



“Crowdfunding: A New Mode of Entrepreneurial Financing”

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ABSTRACT

This study aims to bring forth some interesting research findings on an emerging field of entrepreneurial financing i.e. crowdfunding by focusing on the some recent advancement in the academic research. Since the inception of world’s pioneer crowdfunding platforms namely: Kickstarter, the scholars have turned their attentions towards this new emergent field of entrepreneurial finance. In crowdfunding, a vast number of people contribute in small proportions towards novel or innovative projects by using internet platforms. This study reveals that till now the research on crowdfunding mechanism has focused on developed markets; while the studies from developing markets are rare. Lastly, this study points out some interesting research gaps and provides future research directions.

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1. Introduction

Crowdfunding has now become an important means of generating huge sum of funds by small contributions with aim of promotion new ideas of people. Crowdfunding represents an innovative mode of entrepreneurial financing where funds are pooled by small contributions from large number of individuals, commonly by means of internet and without involvement of conventional financial intermediaries [1]. Normally, the funds are raised for different types of projects e.g. technological products, innovations, films and movies, artistic work, dance, theatre, publishing, social projects etc. There are three important parties involved in crowdfunding: fund-seeking entrepreneur (who is collecting funds for certain innovative project); crowd-funders (individuals who invest small sums of money in aforesaid projects) and crowdfunding platform (online intermediary who connects fund-seekers and crowd-funders) [1].

Currently, different models of crowdfunding are in practice on the basis of rewards/incentives they offer to the funds providers. The most important models are comprised of reward-based, equity-based, donation-based and lending-based crowdfunding. In reward-based crowdfunding, intangible or non-monetary tangible rewards (repute, identity, product etc.) are provided to the investors. Equity-based crowdfunding gives share in equity or share in profits/revenues of the new venture. In donation-based crowdfunding, the backers are given a donor agreement without any tangible or pecuniary rewards. Finally, in lending-based crowdfunding there are no financial intermediaries and a credit contract is presented to the supporters [2]. There are two stages in crowdfunding process from crowd-funder’s perspective i.e. pre-investment stage and post-investment stage. Pre-investment stage is pertinent to the phase where backers are engaged in the process of due diligence and decision making on the basis of motivation for certain crowdfunding ventures. Post-investment stage is concerned with the phase where the desired investment level

for a crowdfunding project has been attained and so far research in this area is still in infancy [1], [3].

The next section of the paper provides detailed review of the major studies on crowdfunding and the subsequent section provides conclusion and future research directions.

2. Literature Review

The literature on crowdfunding is still in its nascent stage. A study inspected the success factors of crowdfunding campaigns by emphasizing on internal social capital that supporters grow within a crowdfunding platform by facilitating other community members’ projects [4]. That study investigated a sample of 669 projects from Kickstarter. The empirical results confirm that internal social capital is vital in alluring financiers and generating funds in the initial days of the campaign. These early contributions are linked with the prospects of a project, accomplishing its financing goals and mediate the impact of internal social capital on the accomplishment of project. In another study, [5] emphasized that such early contributions are drivers of success in a self-reinforcing behavior. Their study valuably extended this view by inspecting the reasons for such behavior for example, observational learning, investors’ feedback, word of mouth etc. Further, funds collected and number of early funders have been documented (quantitatively) to observe the aforesaid pattern. The findings depict that funds (initially collected) have the greatest impact on the self-reinforcing pattern.

Previous studies [6] approve that entrepreneur’s capability to acquire seed investment is affected by his/her personal social contacts (social capital). They contributed to this discussion by emphasizing that social contacts developed within crowdfunding communities also serve as factors to entice seed financing e.g. members of communities will financially contribute in compliance with social obligations i.e. norms of reciprocity either specific or generalized [7]. Such social obligations are articulated by platform-specific pattern such as scrutinizing, financing and providing feedback

