177	63,28,992	85,53,273	60,75,091	70,11,614
Direct income from operations	1,70,961	2,77,131	10,07,394	50,06,878	35,50,727	25,51,760
Other income (interest income etc.)	55,951	5,56,949	25,22,529	26,83,375	19,97,497	12,64,727
Total Income	2,26,912	8,34,080	35,29,923	76,90,253	55,48,224	38,16,487
Profit/losses	-59,15,129	-74,20,097	-27,99,069	-8,63,020	-5,26,867	-31,95,127
Grants raised	100,00,000	162,00,000	1,50,000	-	8,48,481	42,96,193
Reserves and surpluses	40,84,871	126,58,515	99,32,628	90,69,608	85,42,741	96,43,807
Trust capital	2,13,350	2,13,350	2,13,350	2,13,350	2,13,350	2,13,350
Restricted revolving funds	150,00,000	149,26,000	149,25,953	139,44,359	19,45,519	28,46,602
Social investment	5,33,600	4,76,004	33,01,148	85,74,410	66,72,198	70,10,361
Float in the bank	182,25,612	267,47,136	268,33,534	311,71,250	167,70,074	183,82,655
Balance sheet size	198,37,491	283,04,075	285,25,304	318,68,378	177,64,914	201,94,557
Social investment raised (includes relending)	NA	109,00,000	255,00,000	319,00,000	652,00,000	NA
% cost of raising investments		75.7%	24.8%	26.8%	9.3%	

Significant income accrues from financial investments (fixed deposits etc.) and interest earned from savings account. This indicates that income from floating funds (difference of funds raised and fund deployed) constitute a major revenue source for Rang De.

Analysis suggests that Rang De is facing challenge of mobilizing social investments corresponding to setup/cost structure it has in place. Additionally grant inflows are also not secured. In order to sustain and grow, Rang De needs either increase in its efficiency of fund raising, secure long term grant commitments or needs to re-look at its business model.

Partnerships with field level intermediaries

CFPs need to partner with various actors such as field partners/MFIs, institutional investors, foundations, banks and payment gateways. The payment partners facilitate transfer of funds between donors and CFPs and constitute a significant cost of operations. A good deal with payment partners can be a competitive advantage for CFPs.

All CFPs deploy volunteers and interns to reduce cost of human resources while using high quality talent. CFPs use their brands and networks to get access to volunteers and interns.

Field partners are organizations that provide last mile connectivity for CFPs. These organizations identify borrowers, document their loan requirement, purpose and household story along with necessary pictures/videos. Field partner also undertakes loan disbursement, servicing and collection of repayment from the clients. Field partners can be *not-for-profit* or *for profit* entity but there is clear preference of non-profit organization as field partners as this is where patient capital provided by crowd funding serves catalytic purpose. Initial analysis of field partner profile listed on websites of studies set of CFPs indicates that typically these partners are non-profit NGOs (society, trust, federation) who use crowd-funding as source of refinancing their microfinance operation. CFPs have a vision to assist these small size NGOs because these are the entities which are serving critical needs of low income people who are overlooked by traditional bank lend bulk lending model to MFIs.

All three CFPs studied in this paper deploy a Partner Selection Process. Field partners are selected after rigorous due diligence to ensure that they have a grounded understanding of the borrowers needs and capabilities. All CFPs have field partners with strong market presence and significant experience of microfinance operations main selection criteria.

Each field partnership is formed after rigorous due diligence that involves organization visits, financial audits, and borrower interviews. Field partner evaluation also consists of the following assessment criteria for which CFPs use structured evaluation measures.

- Field partner experience in disbursing and managing loans
- Field partner policies and practices in borrower selection
- The range of projects and borrowers to ensure the risk-spread
- The loss reserves they maintain to mitigate the risk of default

All CFPs deploy partner management tools including SMS and web-based reporting which create transparency and accountability at all stages. Field partner carries out following tasks for CFPs -

- Identification of potential borrowers
- Collection of all KYC documents from these person
- Separate agreement with the borrowers whereby the borrower agrees to pay the respective service fees to the local partner as well CFPs, if applicable
- Procuring all documents required legally as security for the due repayments of the amount lent, with interest and other moneys payable
- Share profile of clients, loan purpose and other required information to be uploaded on web portal
- Assist in execution of other documents required by the social investor in the format specified by social investors
- Timely disbursement of loans to selected borrowers once money is received by CFPs
- Collection of repayment (principal and interest) from the borrowers as in accordance with the corresponding repayment schedule.

- Transfer repayments to CFPs in designated back account and to provide client wise full details of the repayment
- Assistance in taking necessary action against the borrower / assets of the borrower in case of default by the borrower

All CFPs indicated that there is regulatory challenge to work with NBFCs as either it is constrained by its own legal form or NBFCs cannot access debts from non-profit legal entities. There is a need to get more information on this aspect.

Fund raising from social lenders

CFPs use a combination of offline and online strategies to acquire and retain social investors. CFPs use digital marketing – Search Engine Marketing (SEM) and Social Media to attract people to the platform. Besides having a strategy to acquire customers, CFPs also adopt various strategies to retain social lenders which include impact reporting, field visits, and online campaigns. CFPs adopt following strategies to raise capital for on-lending.

