

# [The driving forces behind crowdfunding management essay](https://assignbuster.com/the-driving-forces-behind-crowdfunding-management-essay/)

How can you raise over 10, 000, 000 in funding for a consumer product, that is not yet produced, without any help from banks, angel investors or venture capitalists. How can you make hundreds of people pay for a meal they just might receive in a distant future? How is it possible to turn thousands of committed customers to also become shareholders without the process of an IPO?

The answer is crowdfunding, which is a financing method that has exploded in popularity the last few years and that is changing the way many individuals, start-ups and businesses seek funding (källa Forbes). “ The basic idea of crowdfunding is to raise external finance from a large audience (the “ crowd”), where each individual provides a very small amount, instead of soliciting a small group of sophisticated investors” (Schwienbacher & Larralde, 2010, p. 1).

The individuals, investors, customers or consumers that make up the “ crowd” are called crowdfunders (Schwienbacher & Larralde, 2010, p. 4) and usually pool their money together via the Internet (källa)

An example of how powerful crowdfunding can be is the Pebble E-paper Watch, a smartwatch for iPhone and Android, which raised $10, 266, 845 in investments during roughly one and a half months on the crowdfunding platform Kickstarter (Kickstarter. 2012c). Another example is the Swedish hamburger restaurant Flippin’ Burgers, which got hundreds of individuals paying for a hamburger before the restaurant even existed and simultaneously financed the start-up of their now immensely popular venue in Stockholm (källa).

example of equity crowdfunding

The crowdfunding market has grown with 557 % in the last five years and crowdfunding platforms raised a total of almost $1. 5 billion in 2011, exceeding one million successful projects (Massolution, 2012). This number is predicted to double in 2012 with the current growth rate, which indicates that this nascent method of financing definitely has the potential to make a substantial change in the way individuals, start-ups and businesses seek financing (källa). The long-term potential of crowdfunding is hard to predict, but currently the phenomena of crowdfunding looks promising.

With scarce research on the subject, there are many aspects of crowdfunding that are still unexplored and with the projected industry growth, a demand will likely arise for a foundation of which entrepreneurs and managers can make informed decisions when hosting crowdfunding projects.

## 1. 1. Background

The background chapter will firstly cover the consumer’s involvement over time and it’s implications on crowdfunding, then a definition of crowdfunding will follow and lastly three different types of crowdfunding will be presented.

## 1. 1. 1. The Consumer’s Involvement

Consumers have traditionally been positioned at the end of a firms value chain, but last decades their role have changed from not only being a target for marketing activities, to actually being a part of the value creation of a firms’ products or services (Hunt, Geiger-Oneto & Varca, 2012, p. 347). The consumers have subsequently become key information sources, co-producers, partners for innovation and, finally, co-creators of value in the related literature (Ordanini, Miceli, Pizzetti & Parasuraman, 2011, p. 444). This shift of focus on the role of the consumer has led to frequent activities by many firms to involve consumers and unidentified individuals in the process of product development and value creation (Zheng, Li, and Hou, 2011, p. 57). Involving consumers as co-producers and co-creators also provides value for the consumers and the process has been positively correlated with the consumers’ product satisfaction (Hunt et al., 2012, p. 347).

This evolution of the consumer’s role was made possible initially by the rise of the Internet and later by technological innovations associated with “ Web 2. 0” (Kleemann, Voß and Rieder, 2008, p. 5). Web 2. 0 is a expression coined in 2004 noting a set of principles and practices that had emerged on the Internet, such as users being co-developers of open source development practices (O’Reilly, 2007, p. 19 & 30). Recently, the consumer’s role has also expanded to include investment support. This phenomenon of collective efforts by consumers and individuals to pool their money together via the Internet to invest in different projects is called crowdfunding (Ordanini et al., 2011, p. 444). Kleemann et al. (2008) argue that we are witnessing an emerge of a new consumer type called the “ working consumer”. Ordanini et al. (2011) also describes the idea of crowdfunding, when consumers and individuals pay for producing and promoting a product instead of buying it, as a further step in the evolution of the consumer’s role. In association with these initiatives of involving the consumers as investors, there are several issues in the boundaries between marketing and finance, that are not yet fully explored and explained (Ordanini et al., 2011, p. 444). Zheng et al. (2011) have shown that consumers get involved in similar kind of initiatives to a great extent because of their intrinsic motivations. However, the field of crowdfunding is still unexplored when it comes to why and how consumers contribute with monetary investments, the selection of initiatives and what implications these behaviors within crowdfunding should have for firms and managers engaging in these kind of activities (Ordanini et al., 2011, p. 444).

