



Crowdfunding our health: Economic risks and benefits

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ABSTRACT

Crowdfunding is an expanding form of alternative financing that is gaining traction in the health sector. This article presents a typology for crowdfunded health projects and a review of the main economic benefits and risks of crowdfunding in the health market. We use evidence from a literature review, complimented by expert interviews, to extend the fundamental principles and established theories of crowdfunding to a health market context. Crowdfunded health projects can be classified into four types according to the venture's purpose and funding method. These are projects covering health expenses, fundraising health initiatives, supporting health research, or financing commercial health innovation. Crowdfunding could economically benefit the health sector by expanding market participation, drawing money and awareness to neglected health issues, improving access to funding, and fostering project accountability and social engagement. However, the economic risks of health-related crowdfunding include inefficient priority setting, heightened financial risk, inconsistent regulatory policies, intellectual property rights concerns, and fraud. Theorized crowdfunding behaviours such as signalling and herding can be observed in the market for health-related crowdfunding. Broader threats of market failure stemming from adverse selection and moral hazard also apply. Many of the discussed economic benefits and risks of crowdfunding health campaigns are shared more broadly with those of crowdfunding projects in other sectors. Where crowdfunding health care appears to diverge from theory is the negative externality inefficient priority setting may have towards achieving broader public health goals. Therefore, the market for crowdfunding health care must be economically stable, as well as designed to optimally and equitably improve public health.

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1. Introduction

Crowdfunding has recently emerged as an innovative method of financing ventures that fall outside the purview of traditional capital markets (infoDev, 2013; Kirby and Worner, 2014). Crowdfunding is an alternative channel for financing a project that uses an online platform to solicit generally small contributions from numerous participants (i.e. the crowd). Crowdfunding is increasingly being used to bankroll health-related campaigns (Moran, 2017; Lancet Oncology, 2017; Young and Scheinberg, 2017).

Crowdfunding in the health market presents unique economic applications, benefits, and risks, which have been inadequately explored. The purpose of this article is to formulate a helpful typology for crowdfunded health campaigns and review the broad economic benefits and risks of crowdfunding in the health market. Our typology and assessment aims to equate the fundamental

principles and theory of crowdfunding with evidence and examples of health-related crowdfunding. This process was informed by a rapid evidence review and from interviews with selected experts on crowdfunding.

2. Background

The fundamental principles and theory of crowdfunding, discussed below, guided the methodological development of our literature search and interview questions. In addition, these principles and theoretical lenses provide the sensitizing and inductive devices used in our empirical analysis.

2.1. Fundamental principles of crowdfunding

A crowdfunding transaction involves three key players: the project initiator who is seeking the funding, the funders who are offering the financing, and the platform provider who is linking the project initiator with funders through an online forum (Kuti, 2014).

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The project initiator is not always the beneficiary of the funding and may act as a representative for another individual. What separates crowdfunding from more traditional financing mechanisms is the online forum, which provides a uniquely accessible method of allowing average people to participate in the funding process and allowing small- and medium-sized enterprises (SMEs) to seek funding external from banks.

Three funding models typically characterize crowdfunding: reward-based, donation-based, and investment-based. Reward-based crowdfunding asks funders to contribute money in return for prizes (Belleflamme et al., 2015). Donation-based crowdfunding involves participants offering philanthropic contributions to a project (Belleflamme et al., 2015). Finally, investment-based crowdfunding is characterized by participants providing financing through high-interest loans or in return for an equity-stake in the company (Belleflamme et al., 2015). These tend to be much larger projects as they present earning potential for funders.

Well known crowdfunding platforms include Kickstarter, GoFundMe, Indiegogo, Crowdfunder, and FundRazr. According to Massolution (2015), a US research firm, there are over 1250 crowdfunding platforms around the world, raising US \$16.2 billion in 2014, up 167% from US \$6.1 billion the previous year. Massolution estimated that this growth rate will have held for 2015 with expected crowdfunding volumes to reach US \$34.4 billion by 2016. This progress is generated from growing uptake in North America and Europe as well as significant growth in Asia. The global crowdfunding market could be further augmented by up to US \$96 billion, unlocked from emerging economies in Africa, Asia, and South America (infoDev, 2013). While dwarfed by the trillions of dollars financed through traditional capital markets, these figures demonstrate a growing and formidable niche market in the financial world (Belleflamme et al., 2015).