Offline strategies

CFPs identify and reach out to socially conscious high networth individuals (HNIs) who are financially well-off and have a desire to give back to the community via personal contacts, referrals, people who signed up for newsletters on websites, LinkedIn, Twitter etc. Recently CFPs are trying to work with private banking teams of banks to offer crowd-funding as a social investment avenue. CFPs raised funds through various events whether by participating in a public event such a marathon or by organizing an event exclusively for itself such as concerts or seminars.

CFPs also target identified corporates/foundations and pitch the crowd funding model of social impact, as being more accountable & transparent compared to traditional NGO/charity model. Revolving loan fund is expected from this channel.

Online strategies

CFPs make websites search engine optimization (SEO) friendly with deep links to content. CFPs also create volunteers network who constantly write articles on the news portals, social media, company blog and then share it in social media networks. The highest pull to the website is generally through social media portals such as Facebook and Twitter.

In order to attract traffic to their websites, CFPs partner with popular e-commerce sites which already have a steady stream of traffic and credit card transactions and adding a checkbox at the payment details page on the partner website to enable one-click loan for users buying tickets, books, mobile phones or undertaking any other e-commerce transaction. Milaap has partnered with a leading pre-paid mobile re-charge website – www.paytm.com

Technology: Key intervention of Crowd-Funding Platforms

When posed with the question if CFP considers itself an IT company or microfinance firm, all three CFPs positioned themselves as IT Company in the business of raising funds for needy borrowers. At least one co-founder of all three CFPs has prior experience in IT sector. IT staff cost is major component of CFP cost structure.

In case of CFPs, technology expertise is the key in creating a user friendly interface on website and also to manage information flow with field partners. All CFPs have internally developed proprietary technology to manage their operation. In 2007, Rang De was able to convince Infosys to provide an initial portal at a cost of Rs 2.5 lakhs (far lower than the discounted quote of INR 20 lakhs offered by Infosys). This system has subsequently been improved by RangDe technical team over time.

Milaap co-founders have experience in designing portals and systems. Initial investment came from angel investors, prize money and incubation support of Dasra. Milaap co-founder did not put any value to this initial investment but suggested that technology is least difficult aspect of the business. Seed money of Rs. 6-10 lakhs should be adequate set up a web portal; however operations and maintenance and continuous development based on feedback from requires investment in high calibre team. Micrograam estimates its investment in IT systems till date in the range of Rs.30 -40 lakhs.

For managing information flow with field partners, Milaap provides sales force licenses to its field partners. While these sales force licences for non-profit intermediaries are free (for max 10 users), Milaap designed its own package which works on Sales-force. Micrograam and Rang De use their own proprietary technology and provide access to it to field partners.

CFPs do not require support for technology development; there is however need for support in capacity building of field partners for operating on the technology.

Regulations for Crowd-Funding Platforms

Crowd-funding is a way in which people, organisations and businesses, including business start-ups, can raise money through online portals to finance or re-finance their activities. In different countries, some crowd-funding activity is unregulated, some is regulated and some is exempt from regulation. Among different crowd funding models, only loan-based and investment based crowd funding are subject to regulatory remit. In the context of this paper, regulatory regime for loan based crowd sourcing in India is reviewed.

While P2P lending and crowd-funding has expanded in countries like the US and much of Europe, it is still extremely early days for the sector in India. Many relevant stakeholders are yet to understand and question the norms of crowd-funding activities prevailing in the country. In the absence of well-defined policy, it is quite plausible that misguided individuals may fall prey to unscrupulous CFP operators that may look to make a quick buck.

Given the low entry barriers, there are a number of players entering the P2P market in the country. While many of these institutions look good on paper, their models are untested. The fear is a repeat of what happened in the micro-finance, chit fund, and the para-banking segment. Crowd-funding may have real potential to make a difference but lack of oversight, regulations and law might nip it in the bud. There is a need of new approach to the economics and governance of P2P. Regulation can impact business models of CFPs like it did in case of Kiva. Kiva is registered as a non-profit because as a for-profit company, it would have had to register as a broker-dealer with the SEC in US, something very difficult without substantial financial backing. The regulatory environment also dictated Kiva's decision not to charge interest on Kiva loans, which contradicted the original business plan of Kiva. Microplace, a for-profit model stopped its operations in 2014, was registered with SEC but could not scale it up. One of the reason cited is significant regulatory constrains in registering, approval, and reporting requirements for issuing security paper whish social and other lenders can subscribe to in order to provide fund for field partners.

As explained before *person to person* lending model which is espoused on most of CFP sites in fact works as *person to fund* model. CFPs are in practise works as microfinance fund for their field partner. Therefore it would be prudent to view existing / potential regulatory requirement for CFPs in the context of (i) regulations applicable to microfinance funds and (ii) regulation to ensure interest of individual lenders and field partners of CFP sites.

Following are the areas of CFPs operations where regulatory aspects need to be considered and further studied.

1. Currently CFPs in India work as Trust (Rang De), Society (Milaap and Micrograam), Section 25 Company (Rang De, Micrograam), Private Limited Company (Milaap and Microgram) and also as Company registered overseas (Milaap registered in Singapore). Since these legal forms fall under defined regulatory regimes, the institutions need to comply with respective reporting requirements and taxation policies.

2. Since CFPs act as microfinance funders, it should work under the purview of RBI for their routine operations of lending to field partners. CFPs should be required to disclose detailed information in public domain regarding their business model along with details of all entities engaged in the lending process.