## 1. 1. 2. A Definition of Crowdfunding

Crowdfunding is defined as:

“ an initiative undertaken to raise money for a new project proposed by

someone, by collecting small to medium-size investments from several other people

(i. e. a crowd)” (Ordanini et al., 2011, p. 444)

The actors involved in crowdfunding are the people who propose projects to be funded, the crowdfunding organization and the crowd itself. The crowdfunding organization serves as a form of hub, bringing together those who may want to invest in crowdfunding initiatives and those who seek investments for their projects via crowdfunding (Ordanini et al., 2011, p. 444-445). These crowdfunding organizations typically conduct their business via a website, (compare: http://www. indiegogo. com/, http://www. kickstarter. com/ and https://www. sellaband. com/) in which actors can advertise their crowdfunding initiatives to the crowd.

The crowdfunding phenomena is much like regular investments, some efforts are successful and some are not. A popular crowdfunding site at the time of writing, Kickstarter, reports that 43. 81 % of the crowdfunding projects at their website are successful  (Kickstarter. 2012d). They also report that they do not accept just any crowdfunding request and that about 25 % of submitted projects are not accepted to the site (Kickstarter. 2012b). This means, in practice, given that their numbers are correct, that about one third (0, 75\*0, 4381â‰ˆ1/3) of the attempted crowdfunding projects at the website in question are successful. One example of such a successful crowdfunding project in 2012 is Pebble E-paper Watch, which in total raised $10, 266, 845 in investments during roughly one and a half months (Kickstarter. 2012c). This demonstrates that it is indeed possible to obtain large investments from crowdfunding.

## 1. 1. 3. Different Types of Crowdfunding

Crowdfunding can be divided into three different types of crowdfunding initiatives: (Schwienbacher & Larralde, 2010, p. 13)

Donations – asking for donations rather than offering some kind of financial or remunerative incentive in exchange of an investment (Schwienbacher & Larralde, 2010, p. 13). Example: Raising money for a good cause, like surgery of a diseased child.

Passive investments – giving some form of incentive in exchange for investments, these incentives can take many forms. In general a higher investments yields a higher incentive. Most crowdfunding like this does not offer any kind of possibility for the investor to participate in the project. This is in other words a form of crowdfunding where the entrepreneurs raise money without giving up control or having the customers actively involved (Schwienbacher & Larralde, 2010, p. 13). Example: Pre-ordering of a product (such as a music CD).

Active investments – offering an active role in the initiative in exchange for investments. This could include offering shares of the profit or voting rights for features of the product. As in the case of passive investments, a higher investment in active investments generally yields a higher incentive. The entrepreneurs can in this way gain insight in their markets and receive valuable information of how the market thinks the product should be customized (Schwienbacher & Larralde, 2010, p. 13-14). This type of investment with involvement in co-production, increases product satisfaction (Hunt, Geiger-Oneto & Varca, 2012, p. 354). Example: Offering shares of profit from a concert, in proportion to how much money is invested.

## 1. 2. Problem Discussion and Previous Research

As a new emerging phenomena, crowdfunding and its consequences for businesses

and consumers are not fully understood. For instance: what drives the engagement of consumers to invest in crowdfunding initiatives? (Ordanini et al., 2011, p. 444) One interesting way of approaching this question is stated by Ordanini, Miceli, Pizzetti and Parasuraman (2011, p. 446):

“ Some extant literature streams are helpful in providing an appropriate backdrop for understanding crowd-funding, although insights from each stream only address some but not all aspects of this emerging phenomenon.”

This method provides an helpful framework for approaching the problem. The actors that invest in crowdfunding projects can be seen as both customers and investors (Schwienbacher & Larralde, 2010, p. 13 & Ordanini et al., 2011). This, in combination with the statement above, suggests that it is interesting to investigate why people participate and invest in crowdfunding projects both from a customer behavior perspective and an investment behavior perspective. Crowdfunding is as mentioned in 1. 1. 2 conducted online. If crowdfunders are seen as customers, the act of participating in crowdfunding can be compared to customer behavior in online shopping.