to the projects of other supporters. The stronger impact of internal social capital indicates that the effect of these norms of reciprocity is far from trivial and demands for future research. Micro-lending has gained significance in providing financial capital to the penurious entrepreneurs particularly in emerging and under-developed countries [8]. Researchers have highlighted the need for advancement in theoretical understanding of various aspects of crowdfunding and micro-financing, due to their increasing importance in providing financial capital to nascent entrepreneurs [9]. On the basis of cognitive evaluation theory, [10] has examined how linguistic cues (intrinsic and extrinsic cues) can structure entrepreneurial narratives into either business opportunity or an opportunity to help others. Their study has been done in the context of prosocial lending. Microloans provided to over 36,000 entrepreneurs in 51 countries via online crowdfunding platform has been taken as a sample for that study. Their results depict that lenders positively respond to narratives emphasizing the project as an opportunity to help others and less positively when narrative is outlined as a business opportunity i.e. the effect of intrinsic cues is stronger than that of extrinsic cues. Further, the impact of diversity language on intrinsic motivation is not significant. The reason may be that diversity does not help someone feel linked to another and thus fails to accomplish the need for affinity. Contrary to this, it seems that family and friends (i.e. implicitly personal language) will feel obligated to the individual who is in need of funds. The study reveals that entrepreneurial narrative language (which boost intrinsic motivation) has a stronger impact in comparison to the language which weaken intrinsic motivation (i.e., language related to extrinsic motivation) [10].

The study of [11] is the first one to empirically investigate the effectiveness of signals (used by entrepreneurs) in persuading the small investors to fund new ventures in the context of equity crowdfunding. The effect of venture quality and uncertainty on the success of fundraising has been investigated by employing human capital, social capital and intellectual capital as dimensions of venture quality. A sample of 104 equity crowdfunding offerings has been examined in this study. The analyses show that giving thorough information about risks and retaining equity are interpreted as effective signals due to which the chances of successful funding is positively affected. On the other hand, intellectual capital and social capital seems to have very little or no impact on the successful funding [11].

Equity crowdfunding provides an opportunity to invite great number of investors by making an open call to sell equity or bonds in a business venture utilizing the internet. Businesses will need to noticeably signal the worth of their ventures to investors in order to effectively collect funds through an equity crowdfunding platform [11]. The data depicts how the uncertainty level (such as equity and financial forecasts offered) and human capital (measured as the percentage of board members with MBA degrees) is significant to the prospective investors. The study unexpectedly shows that social (alliance) capital and intellectual capital (determined by patents) had very little or no substantial effect on successful funding [11].

Crowdfunding literature lacks in understanding the mechanisms that motivate individuals to invest or pledge in new projects in different forms of crowdfunding [12]. In another study, [2] attempted to contribute towards the literature by investigating the impact of incentives (both

financial and non-financial) on investors' inclination to finance or pledge for equity in crowdfunding ventures. Based on self-determination theory [13] and its extension cognitive evaluation theory [14], both equity and reward-based crowdfunding investors have been examined by mapping their decisions with a crowdfunding project both as a pledge and opportunity for equity. In their study, [2] used Symbid (the biggest crowdfunding platform in Netherlands) as a data source and the registered investors were requested to join a quasi-experiment. In first step, the project was offered as reward based, then as equity based project and in the final step participants discretely selected it as reward or equity based project. According to the results, there was no significant impact of non-financial intentions on the investors' decision making to pledge or invest in crowdfunding projects. Interests of individuals in getting rewards and to trust the entrepreneurs positively affect the decision to pledge to a project. Moreover, contrary to predictions of cognitive evaluation theory, investment in equity is found to be a positive factor of holding a pledge to the project instead of crowding out the willingness of individuals to pledge.

The findings also highlights that projects might use two strategies on crowdfunding platforms for example Crowdcube is employing mixed-rewards strategy by providing its equity investors with both ownership and additional non-pecuniary benefits. Lastly, the results depict that financial incentives and trust (the only non-financial incentive) play the significance role in inspiring the investors' decision. This study is based on existing inductive research on crowdfunded investors on Kickstarter [15], so other related factors (e.g. excitement, adventurous/fun activities, knowing the founders etc.) couldn't be included.