3. Individuals and institutions lend on CFPs for social impact/return. CFPs should be required to provide credible documentation for indicating social returns or leveraging multiplier in addition to anecdotal evidences currently available on their websites.

4. Since CFPs raise money from general public for on-lending purpose, rules related to investor protection need to be reviewed. There is need for prescribed guidelines for the event of closure of CFP operations or event of default.

5. CFPs keep lenders money in their account under escrow model/custodian of funds, so rules related to “Clients money” need to be reviewed in the context of funds raised from various sources but still not deployed in the field and similarly for repayment received from the field partners but yet to be remitted back to lender’s bank account. All bank account and transaction details need to be monitored to ensure safe custody of client money.[2] Additionally this concern become more significant in case of auto-relending, which is common in CFPs. Actual working and implementation of auto-lending needs to be properly understood and reviewed.

6. CFPs lend funds to field partners who in turn lend it to clients, therefore rules related to due diligence and disclosures requirement for field partners need to be reviewed. There need to be set minimum standards of due diligence that must be disclosed when CFPs assess the creditworthiness of field partners. Additionally any other publicly available rating or assessment report of these field partners can be made available on CFP websites.

7. There should be prudent use of words that describe capital security (e.g. the use of terms such as ‘guaranteed’, ‘protected’, ‘safe’ or ‘secure’). Though CFPs do not guarantee principal repayment, their websites indicate successful past performance in terms of loan repayments from field partners. There is no independent verification of these numbers and also methodology of calculating these loan repayments and delayed payments is not indicated. Audits may be required to verify these numbers before publishing on websites and communication materials.

8. Standard criteria are required for classification and reporting of default, rather than allowing CFPs to develop their own approach. CFPs should disclose statistics in relation to loans in late payment or default. Also needed is a standardized risk rating for loan classification.

9. There can be a standard on maintenance of contingency fund for covering a minimum level of default. This can be in the form of slab based requirement to maintain contingency fund. Additionally, CFPs may provide some default guarantee to lenders. Currently CFPs are availing grant money/donation/low cost funds from public without demonstrating sufficient commitment to repayments.[3]

10. There seems to be many investors who use auto lend / re-lend option on CFPs sites. These options allow CFPs flexibility to deploy auto-lend category of fund. Portfolio quality of these funds should be reviewed separately so as to ensure that CFP uses this unrestricted fund more judiciously.

11. A crucial set of information not provided by CFPs currently is their fund raising ability on periodic basis. There are CFP sites which provide information on money raised in last week/month/quarter/year/since start of operations. This information is critical as it indicates health of the operation of CFPs.

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[2] In 2009, the RBI had come out with directives for the opening and operation of accounts and settlement of payments for electronic payment transactions involving intermediaries. In the current system settlement of e-commerce/m-commerce/bill payment transactions, are credited to the accounts of these intermediaries, before the funds are transferred to the accounts of the merchants in final settlement of the obligations of the paying customers. Under this system a Nodal Account is created for the purpose of pooling the monies collected from buyers and subsequently paying out to the seller. This nodal account is not operated by the intermediary and this reduces the chances of fraud. There is also a need for such directives for CFPs platforms engaged in social lending as CFPs also engaged in pooling funds on the name of borrowers profiles listed on its websites.

[3] Micrograam and its field partners provides 20% guarantee fund but details of how this guarantee funds operates are not provided on the website and most importantly in “terms and conditions” section, Micrograam again absolves itself from guaranteeing repayment to lenders.

12. Milaap, Micrograam and other Kiva's partners receive external commercial borrowing (ECBs), therefore transaction related to ECBs need to be subjected to review for compliance and monitoring.

Regulatory issues are a concern for nearly all of the P2P platforms interviewed for this study. Crowd-funding and P2P lending is not new but in most countries, government is yet to establish the required regulatory structure. There are some countries like US where P2P platforms (equity based and loan based) work under existing regulation in order to operate their sites; as such they are subject to state and federal regulations on lending, privacy laws, and interest rates. There have been instances in countries like Canada where P2P operations were suspended because of lack of regulatory clarity.

For international P2P platforms, the regulatory environment can be equally if not more complicated. Platforms must abide by lending regulations within their home countries as well as in those countries where they have borrowers or lenders. In addition, platforms must comply with restrictions on capital flows between countries and on withholding taxes where applicable. In India, though Kiva, Milaap and Micrograam have been able to use ECB route for mobilizing funds, external borrowing has been a challenge in terms of need of annual renewal of permission, frequent reporting requirements, 3 year resting period for principal repayment and strict control on forex hedging requirement.

In India, SEBI initiated the process of devising a regulatory mechanism for raise equity funds through crowd-funding. In this context SEBI released a consultation paper[4] June 2014, inviting comments and suggestions from the industry regarding the possible structure of crowd-funding in India within the existing legal framework. In this paper SEBI had raised 27 questions pertaining to the guidelines, framework, limitations, scope etc. of crowd-funding. In May 2015, SEBI decided to put this process on hold. SEBI suggested that crowdfunding is in nascent stage and regulatory challenges should not fetter required innovation to expand this sector.

The RBI is yet to release a consultation paper for developing guidelines for loan based crowd funding especially in the social sector. Individual players like Rang De are taking initiatives to reach out to the RBI for facilitating an enabling regulation; there is however lack of concerted effort among different players in the sector.

