

Working Paper: Crowdfunding

O Riordan, Niamh, National University of Ireland, Galway, Ireland, n.oriordan@yahoo.com

Introduction

Star Citizen is a massively multiplayer online video game that is being developed by Chris Roberts and Cloud Imperium Games¹. What sets it apart from any other online game is that as of 3 September 2013, its creators have raised more than \$17 million dollars through crowd funding. Crowd funding occurs whenever individuals make a collective effort to pool their money, usually via the Internet, to support efforts initiated by other people or organizations (Ordanini et al., 2011). Crowd funding websites like Star Citizen and KickStarter are growing in importance and are being used to drive innovation in firms. According to the Huffington Post, crowdfunding websites helped companies and individuals worldwide raise \$0.89 billion from members of the public in 2010, \$1.47 billion in 2011 and \$2.66 billion in 2012². In this report, we define the phenomenon of crowd funding within the overall context of crowd sourcing and open innovation. We identify some of the main crowdfunding success stories to date and trace out some of the key ways that these sites are influencing organizational decision making and leading to the emergence of new business forms. Using this analysis, we conclude by identifying some of the key research questions that need to be addressed, such as those concerning intellectual property management and organizational governance.

Definition

Crowd funding, also known as crowd-sourced fundraising, is a bottom-up (Gaggioli and Riva, 2008) and collective (Ordanini, 2009) approach to financing. When it is used, the role of the customer is changed: the customer becomes an investor in the idea or in the business that is being funded (Ordanini, 2009). Crowd funding is not new: it has, for example, been used as a means of funding political campaigns (Kappel, 2009) and as a means of funding Non-Governmental Organizations (NGOs) for quite some time. However, contemporary forms of crowd funding differ from previous forms. First, they are being used to finance a wider variety of projects than before such as arts-based and entertainment oriented projects (Kappel, 2009) and technology-based projects (Gaggioli and Riva, 2008). Second, contemporary forms of crowd funding take advantage of the concept of the wisdom of crowds which suggests that the many are smarter (and make better investment decisions) than the few (cf. Surowieki, 2004, p. xiii). Third, contemporary crowd funding initiatives like Star Citizen and KickStarter are increasingly used to fund highly innovative ideas and/or entrepreneurial companies. For these reasons, contemporary forms of crowd funding are closely related to the concept and practice of open innovation, an emergent model of innovation in which firms draw on research and development that may lie outside their own boundaries (Chesbrough, 2003, p. 104).

¹ <http://en.wikipedia.org/wiki/Crowdfunding> Accessed October 11, 2013

² Global Crowdfunding Volumes Rise 81% In 2012, 04/08/2013, The Huffington Post, Retrieved at 7 September 2013

Reviewing the state of the art

As contemporary forms of crowd funding are an emergent phenomenon, the academic literature on them remains in its infancy. The literature to date has primarily concentrated on documenting the phenomenon of crowd funding and on providing anecdotal evidence of successful crowd funding initiatives. Scholars have focused on defining the phenomenon (e.g. Kappel, 2009; Lawton et al., 2010); measuring the growth of the phenomenon (e.g. Agrawal et al., 2011); identifying techniques that can be used to maximize returns on a particular proposal (e.g. Bellaflamme and Lambert, 2011); investigating the legal and IP risks associated with crowd funding (e.g. Hemingway et al., 2010; Satorius and Pollard, 2010) and finally, looking into the economics of microfunding (Ward et al., 2010) and microstartups (Pope et al., 2010).

At a high level, a number of key themes are apparent. In terms of the opportunities afforded by crowd funding platforms, there is a broad consensus that crowd funding is an effective way of funding small companies who might not otherwise have access to investment funds as investors can limit their exposure by choosing to invest only small amounts. Similarly, crowd funding is also a useful way of funding new businesses, again because it allows investors to limit their exposure to (potentially) risky investments.