2.2. Crowdfunding theory

Behavioural and economic theory can aid in understanding the recent rise of crowdfunding, the main benefits from participating, and possible market failures. According to Agrawal et al. (2014), crowdfunding has developed as a result of the commercialization of modern-day Internet. Web 2.0 has lowered the transaction costs and financial risks of crowdfunding to the point where it is an economically viable method of financing small ventures. For instance, the Internet lowers search costs by facilitating cheap, effective, and efficient matching of funders and project initiators (Agrawal et al., 2014). Communication costs are also lower, allowing funders to easily gather information, monitor their investment, and engage with the project initiator, regardless of their geographic location (Agrawal et al., 2014). In addition, the large number of funders accessible through the Internet allows a project's risk to be spread over many contributors and permits funders to contribute small denominations (Agrawal et al., 2014).

In some circumstances, market participants may prefer crowdfunding over traditional funding sources (Agrawal et al., 2014). From the project initiator's perspective, crowdfunding can lower the cost of accessing capital by: matching project initiators with funders that have the highest willingness to pay; bundling multiple project goals together; and generating valuable social media attention. Project initiators may also view crowdfunding as a way of engaging their customer base and accessing valuable market information from funders such as customer preferences (Agrawal et al., 2014; Gerber and Hui, 2013). Funders may participate because they can access affordable investment opportunities without being an accredited investor, acquire products before mainstream uptake, participate in the crowdfunding community, support a project that is important to them, and formalize their

contribution through a reputable platform (Agrawal et al., 2014). The crowdfunding platforms themselves are motivated by the profit potential generated from nominal and percentage transaction charges on contributions (Agrawal et al., 2014; Belleflamme et al., 2015).

However, the market for crowdfunding is susceptible to market inefficiencies that may impede economically valuable transactions or even cause market failure. The primary dilemma appears to be asymmetrical information (Agrawal et al., 2014; Belleflamme et al., 2015; Belleflamme and Lambert, 2014; Schweinbacher and Larralde, 2012). In reality, the project creator will know more about the project than the funder. This discrepancy in information availability is amplified in the crowdfunding setting. Project initiators are often geographically isolated from their funders whom are often inexperienced in the project field (Agrawal et al., 2014; Agrawal et al., 2015). Thus, the relationship between funders and the project initiator is described as that of a principal and agent (Fig. 1) (Ley and Weaven, 2011). The project initiator (i.e. the agent) is essentially paid to carry out the project's stated goals on behalf of the funders (i.e. the principal).

Two chief negative outcomes can arise from a principal-agent relationship: moral hazard and adverse selection (Agrawal et al., 2014). Moral hazard would describe a situation where a project initiator acts in self-interest and fails to deliver on project goals (Agrawal et al., 2014; Strausz, 2016). Given the nature of crowdfunding, funders cannot easily hold the initiator accountable or may not be privy to information regarding the project's progress and success. Adverse selection might occur when high-quality project initiators consistently choose to access funding through more traditional avenues like banks, leaving only low-quality ventures in the crowdfunding market pool (Agrawal et al., 2014). Both moral hazard and adverse selection could drive funders out of the market. Consequently, signalling is an important aspect of crowdfunding (Belleflamme et al., 2015). Project initiators will actively signal to potential investors that they have a high-quality campaign and are committed to fulfilling their stated long-term goals by promoting on social media, brandishing past successful projects, and offering prizes to early contributors.

Herding behaviour is another consequence of information asymmetry that has been observed in the crowdfunding market (Agrawal et al., 2014; Belleflamme et al., 2015; E. Lee and Lee, 2012). Herding occurs when funders collectively make inferences about project quality based on decisions of other funders. There is a tendency for funders to swarm projects that are receiving strong support because the crowd perceives these projects to be higher quality. Several studies suggest that herding behaviour in crowdfunding can lead to efficient outcomes in certain circumstances (Burtch et al., 2013; Freedman and Jin, 2008; J. Zhang and Liu, 2012), while another study found that irrational herding dominates the market (Chen and Lin, 2014). Herding is particularly problematic when collective funder decisions are made at the expense of conducting individual due diligence. A free-rider scenario could arise when funders choose to postpone funding until a project has been vetted by early contributors and reached a certain threshold indicating quality (Agrawal et al., 2014; Belleflamme et al., 2015; Boudreau et al., 2015). The market could fail if everyone acts as a free-rider resulting in no projects being fully funded.

3. Research methodology

Our research has two key objectives: determine how crowdfunding is applied in the health sector and assess the important economic benefits and risks of crowdfunding in the health market. Our research methodology was a rapid evidence review of peer- and non-peer reviewed literature that was supplemented with

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