In future, crowdsourcing sites can evolve into marketplace lending platforms. These platforms might offer a wide variety of financial products (including student loans, small business loans and real estate loans) in addition to the consumer loans on which the industry initially focused. In contrast to expectations that may once have prevailed, most internet-based lenders today do not fund themselves by selling pass-through notes to retail investors over the internet (i.e., the "pure" P2P model); instead they rely upon a combination of equity, privately placed pass-through notes, commercial lines of credit and/or wholesale loans to institutional investors.

The RBI should conduct impact assessments and come up with laws and mandates that include the overall CFP space in financial inclusion field. RBI needs to appoint monitors that are trusted by users, have clear laws about acceptable ways of doing business and the required disclosures and compliances and lay down procedures to resolve conflicts.

Transparency concerns

There is a need and perhaps an obligation to be as transparent as possible on the part of CFPs; in CFP sector transparency and impact are primary. It is very important for entities like CFPs to provide sufficient information in order to be perceived as transparent organisations in order to raise social funds from the public. CFPs need to specifically find a balance between protecting the privacy of borrowers and the interests of lenders. Most of the P2P platforms are quick to publish statistics on the performance of loans by risk rating and other characteristics. This allows investors to make investment decisions. In the case of business models where CFPs act as fund managers for field partners, which is mostly the case in India, there is a trade-off between promoting the direct P2P relationship between borrowers and lenders, which is very powerful in attracting socially oriented lenders, and the transparency involved in explaining the relationship with the intermediary.

[4] http://www.sebi.gov.in/cms/sebi_data/attachdocs/1403005615257.pdf

Repayment rate: While indicating repayment rate from a field partner, from a reputational standpoint it is often "cheaper" for an MFI to re-pay to the CFP irrespective of whether the client has repaid the loan to the MFI. This is perhaps appropriate given the margin MFIs earn on the loans; this however inflates repayment statistics because MFIs will not report when they cover a client's loan. Recognizing the risk of appearing non-transparent, some CFPs like Kiva is currently revising its operating system so that MFIs will be required to report on delinquent loans even if they choose to cover the loan themselves.

Interest rate and APR: CFP platforms should be as transparent as possible regarding the interest rates charged to field partners and end borrowers. The majority of CFPs charge origination and facilitation fees to raise funds, which increases the real cost of their loan, and when intermediaries are involved, they often also charge high fees for sourcing, posting and managing the loan. Thus a 0% interest loan on Kiva or Milaap may ultimately cost the borrower upward of 18% annually. In order to be perceived as low cost service provider, CFPs indicate their fees as certain % flat fees and not in terms of the APR. This poses concerns about transparency given that it is difficult for CFPs to advertise to its lenders that the end borrowers may pay certain interest while lenders are not paid any interest. The users of these CFP sites are often unfamiliar with microfinance and may be very surprised and disappointed to learn such information without receiving an explanation. Most Intermediary platforms interviewed for this research understand the importance of transparency, yet offered their lenders varying degrees of transparency on annual interest rates.

Financial inclusion and Crowd-funding: Opportunities and Risks

Crowd-funding represents a new source of (re-)financing for MFIs, full of opportunities but also risks. MFIs draw on a number of financing sources, ranging from grants, equity, bank loan, mutual funds and institutional investment bonds. The total volume of crowd-funding to MFIs in India to date is uncertain, but based on rough estimates available from select crowd-funding sites for the purpose of this paper, cumulative disbursement via CFPs till date is estimated at Rs.600-700 million and the loan outstanding at Rs.200-250 million. This currently makes CFPs a small source of MFI funding compared to banks, institutional investors, lenders but based on exponential growth of the overall crowd-funding volumes in microfinance crowdfunding has potential of expansion.

MFIs suggested that CFPs provide funds for providing loans in the areas or sectors for which banks do not provide debt fund directly or through business correspondent model. Samahita, a section 25 microfinance organisation used Milaap funds to expand in Bundelkhand region of Madhya Pradesh as banks were not providing funds to provide loans in this area. Annapurna uses Kiva funds to provide education loan in Odisha. CFPs essentially is viewed as alternate source of funding for MFIs when mainstream bank funding is limited.

The expectation of MFIs from crowd-funding sources is twofold: (1) Lower cost refinancing; and (2) Access to more risk-tolerant debt or capital. MFIs look out for this type of softer funding beyond limited grant funding; particularly for expanding into a relatively new field such as energy lending or vocational training.

In terms of fund deployment in the field CFPs work in a similar fashion as existing wholesale lenders like Ananya and Manaveeya and provide debt funds for microfinance activities to the field partner. However the main difference between wholesale lenders and CFPs lies in fund raising strategies. While institutional sources of funds are similar for both, CFPs leverage on committed institutional funds to raise debt funds from retail social lenders also. Arc Finance provided Milaap grant-based revolving loan fund of $ 100,000 in April 2013. This fund was matched dollar-for-dollar by Milaap through its own online fundraising. Arc Finance disbursed money in tranches as and when Milaap was able to raise online funds from retail lenders. In the alternate model, institutional investors try to match retail funds raised by CFPs to identified causes by the multiple ranging from 1x-4x. Though institutional funds constitute significant portfolio of CFPs, CFPs target to mobilise more retail funds to demonstrate importance of its model. Current tier-2 wholesale lenders like Ananya and Manaveeya have defined regulatory regime to comply while regulations for CFPs is yet to be developed.