Another study [16] aimed to provide theoretical base and a systematic framework for comprehending the novel financial instruments that can be used in instigation of new business ventures by entrepreneurs. These novelties share many common features e.g. spreading from one part of the world to other e.g. micro-financing, crowdfunding etc. [17]. These financing initiatives utilize online platforms and social networks to not only accumulate huge funds (from small investors) but also to enhance bonding and association between the entrepreneurs and investors for effective execution of the business ventures [18]. These new modes of financing are the consequences of disparities between the supply and demand for capital and rapid expansion in technology. These new financing modes face concerns of governance, ownership and outcome which are rooted in the institutional context (from which they develop and operate). Their framework is comprised of five important components which are institutional contexts, sources and types of capital, demand for capital, resulting ownership and governance and outcomes. Institutional contexts is the predominant constituent that influences all the other four stages. Institutional settings have substantial impact on the foundation, dissemination, acceptance and progress of new financing approaches for stimulating entrepreneurship all over the world. Different sources and types of capital are used in the modern financing techniques e.g. banks, micro-financing institutes, government bodies, individuals etc. Use of internet and social media is increasing as financial intermediaries and platforms in crowdfunding and peer to peer financing (a major difference from traditional financing). Perception of entrepreneurs about supply of capital affect the

sources from which they pursue funding. Further, ownership, governance and outcomes considerations will have significant implications in strategic management of new business ventures [19].

The study also outlines new platforms for future research. The five components of the proposed framework provides prospects for future research at macro, organizations and individual levels. In consideration of institutional contexts, at macro level it is important to explore differences of alternative financing mechanisms in developed and developing economies i.e. policy differences, process of progression to the next level of financing, entrepreneurs' awareness level etc. Further, there is a need to study the varying organizational forms (at organizational level) and the impact of cognitive factors and networks (at individual levels) in developed and developing countries. From the perspective of supply and types of capital, research is required to investigate the impact of competition and regulation (at macro level), technology and informal organizational forms (at organizational level), and motivation and cognitive decision making process (at individual level).

Crowdfunding projects differ in goals and nature of financing struggles, from small artistic projects to projects pursuing huge investments as a substitute to traditional venture capital investment [12]. Since its emergence as a new mode of entrepreneurial financing, billions in dollars have been invested by individual crowdfunding backers in new ventures. However, despite of its increasing importance, little is known about the dynamics of efficacious crowdfunding and its diverse mechanisms. The pioneer paper of [1] has attempted to bridge this gap by conducting an analytical investigation of factors pertaining to success and failure of crowdfunded projects. This research [1] employed US based data of 48,526 projects from Kickstarter (biggest crowdfunding site) with funding over \$237 million. The analyses depicts that crowdfunding projects generally succeed by trivial margins, or otherwise flop by huge amounts. The quality of project seems to be associated with the success of crowdfunding initiative because high quality projects are more likely to get funding. Also, great number of friends on social networking site is linked with project triumph. Similarly, in geographical areas (where the projects are proposed) e.g. country music in Nashville, Tennessee and nature of population, founders' work is linked with the success of projects. However, founders give their best to provide the guaranteed products well in time to funders, but projects often get delayed. Such delays are anticipated by project size i.e. overfunded projects are vulnerable to delay due to high hopes and complications linked with big projects.

In their study [20] explored the evolving crowdfunding field where customers cooperatively struggle to pool resources and develop networks (normally on internet), with aim of financing and facilitating efforts instigated by other individuals or groups. Prosperous service businesses are developing which are coordinating and operating as intermediaries in crowdfunding domain. Their study used grounded-theory approach [21] by qualitatively examining three crowdfunding cases (signifying different set of activities) i.e. SellaBand (music business), Tampline (financial services), Kapipal (non-profit services). The study specifically investigates the reasons and process of customers turning into crowdfunding participants and the mechanism by which service-providers are creating a crowdfunding venture. The study contributes to the marketing literature in two ways.

First, from customers' perspective, the findings divulge motivations, roles and responsibilities, features and magnitude of investment in crowd-funding project. Second, from service-providers' view, the study reveals service roles, objectives and network effects in context of crowdfunding action. This study extends the role of customers into investors via crowdfunding platforms and adds value to service theory. The findings show different inspirations of consumers (involved in three cases) for their contributions and choices to finance. For instance, customers in SellaBand are driven by strong association, encouragement, financial assistance and care; consumers in Kapipal are stimulated by social participation (or participation spirit as labored by Kapipal's founder) and in Trampoline consumers' inspiration is due to the pecuniary returns and uniqueness of crowdfunding model.