Research in online customer behavior suggest that customers are motivated by extrinsic and intrinsic motivations when shopping online (Shang, Chen, & Shen,  2005, p. 401).

Since crowdfunding is a relatively new phenomena, the literature in the subject is far from extensive. To demonstrate this, examples of searches in Scopus and Thomson Reuters’ Web of Knowledge as of the 25th of October 2012 will be presented below. Scopus and Web of Knowledge are extensive databases tracking citations with 47 million (SciVerse, 2012) and 49, 4 million (Web of Knowledge, 2011) records respectively. A search for the term “ crowdfunding” in Scopus rendered 5 results when limiting the results to articles. The same search in Web of Knowledge rendered 9 articles. Out of all these articles the oldest one was from 2011 (Ley & Weaven, 2011), and the rest were published in 2012. This demonstrates that crowdfunding is indeed a new phenomena, and from these quick searches it can be concluded that the literature in crowdfunding is scarce.

In a review of the literature found during the literature study which laid the foundation to this thesis (and included broader search terms than the above mentioned) it was found that it was only Ordanini, Miceli, Pizzetti & Parasuraman (2011) who have studied how and why people engage in crowdfunding initiatives. The authors did this by conducting interviews with employees at three major crowdfunding platforms. Their findings revealed that crowdfunding participants’ motivations were very dependent on the type of project. Their study showed that the main motivation is patronage for music projects, monetary return for financial loaning and social participation for charity. However, their findings are based on interviews with informants from the crowdfunding intermediates without including any individual investors in their study. It appears to be a knowledge gap from an investor perspective, investigating the investors’ motivations to participate in crowdfunding initiatives.

Since the actors engaging in crowdfunding initiatives can be seen as both customers and investors (Schwienbacher & Larralde, 2010, p. 13 & Ordanini et al., 2011), it is interesting to research why individuals get involved in crowdfunding both from a customer behavioral perspective and an investment behavioral perspective. To the extent of our knowledge, this has not been covered in the literature so far.  In summary, the literature on crowdfunding is scarce and while some aspects of crowdfunding has been studied, others remain unexplored. The purpose of this study is to attempt to fill the mentioned knowledge gap about motivations in the literature of crowdfunding and contribute to widening the research on crowdfunding. This thesis will examine the factors that motivate customers/investors to engage in passive crowdfunding projects.

## 1. 3. Research Questions

The problem description has resulted in the following research questions:

1. How do crowdfunders’ intrinsic and extrinsic motivations affect their size of investment in passive crowdfunding projects?

2. How important is the influence of other crowdfunders’ investments?

## 1. 4. Purpose

The purpose of this study is to research the relatively new phenomena of crowdfunding and examine the motivational factors that make people invest in crowdfunding projects. By examining why consumers invest in crowdfunding projects this study is intended to contribute to fill the knowledge gap identified in the problem description. The literature in general about crowdfunding is scarce and to our knowledge this type of study about crowdfunding has not been conducted before.

Praktiska tillämpningar

## 1. 5. Disposition

The disposition of the thesis will be as follows, after this section a chapter about the theory used in this thesis will be presented, followed by a chapter about the research design and methods used. After that, the results of our surveys will be presented and a critical discussion about the results will follow. At the very end, the conclusions from the study will be presented and after that a list of references and appendixes will finalize this essay.

## 2. Theory

This chapter will present the theory that lays the foundation to the thesis. First, customer behavior and relevant motivation theory will described and related to crowdfunding, including the important distinction made in this thesis between intrinsic and extrinsic motivation. Second, relevant investment behavior theory related to crowdfunding and an explanation of the phenomena of momentum in crowdfunding will be explained.