Crowd-funding provides an opportunity to raise patient, risk tolerant capital where funders are keen to new experimentation and share vision of MFIs. There have been instances in which following success of crowd-funded pilot for product development, MFIs have scaled up the project with debt from banks. However, relying more on crowd-funding also possess risks for MFIs – including:

1. Higher transaction costs to satisfy reporting requirements of CFPs (in particular for preparing and updating borrower profiles and stories, pictures etc.);
2. Foreign exchange risks when the CFP currency is different from the local currency;
3. Unpredictability of funding streams because the crowd funders are an anonymous and not well understood group; and
4. Sustainability of CFPs business model and its ability to continue to raise funds;
5. In the absence of independent rating systems for CFPs, MFIs need to undertake due diligence and maintain a diversity of funding sources to manage funding risk.
6. Synchronization of demand of loan from field and supply of funds from social lenders. MFIs face a spurt in demand of loan in certain time of the year for purposes such as festivals, agriculture etc. however CFPs have relatively stable supply of capital which poses a challenges of managing demand and availability of funds.

Initial analysis of field partners of CFPs also indicates that most field partners are small non-profit NGOs and MFIs. There are not many examples of CFPs partnering with large size MFIs (> Rs.100 crore turnover). Following issues emerged while assessing the reasons behind large MFIs' disinterest in CFP funding model -

1. Uncertain fund flow
2. Operationally intensive process of writing client stories, getting good quality pictures, reporting requirement and frequent qualitative studies 0
3. Down time with technology where data have to be uploaded for sharing client information with CFPs
4. Long waiting time for fund release and resultant problems in the field like client dissatisfaction in case funds are not generated, risk of losing clients to competitors, client refusal to take delayed loan etc.

Case study – 1: Kiva.org – People's Forum partnership

People's Forum has been working with women's self-help groups since 1994. Today, it works with 120,000 rural women through its network of 30 branches spread across Odisha and Chhattisgarh. The organization's microfinance program is carried out by its subsidiary NBFC, Annapurna.

In August 2012, People's Forum in Odisha partnered with Kiva.org to raise funds to expand and launch credit programs with some of India's most vulnerable populations including widowed women, transgendered women, disabled individuals, and families affected by leprosy. Kiva's low-cost funding enabled People's Forum to scale up the programmes for these target communities. Widowed women are considered a bad omen in some parts of India and are often excluded from the social and economic life of their communities. Microfinance institutions in India usually focus on married women because they are considered "less risky" to lend to and Self Help Groups hesitate to include single women. People's Forum has always wanted to provide an individual lending product for these women but could not find any lenders willing to support them, until Kiva. Loan products for individual women will include livelihoods training and supplies for income generating activities such as weaving, petty shops, stitching, tailoring, and fast food stalls. People's Forum provided borrowers profile to Kiva and received favourable response from social lenders. In this process since lenders know what kind of loan they are extending, they were willing to experiment and provided risk tolerant patient capital. People's Forum also realised that it is much faster to raise funds for this kind of borrower profiles.

People's Forum is able to launch an entirely new loan product for individual widowed women, single mothers, and unmarried women. Kiva's flexible, zero-interest capital will allow People's Forum to reach even more borrowers in Odisha, one of the poorest states in India. The funding provided by Kiva lenders helped change the lives of people in these communities by providing them with cost-efficient financial products, along with training and other support services.

People's Forum also raised Kiva loans for sectors which are in negative list of banks like training for heavy vehicle (like cranes) drivers. Encouraged by success of these pilots enabled by crowd funded loans on Kiva, now People's Forum has started provided mainstream bank loans to above mentioned segments. People's Focus has sanction of $110000 per month from Kiva. Most of Kiva loans are now in the sector of water-sanitation and improved cook stoves. As per Kiva website, People's Forum has lent $1.69 million kiva.org funds in last 34 months of partnership.

People's Focus values its partnership with Kiva as they are able to run small lending pilot for identified social caused. Annapurna also like Kiva provides support to the causes it believes in. Based on success of People's Forum lending programme to physically disabled people, recently Annapurna has been approached by Central Bank of Nigeria to provide TA to Nigerian MFIs on credit to physically disabled segments.

Case study – 2: Arc Finance – Milaap partnership model

As part of a long-term partnership to promote energy lending in India, Arc Finance provided grant of US$100,000 over a 3 (three) year period to Milaap to be used to create a revolving loan fund to expand Milaap's clean energy portfolio. Milaap's mission is well aligned with Arc's mission and strategic objectives. Like Arc, Milaap aims to mainstream new areas of microcredit such as financing for energy, water and sanitation. It supports MFIs committed to the growth of non-traditional portfolio through its funding. Milaap will contribute a US$100,000 capital match to the revolving fund. Milaap and Arc collaborated on developing joint funding proposals and building a long term relationship to support the expansion of energy lending.