The research of [22] has examined response of social innovation to the strategic changes in a sector which has developed into technology oriented from a traditional one. The study brings forth some interesting insights in crowdfunding field by qualitatively assessing the Rang De (social lending website) operating in Indian market. Rang De is operating in an environment where lenders are very concerned about firms' legal status, pricing transparency and strategic governance issues. The strategy of Rang De is to take loans from lenders at interest rate (below the market) and provide it to poor borrowers at below the market interest-rate vide its field partners. So far, Rang De has not faced issues of managing big profits and encouragement to shift from not-for profit governance model to a for-profit status. Rang De is stuck between the restraints of the borrowing side (to find and evaluate borrowers in short time) and the lending side (social lending is still in initial stages in India). Therefore, following the work of [23], their study also recommends methods to avoid the most common reasons for failure during strategic change efforts. There should be effective and sustainable alliance among different constituents of the organizations with no urgency of moving people from their comfort zones. There should be no ambiguity in the vision and it must be effectively communicated besides eradicating impediments from the new vision and influential resisting individuals.

The study of [24] reveals that probability of project's success and overfunding of crowdfunding projects is affected by three significant factors which are investment demanded by crowd-founder, project's duration and frequency of funds' contribution. The study inspects the details of 1127 technological projects given on four distinctive crowdfunding platforms and the findings are in accordance with the results of other studies [1]. First, an increase in funding goal of the project is linked with the lower prospect and degree of success. Second, both duration of project and an increase in dollar amount of per day contribution in a project give boost to the chances of success. These findings are in favor of "reinforcement model" i.e. more contributions results in other contributions and opposite to the substitution one [25]. There is a need to investigate further features e.g. quality of project presentation i.e. sentiment of its text, spelling errors etc. [26].

In a study [27] examined how and to what level innovative investment models e.g. crowdfunding (as a game changer), compelling the strictly controlled securities market to follow the rules of Web 3 era and requirements of JOBS Act, could become a possible threat. Their study elucidates the advancement of equity crowdfunding model in relevance to the technology push and demand pull context besides investigating the present situation of the market. The study

reveals that proponents of equity crowdfunding anticipate it to become a game changer not only for new ventures but also for poor nations. On the other hand, the antagonists blame these innovative financial products for the recent financial/mortgage crises and demand that such naïve investors should be discouraged from the equity crowdfunding system completely. However, it is argued that the mortgage crises has occurred due to 'higher risk craving' of investors by exploitation of those loosely regulated markets. Lastly, for the effective advancement of equity crowdfunding in secondary markets, the study suggests to implement some measures to reduce the aforementioned risks. These measures include increasing transparency regarding shareholder rights, engaging a certain percentage of professional investors, employing self-regulation and involving a third party auditor to give an impartial judgement of the business finance and quality. Further measures include drafting and communicating "right charter" for investors, information disclosure about the individuals who are controlling pricing, enlightening and informing investors about effective techniques for projects' evaluations and forming put and call options for improved exit opportunities for investors.

3. Conclusion and future research directions

This study enriches the understanding of crowdfunding and its diverse aspects. Especially, the review of research from top journals will enable the readers to explore future research area. Nevertheless, more literature review on crowdfunding features is still required because at present crowdfunding is the promising topic in entrepreneurial financing and new studies in this domain are emerging continuously.

Researchers can get new insights by investigating the behavior of crowdfunding investors (especially path-dependency in cumulative contributions), specific market niche of project (techno-investments), investors' experience (both relevant to current venture and previous experience) in the project initiated and investors' participation in ventures' revenue sharing [24]. Future research from consumer's perspective is necessary to examine individuals' varying personality traits that enable them to contribute in crowdfunding enterprises. This research also contributes to the escalating literature on "service dominant logic (SDL)" [28], by extending SDL's basic principle in context of consumers' significance as co-creators of value [20]. Future research can explore how other motivational theories envisage crowdfunding and micro-financing in connection with the role of other types of motivational cues (intrinsic and extrinsic). Crowdfunding operations are conducted via social networks and websites, future research is required to grasp the role of websites in firms' outcomes [29], [30]. Analogies and metaphors enable entrepreneurs to make sense of opportunities which gives a platform for future researcher to further apply qualitative methods in revealing the role and impact of analogical and metaphorical reasoning in crowdfunding and micro-financing [31]. It may be productive for researchers to explore the decision making process in crowdfunding to comprehend the signaling process of new venture [32]. The investing patterns and behaviors of investors in crowdfunded micro-lending also provides a platform to entrepreneurial researchers to understand the decision making phenomenon of crowdfunding investors [33].

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