## 2. 1 Customer Behavior

As mentioned in the problem discussion, the individuals participating in crowdfunding projects can be seen as both customers and investors (Schwienbacher & Larralde, 2010, p. 13 & Ordanini et al., 2011). The first research question of this thesis is “ What motivates crowdfunders to invest in crowdfunding projects?”, therefore motivation theories will be presented below. In general, motivation research  is directed to finding motives for peoples behavior (Sheth & Mittal, 2004, p. 234). Within customer behavior, motivation research is aimed at finding out “ the conscious or subconscious reasons that motivate people to buy or not to buy a particular product, service or brand, or to patronize or avoid a store, or to accept or reject a marketing communication” (ibid.). In this study, the research will be aimed at finding out the reasons why customers engage in crowdfunding initiatives, in other words, why they purchased the incentive offered at a given investment level.

## 2. 1. 1. Motivation

Ryan & Deci describes to be motivated as the “ means to be moved to do something” (2000a, p. 54). A person who is motivated is a person who is inspired, energized or activated to act, where as an unmotivated person, feels no drive, incentive or stimulus to act. Motivation can be measured in terms of the level of motivation and the orientation of the motivation. The level of motivation refers to how much motivation an individual has, for example when a potential customer is out shopping for a car, if the salesman who assists the customer get paid in terms of commission it could be expected that this salesman has a higher level of motivation to make the sale than if the same salesman would have a fixed salary and no commission. The orientation of motivation refers to the underlying motives, goals and attitudes of the motivation, in other words why someone is motivated. An example of orientation of motivation is that a student may do her homework because she finds it interesting and intriguing, or the student may do her homework because her teacher and parents require her to do it. The student in this example may have equal level of motivation in both cases, but the nature of the motivation is entirely different because of its origin (Ryan & Deci, 2000a, p. 54-55).

A basic distinction of orientations of motivation is the distinction between intrinsic motivation and extrinsic motivation: (Ryan & Deci, 2000a, p. 55)

## 2. 1. 1. 1. Intrinsic Motivation

Intrinsic motivation is an orientation of motivation that origins in doing something for its inherent satisfactions rather than doing something to achieve an outcome. An intrinsically motivated person is a person who is motivated because an activity is fun, challenging, novel, interesting or simply put satisfying psychological needs (Ryan & Deci, 2000a, p. 56-57). This can be compared to that children from the date of birth are active, curious and playful in despite of rewards being absent. It is a natural motivation that encourages “ assimilation, mastery, spontaneous interest and exploration that is so essential to cognitive and social development and that represents a principal source of enjoyment  and vitality throughout life” (Ryan & Deci, 2000b, p. 70).

In crowdfunding, examples of intrinsic motivation could be to fund a technological project of a gadget because it is fun, or funding a project raising money for surgery of a child out of compassion. An important concept in the case of charity is warm-glove giving. Warm-glove giving means that donors are egoistically motivated by the act of giving and not only the altruism    (Andreoni, 1990, p. FIXA).

## 2. 1. 1. 1. Extrinsic Motivation

Extrinsic motivation is in contrast to intrinsic motivation when the origin of motivation lies in obtaining a separable outcome from performing an activity. Satisfying psychological needs is not necessarily related to extrinsic motivation, instead extrinsic motivation covers the continuum between amotivation and intrinsic motivation (Ryan & Deci, 2000b, p. 71-72). An illustration of this is that a student may do her homework because she fears sanctions from her parents or because the student sincerely believe that doing the homework will be valuable for her future career. In the latter case intrinsic motivation and feeling of choice is present, while in the prior case external control and compliance is imminent. Even though both cases involves intentional behavior, the types of extrinsic motivation is different because they vary in autonomy.

In crowdfunding, examples of extrinsic motivation could be to fund a technological project of a gadget because an incentive given is the actual gadget, or funding an artist’s concert for a share of the profit.

## 2. 1. 2 Shopping experience

## 2. 2. Investment Behavior

According to Ordanini et al. (2011), the emerging phenomena of crowdfunding has transformed consumers into investors. The consumers are contributing financially to other peoples’ or organizations’ projects and expect either a monetary or non-monetary incentive for their support. Thus, the characteristics of crowdfunding are very similar to financial investments and the behavior of crowdfunders can thereby resemble the investment behavior of individuals in financial markets  (Ordanini et al., 2011, p. 450).