Following are some of the strategic reasons for forging this partnership:

- Offer a low cost revolving loan fund focused on water and energy to promote scale: MFIs in India have just started to understand the importance of diversifying their portfolio by offering "Credit Plus" products. The leaders in the industry, such as Bandhan (health and education), Ujjivan (financial education) and Grameen Koota (energy) to name few, are trying to bring value-added products to their clients. Once the business case is proven, other MFIs will also start including them in their portfolio. Arc – Milaap partnership was aimed to ensure that MFI partners receive consistent, standardized levels of loan capital monthly over a specific period in order to plan the scope of their energy lending operations.
- Providing debt fund to promising, efficient and committed MFIs: Milaap has been successful in identifying a range of MFIs and NGOs (small and large) that are committed to scaling up their energy, water loan portfolios.
- To serve as leverage, assisting Milaap in its efforts to source additional funding from online lenders, HNIs and CSR initiatives, and thus increase the total amount of capital available for on-lending by MFI partners. At the end of the three-year agreement period, Arc will release funds from the revolving fund to Milaap and absolve Milaap of its reporting obligations at that time. The revolving loan fund which Arc will award to Milaap will continue to help other MFIs for years beyond this project period.
- Arc also provided technical support to smaller MFIs that are less experienced in energy lending, and conducted detailed documentation of key elements of partner energy programmes for the purpose of promoting new practices to the sector as a whole.

Arc's partnership with Milaap made important progress from 2013 onwards. Arc Finance provided grant-based revolving loan fund of $ 100,000 in April 2013. This fund was matched dollar-for-dollar by Milaap through the latter's own online fundraising. The combined amount was distributed as loan capital to Milaap's three energy field partners, WCDS, MSF and DCBS, enabling new energy loans (solar portable lanterns and clean cook stoves) for low-income households and businesses in rural districts of Odisha and West Bengal. Arc's close and on-going consultation with DCBS, in particular, has resulted in important corrections to the organizations solar portable lantern loan program that resulted in rapid portfolio growth.

In addition to conventional lantern/cook stove programs, Milaap is now focusing on financing more innovative energy technologies that have a broader impact on income and productivity. These may include but are not limited to small microgrids (entrepreneurs or end-user loans in a cooperative model); solar irrigation applications; end-user finance for electricity using equipment in areas where microgrids have been introduced; energy efficiency housing investments and working capital for energy product retailers. Milaap has already had discussions with Mera Gao Power, and, through an Arc introduction late last year, Pollinate Energy, a Bangalore-based non-profit that builds and finances urban retailers in 240 communities in Bangalore and Chennai.

Case study – 3: Proposed PSI – Micrograam partnership model

Sanitation financing has come up as one of the major challenges in improving the supply side value chain in rural Bihar. Supporting Sustainable Sanitation Improvements" (3SI) Project landscaping findings suggest that approximately 60% of households in rural Bihar will require loans for purchasing the toilets. Financial inclusion and MFI penetration in Bihar is very poor and less than 13% of the households in 3SI focus districts have a bank account. Moreover Sanitation loans are considered as consumption loans and there are regulations limiting disbursement of such loans to 15% of the portfolio. The 3SI needs to focus on strengthening the financial value chain for the sanitation sector to enable poor households to avail affordable toilets. The empirical calculation suggests that 3SI may require USD 72 million (Rs. 400 cr) to facilitate sanitation credit to more than 80% of the total target client.

PSI has budgeted USD 3, 50, 000 (Rs. 2cr) for sanitation financing in Bihar under the BMGF grant in 3SI project. PSI mandate is to leverage this budgeted fund to establish larger debt fund for sanitation finance, supporting local MFI for sanitation financing, creating favourable loan products for toilet construction, providing guarantee support to the financing institutions and attracting further investment for sanitation fund. However PSI had following limitations -

- PSI constraint by its legal entity in India cannot undertake lending operation and can only provide grant support to its partner organization which is not sustainable for any financing.
- FCRA clause also restricts PSI from using BMGF fund for commercial activities (lending purpose) even if it has been made at capital cost to any MFI.
- PSI can't do equity investment unless it strategically decides to work as a lending institution with its equity stakes involved.

In this case, the best way to use 3SI corpus fund is to provide guarantee support to financing institution as corpus for financing activities.

Therefore, PSI was looking for fund managers who had experience in institutional financing and who can leverage funds from the market. This fund manager would manage the 3SI corpus fund, leverage it and lend it to PSI partner MFI in Bihar at certain interest rate. The fund manager should be able to raise debt funding from wholesale funders, high net worth individual or social investor like Acumen and MSDF. The fund manager should be sensitive enough to adopt sanitation financing in future even after PSI withdraw its support and innovate suitable loan product for rural poor.

MicroGraam has also been exploring potential NGO MFI partnership for increasing their operational coverage in eastern region of India and sanitation financing is one of the focus areas that can be addressed through these partnerships. PSI sees lot of potential for partnering with MicroGraam specifically for sanitation financing and leveraging soft funding for sanitation sector.

In the proposed partnership, MicroGraam has agreed to initiate sanitation financing in Bihar preferably in the 3SI intervention region. MicroGraam will link the client to their peer to peer lending platform or to KIVA platform to raised required funding. The loan product will be specific for construction for toilet in client household and can be directly disbursed to SHG/ JLG or NGO MFI.

MicroGraam will be lending at 7.5% interest rate to the retail lending institution (NGO MFI, SHG federation etc.) and charge 1% as documentation fee every 6 month of loan term. Therefore, a typical loan term of one year will cost 9.5% to the NGO MFI or lending institution. MicroGraam also advocate interest rate cap for the end users @ 16-18%. It means that retail lending institutions has to operate within operational cost of 6-8% for microfinance activities.

In order to facilitate this model, PSI is exploring ways to facilitate partnership between Micrograam and NGO by possibly undertaking following activities

- Identification of credible NGO MFI or SHG federation for sanitation financing and establishing Microgram linkages.
- PSI may provide dedicated resources to facilitate and raise loan application form target beneficiaries on the behalf of MicroGraam.
- Initial training and orientation to local institutions on MicroGraam lending process and initiating the loan portfolio.
- Encouraging Micrograam and NGOs to undertake sanitation finance by creating a guarantee fund to absorb probably default losses

Enablers for crowd funding initiatives in India

Development agencies can provide following support to crowd funding model.