Nevertheless, there are a number of important issues that must be resolved if crowd funded enterprise is to gain significant traction. The first concerns the changing role of the customer in crowd-funded enterprise. Specifically, once a customer has invested in a business or in a business idea, they are now entitled to benefit from that business or idea. The difficulty is that in existing platforms this can be difficult to formalize. One solution that is gaining ground, known as equity crowdfunding, is based on turning customers into shareholders³. However, it is clear that such proposals in turn have important consequences in the area of corporate governance.

Key gaps in existing knowledge

Notwithstanding the level of interest in this phenomenon, there are a number of key gaps in current knowledge. In the context of this paper, we consider key questions from the perspective of companies, customers and crowd funding platforms in turn.

From the perspective of companies looking to get funding through crowd funding platforms, one of the key questions concerns the ability to clearly map the different types of crowd funding platform that currently exist and to be able to identify the most appropriate platform for their particular proposal. It is clear that these companies need to clearly understand what customers who choose to invest in them are to gain in terms of ownership of and other rights to the idea. At the same time, these companies need to be able to effectively pitch their ideas. As an important first step, companies need to analyze existing proposals in order to identify the key characteristics that distinguish successful and unsuccessful ideas. At the same time, these companies need to clearly understand the motivations of investors: who are these investors, how can appropriate investors be targeted and how best to engage particular investors? For instance, are investors primarily motivated by a desire to make money or by more altruistic goals? The answer to this question will have important implications for how companies choose to promote their ideas on crowd funded platforms. Further, the company that can successfully answer these key questions and deliver a pitch that satisfies these investors' needs is most likely to succeed in getting their idea funded.

From the perspective of customers who are wishing to invest in crowd funded initiatives, a number of key questions need to be considered. For customer who might be interested in benefitting financially from investing in crowd funded projects, research is needed to ascertain what metrics are most useful in identifying projects that are most likely to be successful if funded. A related question is to investigate whether a particular 'algorithm' can be identified for selecting suitable projects and for then choosing a

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<http://www.theglobeandmail.com/report-on-business/small-business/sb-money/business-funding/crowdfunding-20-will-turn-customers-into-shareholders/article14870380/> Accessed October 16th 2013

strong portfolio of projects. Customers also need to understand how these kinds of investment opportunities differ from more traditional opportunities and to be able to balance their investments in that overall context. Customers also need to clearly understand the different benefits models that are being operated by crowd funding platforms in terms of benefits for investors. Will the customer have stocks in the company they invest in? How will their investment lead to a return?

Finally, the core motivation of the crowd funding platforms is to grow the market for crowd funded platforms. As such, the key questions for this group of organizational stakeholders are somewhat different from the key questions for customers and the key questions for companies. More specifically, the platforms themselves need to better understand how to resolve questions related to customers-as-shareholders, corporate governance, intellectual property ownership. One key question that has not been tackled in the literature to date is to do with how crowd platforms might proactively stimulate the growth and development of successfully funded projects. If these platforms can perform these kinds of services, then larger corporations are more likely to engage with the platforms leading to the growth of the market in this area and at the same time, the platforms themselves will have strengthened their competitive positions in the marketplace.

Initial statement of research questions

Our analysis indicates that most of the published literature on crowd funding to date has been anecdotal in nature. For this reason, there is a need for empirical research on existing crowd funding platforms. We would like to carry out an exploratory investigation of existing crowd funded platforms to address some of the key questions identified in the previous section. More specifically, we would like to conduct a systematic investigation of the existing projects on KickStarter with a view to mapping things like the ratio of successful to non-successful projects, the average amount of investment into each project and to explore the possibility of identifying particular characteristics that might enable organizational stakeholders to better identify successful projects.

We believe the answers to these questions will result in tangible benefits for companies looking for funding and customers looking to invest. More broadly, we feel that there is a strong need for further research on crowd funding given its potential to stimulate entrepreneurial activity particularly at an SME level. This is of particular relevance in the current economic climate given that more than 70% of people in this country alone are working for small companies.

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