Herding Behavior in Online Shopping

A large group (a crowd or mob) is likely to show examples of group behaviour

## 2. 2. 1. Herding Behavior in Financial Markets

Crowdfunding projects seem to follow similar patterns where the financing of the crowdfunders triggers a chain reaction and facilitates rapid growth at a certain point (Ordanini et al., 2011, p. 457-458). This kind of snowball effect in the crowdfunders’ behavior, of something small building upon itself and becoming larger, can be found and be explained in several investment situations and can be both positive and negative. This investment behavior can be found as a negative effect in bank runs (Iyer & Puri, 2012, p. 1414) and as a positive effect in rational herding in financial economics (Devenow & Welch, 1996, p. 603). Bank runs are situations when bank customers withdraw their deposits from banks because they don’t believe that the bank can keep them safe. This phenomenon has been a recurrent case in the history, from the Great Depression in the 1930’s, to the financial crisis recently (Iyer & Puri, 2012, p. 1414). The same pattern can be found in rational herding in the financial markets, when investors act based on other investors’ decisions rather than information about the investment itself (Masson, Gotur & Lane, 2001, p. 100). Imitation and mimicry are two of the humans most basic instincts, which could partly explain why investors are influenced by the decisions of other investors in financial economics (Devenow & Welch, 1996, p. 603). Rational herding occurs because of payoff externalities and information externalities. Payoff externalities is when investors benefit from other investors following their actions and information externalities is when investors gain useful information from observing previous investors’ decisions to a level where they consider it to be more reliable than their own information (Masson, Gotur & Lane, 2001, p. 100).

## 2. 2. 2. Investment Momentum in Crowdfunding

Ordanini et al. (2011) have found that a similar momentum in crowdfunding occurs at a recurrent stage of the crowdfunding process and they have identified three distinct phases in the investment process that are applicable to most crowdfunding projects. The first phase includes the investments reaching approximately half of the project’s target capital and mostly consists of investments from people who are directly connected to the project or the network of the creator of the project. The emphasis in this phase is the involvement of people related to the project or the creator to accumulate a start funding underlying the rest of the crowdfunding process (Ordanini et al., 2011, p. 457-458).

The second stage usually slows down in investment growth and is considered to be the most delicate and important phase, since it typically determines if a project fails or succeeds. Motivating and involving people in this phase is crucial to trigger the crowding process and the inability to do so is a very common reason for failure (Ordanini et al., 2011, p. 457-458).

The third and last phase is when a project triggers a chain reaction that facilitates rapid growth to reach and, in some cases, exceed the investment target. The crowdfunders in this phase are primarily people without any original connection to the project and the investment process usually speeds up when it comes closer to the accumulated target investment. Ordanini et al. (2011) claim that the reason for this is that in many cases, the opportunity to invest will disappear as the project reaches its target investment. In this situation, the crowdfunders act very similar to investors in the financial markets and nobody want to miss the opportunity to invest and be a part of the project, which results in a chain reaction triggering more and more people to invest (Ordanini et al., 2011, p. 457-458).

Crowdfunding momentum graph? (Ordanini)

## 3. Method

This chapter will explain the method used in this thesis. Firstly a broad perspecitve of the method used will be presented, the Research approach and Research design. After that a more narrow view and thesis specific details will be presented; the Research strategy using surveys, the conduction of the survey and the data analysis. Finally the reliability, validity and replicability of this study and the presentation of data will be presented.

## 3. 1. Research Approach

As shown, crowdfunding is a subject on which there is little existing literature and scarce knowledge. Because of the insufficient prior research on the topic, it is simply not possible to define a theoretical framework for a hypothesis, which precludes a deductive research approach (Saunders et al., 2007, p. 127). The research questions emphasizes on why something is happening, rather than being able to describe what is happening, which implies that a more inductive approach would be appropriate (Saunders et al., 2007, p. 126). Although, an inductive approach involves drawing generalizable inferences out of observations (Bryman & Bell, 2007, p. 14), which is not an accurate relationship between the theory and data in the study since the research questions are based on previous studies. The objective of the study is to discover new variables and relationships and to stress theory development, rather than theory generation or confirmation of existing theory. For such a study, Dubois & Gadde (2002) suggest an abductive approach which enables continuous interplay between theory and empirical observations. The abductive approach also allows the framework to be successively modified as a result of unanticipated findings and insights during the research process, which enables new conclusions when theoretical models and new concepts encounter the reality (Dubois & Gadde, 2002, p. 559).