- Commission further research on the existing regulatory issues in P2P funding and advocate for mutually agreed sectoral Code of Conduct including disclosure norms for CFPs and field partners for CFPs.

- Support agencies can help raise the profile of P2P lending and build awareness of P2Ps with regulatory agencies. Regulation and transparency ultimately pose some of the greatest bottlenecks to the industry and growth prospects can be substantially improved with better regulatory structure. Regulators need to understand the risks and opportunities of these models while considering best possible regulatory regime for P2P lending model. MFIs believe that better understanding of P2P in social lending can possibly change RBI's stand related to the following:
    - Annual exercise for receiving ECB approval – It generally takes 1-2 months for getting approval every year ceasing fund flow from Kiva during that period
    - MFIs need to report to RBI on each tranche of fund receipt. Since funding is in small (as compared to mainstream ECBs) and uncertain volumes, priority is not accorded to provide approvals.
    - Even though Kiva offers to cover foreign exchange risk of more than 10% change in exchange rate, RBI requires MFIs to hedge full risk of fluctuation on exchange rate. This result in high hedging costs. MFIs are actually need not to hedge loans from KIVA since KIVA provides interest free loan for 3 years. Therefore in 3 years even if MFI covers 10% fluctuation in exchange rate, effective cost of fund would still be around 3.5% APR which is less than cost of hedging for Kiva loan.
    - ECBs have 3 years resting period before it can be remitted back to lender abroad but to enable large cash inflow in crowd-funding, where lenders know that loans to borrower are generally of 6 months to 1 year maturity, it would be desirable that for social lending this resting period can be reduced to 1 year so that more overseas lenders can participate in this initiative.
    - Tax exemption on approved social lending via CFPs can be done initially on case to case basis. Coupled with guarantee fund, this can lead to much greater and quicker raising of money specific cases such as disaster support programs.

- There is limited publicly-available industry-wide information about the crowd funding in microfinance. Development support organizations can begin to include P2P platforms in discussions about democratizing access to finance, initiate innovation in this area and promote networking and partnerships between P2P platforms, MFIs and investors.

- Development agencies could develop and offer partial guarantee mechanisms for specific region/loan purpose/profile of the clients for which risk tolerant, less costly funds provided by social lenders are required. These guarantees, backed by proper due diligence, will provide more comfort to social lenders in terms of perception of social return/impact as well as repayment. This mechanism will work more effectively in models in which investors expect nominal returns on top of principal amount as they are more sensitive to the risk of losing their investments. DSOs can also work with CFP's partners in areas currently not served by existing network of MFIs, thus directly promoting the private sector.

- In order to raise the profile of CFP among lenders, development agencies could invest in providing technical assistance aimed at strengthening selected P2P platforms. This would serve as a stamp of approval for these sites, which can advertise the donor's participation and support. Some CFPs have suggested that this type of support would benefit their marketing. While providing such support, caution should be taken in not appearing to "guarantee" loans or "certify" information published on the site.

- Development agencies can set up revolving loan fund for specific purposes and leverage it by mandating CFPs to raise matching funds (Arc-Milaap partnership model) or in some multiplier.

- CFPs and field partners could be supported in better deployment of funds by providing research inputs on identified region/activity or borrower segment, and linkages to CFPs with existing network. DSOs could support due diligence and monitoring efforts of field partners especially where the cost of due diligence is high, such as in post-conflict/post disaster environments. Donors could provide special technical assistance teams, perhaps leveraging existing field projects, to help identify, assess and monitor partner NGOs/MFIs in these contexts.

- Support for fund raising and networking - As a young and growing industry, CFP seeks additional investment as well as strategic partnerships with organizations that can increase awareness of and participation in the company's core online and offline fundraising activities. Industry leaders and support organizations can help organize fund raising events to raise profile of CPFPs with influential individuals and networks. DSOs can support social marketing/public awareness campaigns like Public Service Announcements for crowdsourcing initiatives in India. This can be positioned in the context of supporting special causes enabled by CFPs, raise public awareness and mobilizing social conscious funds from general public.

- Support can be extended for training and capacity building of both CFPs and their field partner for effective social performance / impact reporting. This support can also include necessary investment in software and hardware for efficient and cost effective flow of information between lenders, CFPs, field partners and borrowers and also covering part of HR cost at CFPs/field partner level for the SP/impact reporting.

Conclusion and way forward:

India is capital starved country and needs new alternative vehicles to increase access of capital. It has been 7 years since first crowd-funding platform for social lending started in India. However industry is still in nascent phase. Business models are evolving and yet to demonstrate sustainability. For-profit models are in pursuit of scale and profitability. Since this model is funded by private equity, it may provide limited scope for entrepreneur to explore, learn and make mistakes. Investors could become obsessed with valuations and their exit can be detrimental. In non-profit model, outreach and growth is directly related to funding availability. There could be issues of transparency, accountability and efficiency.