## 3. 2. Research Design

The research desigend is intended to generate evidence to answer the research questions that are established and to act as a framework for the research process (Bryman & Bell, 2007, p. 39-40). The study entails data from several cases at a single point in time in order to collect quantifiable data to detect patterns of associations. Because of this, this study is based on a cross-sectional design, which is the study of a phenomena in a given point in time (Saunders, 2007, p. 155).  A cross-sectional design enables examining several variables to explore potential variations, which suits the research questions of identifying motivations and distinguishing differences between different categories in crowdfunding. In cross-sectional design research, the data is also collected simultaneously, in contrast to experimental design, and the data is quantifiable by a systematic method for measurement and benchmarking. However, with the cross-sectional design it is only possible to examine relationships without being certain of the casual influence, in contrast to an experimental design where variables are manipulated (Bryman & Bell, 2007, p. 55). Although a cross-sectional research design is sufficiently adequate to serve as a foundation for drawing certain inferences (Bryman & Bell, 2007, p. 56).

## 3. 3. Sampling

This study has been conducted on the following crowdfunding websites:

http://www. rockthepost. com/

http://www. sponsume. com/

http://www. helpersunite. com/

http://peerbackers. com/

https://www. sellaband. com/

The reason for choosing the above mentioned crowdfunding websites is that they permit contacting the participants in their crowdfunding projects via the websites’ respective internal mail systems. There are a few more crowdfunding websites in which it is possible to contact investors, but some require that you have invested in the same project as the users that you want to contact and others have no compulsory contact information, meaning that the users manually would have to post their contact information in their description to be contactable through the website. Worth noting is that even in the websites chosen for this study, there are some users that can not be contacted because of the option of being anonymous when investing.

The study is also, as mentioned in the research questions, limited to passive investments in crowdfunding. Within passive investments this thesis is also limited to only successful crowdfunding projects, because the crowdfunding websites appear to remove the unsuccessful projects as to not discourage potential clients. This makes it impossible to access information about unsuccessful crowdfunding projects without the owners of the websites’ collaboration. Collaborating with the crowdfunding websites themselves has though been judged to be out of the scope for this study due to time restrictions.

A consequence of studying only successful crowdfunding projects is that the participants in our study are asked about their motivations retrospectively. This means that the participants’ investment motivations rather are their retrospective rationalization of their investments, than their decision making process prior to the investment. Therefore, it is impossible to determine to what degree the customers/investors were affected by any post-purchase rationalization or dissonance to justify their investments. In an attempt to counter this problem, only crowdfunders that have participated in crowdfunding projects that have recently ended has been contacted. The time frame chosen for this was one week. Within the crowdfunding projects chosen within the different categories of crowdfunding no sampling were made, instead all participants that were not anonymous were contacted.

## 3. 4. Research Strategy: Surveys

The research strategy chosen for this thesis is surveys in the form of Internet questionnaires. This research strategy has been chosen because it is common in business and management research and allow for collection of large amounts of data to a relatively small cost (Saunders, 2007, p. 144). Given the quota sampling and the internal mail systems provided by the crowdfunding sites, Internet surveys provided us with a simple solution of reaching out to all participants in selected crowdfunding projects, seeing as it was fairly easy to contact the crowdfunders via the internal mailing system. This allowed for generating findings that are representative for the entire population in the chosen crowdfunding projects. In comparison to interviews this is also a less time consuming strategy and seeing as this is a bachelor thesis, time is of the essence.

Surveys allows for collecting large amounts of data for statistical analysis. The data collected from surveys could for example be used for suggesting possible relationships between variables and produce models for these relationships (Saunders, 2007, p. 144) (Bryman & Bell, 2007, p. 56). This is much in line with our research questions.

## 3. 4. 1 Survey Design

When designing a survey it is important to use standardized questions that will are likely to be interpreted in the same way by all respondents (Saunders, 2007, p. 393).

The surveys sent out to the different crowdfunding projects where therefore identical.

Language – non native English speakers

The questionnaire consists of XX questions in total, this because a questionnaire should not be longer than is necessary to meet the research objective and that it is generally believed that a shorter questionnaire has a higher response rate than a longer questionnaire (Saunders, Lewis, & Thornhill, 2012, p. 436).

Designing questions

(Bryman & Bell, 2007, p. 266-271)