CFPs argue that impact measurement need not to be conducted very rigorously as it is a costly exercise. CFPs suggests that as long as fund is transparently deployed for the causes for which it is meant to, onus of measuring impact should not be on them. There are divergent expectations of measuring and reporting impact. CFPs have been in the business of some year now. It is a good time when an independent agency can analyse contribution of crowdfunding experiment and its potential in detailed manner and suggest simple, easy to implement and cost effective impact/SPM reporting framework for CFPs.

The alliance between technology and finance is heading towards a new paradigm with the emergence of peer-to-peer (P2P) lending/crowd funding technology platforms. While in certain regulatory jurisdictions this space is being looked at as more favourable, some other regulators have raised concerns mainly relating to distress for lenders in the event of a sudden closure of such platforms. While these platforms are still new to India and the scale of transactions is insignificant, this is a gap which requires regulatory attention. The lack of clarity of rules and regulations has meant the industry is shooting in the dark. As the P2P market matures, and is better understood by consumers and regulators alike, we can hope that the grey area in which many platforms are still working becomes clearer and that the regulatory authorities will adopt policies conducive to the industries' growth and transparency. This is all more important since many players are making an entry into this space amidst concerns over regulatory arbitrage.

It may not be appropriate to restrict promotions for 'social investments' that raise money for a good cause in the same way as promotions for other investments. Applying restrictions could act as a disincentive and limit growth in this sector. Social investors are not primarily focused on monetary profit and are more willing to accept the risk of capital loss. However an investment's social or other non-financial objective should not be the reason to reduce consumer protection when the same risks of potential capital losses and illiquidity can apply. While it might be appropriate at present, since the market is embryonic, this may change in the future if loan-based crowd-funding becomes a significant investment for a large proportion of investors.

Landscape of financial services is changing very fast with new institutions like payments banks and models like mobile money. This innovation will certainly provide fillip to true peer to peer lending in India. Initiatives like public service announcements planned by Milaap and celebrity endorsements (Kiva.org benefitted by celebrity endorsements like Clinton and Oprah Winfrey) can provide much needed push to web enabled social lending. .

Going forward, there is a need to undertake detailed research in this space covering the following aspects/questions:

- Detailed analysis of operating costs and business projections of CFPs backed by financial statements of at least last 3 years. This analysis should allow drawing some conclusion of how current models are positioned against mainstream microfinance funds and its sustainability going forward.
- Why do lenders really want to lend? How do members come online, how are they identified, and how are info/online security matters handled?
- Detailed analysis of due diligence of field partners conducted by CFPs.
- Since CFPs handle lenders money by so called escrow accounts, how are escrow accounts maintained and what is their legal status? Can a private limited company be an Escrow agent in India or is this limited to NGOs?
- How do real Funds Transfers happen - between lenders and the MFI, and between the latter and its borrowers? How are funds returned to lenders if required or real time basis?
- How can online models boost savings of the poor people and provide other financial services to the poor? How can cultural changes be initiated in the Indian environment?
- What are privacy protection regulations for all the photographs of borrowers on the websites? Are borrowers aware that their MFI is forwarding their photograph and profile to CFPs? What permission is taken?

Annexure – 1 Summary for key information for identified crowd funding platforms

Sl.No.	Particular	Milaap	Rangde	Micrograam	Kiva
1	Business model	For-profit	Not for profit	For profit	Not for profit
2	Legal form	Company	Trust	Company	US Non-profit
3	Start year of operation	2010	2008	2009	2005
4	Website address	www.milaap.org	www.rangde.org	www.micrograam.com	www.kiva.org
5	Alexa ranking (Global)	77,287	1,39,475	21,00,083	4,105
6	Alexa ranking (Indian)	7,902	14,779	NA	14,330
7	***Date of data from Sl.no 7-13***	***May 22, 2015***	***May 26, 2015***	***April 30, 2015***	***May 27, 2015***
8	# of loans	29094	35982	9355	8,90,453
9	# of investors	NA	7388	3603 (3508 Kiva)	12,96,802
10	Total disbursement	Rs.258.02 million	Rs.297.6 million	Rs.136.5 million	Rs.42730.1 million
11	Outstanding	NA	Rs.72 million	Rs.47.8 million	NA
12	Repayment rate	99.78%	99.78%	99.60%	98.72%
13	# of field partners	35	28	32	296
14	Effective cost of fund to field partners	10-16%	9-10%	10-12%	0%
15	Effective interest rate for end clients	As per field partner own policy (16-24%)	16%-17%	As per field partner own policy (16-24%)	As per field partner own policy (20-24%)
16	# of state / countries	18 states of India	15 states of India	7 states of India	85 countries
17	***Date of balance sheet information***	***March 31, 2014***	***March 31, 2014***	***March 31, 2014***	***December 31, 2013***
18	Balance sheet size	NA	Rs.20.19 million	Rs.2.65 million	$23.2 million
19	Fund mobilised and lent during the year	NA	NA	NA	$118.9 million
20	Revenue	NA	Rs.3.72 million	Rs.0.78 million	$22.6 million
21	Revenue from operations / online donation	NA	Rs.2.54 million	Rs.0.78 million	$12.1 million
22	Expenses	NA	6.92 million	3.18 million	$16.8 million
23	OER calculation	NA	Expenses/fund mobilised (2012-13)	NA	Expenses/fund mobilised
24	Operational efficiency	NA	10%	NA	14%
25	OSS calculation	NA	Revenue/expenses	Revenue/expenses	Kiva's online revenue / total expenses
26	OSS %		54%	25%	72%

Source: Information available on organization's respective website and published annual reports