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Success drivers of online equity crowdfunding campaigns

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ABSTRACT

While equity crowdfunding provides ventures with an opportunity to collect funding from a large base of investors, many campaigns tend to remain unsuccessful. We draw from two fields of financing adjacent to equity crowdfunding, venture capital (VC) and angel investing, as well as rewards-based crowdfunding, to develop an understanding of the drivers of investment decisions in equity crowdfunding. Using data from a leading equity crowdfunding platform in Northern Europe, we explore factors that drive the number of investors and amount of funding attracted by equity crowdfunding campaigns. The results suggest that the investment decision criteria traditionally used by VCs or business angels are not of prime importance for success in equity crowdfunding. Instead, success is related to pre-selected crowdfunding campaign characteristics and the utilization of private and public networks. The findings are relevant for the decision making of entrepreneurs and crowdfunding platforms, as both parties benefit from campaign success.

1. Introduction

In recent years, *crowdfunding* has emerged as a new relevant financing mechanism alongside more traditional means of financing new ventures [43]. Crowdfunding refers to the act of drawing funds from large groups of people.[4] The crowdfunding market has been growing fast in recent years. In 2014, USD 16.2 billion was raised through crowdfunding globally, representing an increase of 167% from 2013 [37]. Crowdfunding is part of a broader phenomenon, *crowdsourcing*, in which an organization outsources an activity—such as idea generation, decision-making support, and/or resource collection—to a large group of people [9].

Crowdfunding is an umbrella term which covers several different forms. *Donation-based crowdfunding* is used to collect charitable funding in support of causes and projects. In *rewards-based crowdfunding*, funders receive non-monetary rewards in exchange for their contribution. *Debt-based crowdfunding* offers a credit contract, whereas *equity-based crowdfunding* offers an equity stake in the target company [2,6,10,32,39,42]. Our focus is on equity-based crowdfunding.

Compared to other forms of crowdfunding, equity crowdfunding is a relatively new phenomenon. Regulations around equity-based crowdfunding differ by country. In the U.S., most unaccredited investors have thus far not been able to invest in equity crowdfunding. However, in October 2015, the Securities Exchange Commission approved Title III of the Jump-start Our Business Startups (JOBS) Act, which entails the legalization of equity-based crowdfunding for unaccredited investors. Consequently, large amounts of previously inaccessible capital are expected to soon become available to early-stage companies in the U.S. [4] Outside the U.S., equity crowdfunding platforms for unaccredited investors have been established in several countries over the past decade [50]. In Europe, the total amount raised through equity crowdfunding grew from 23 million euros in 2012 to 194 million euros in 2014 [50].

While campaign success is important for entrepreneurs and platforms, many campaigns fail. Of the campaigns conducted on the equity crowdfunding platform Invesdor, 30% were successful in the sampled time frame. Success rates at several other crowdfunding platforms have been at similar levels [13,39,51]. In order to better understand the dynamics of crowdfunding and to improve campaign success rates, knowledge of the factors contributing to success in crowdfunding is required. However, little is still known about how contributors in crowdfunding assess targets [38].

Currently, research about campaign success drivers and investors' investment criteria in equity crowdfunding remains very limited. To the best of our knowledge, empirical research on the success drivers of equity crowdfunding for mostly unaccredited investors is limited to

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[4] Belleflamme et al. [5] provide the following definition: "Crowdfunding involves an open call, mostly through the Internet, for the provision of financial resources either in the form of donation or in exchange for the future product or some form of reward to support initiatives for specific purposes" (p. 588).

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the work of Ahlers et al. [3]. They examine the Australian equity crowdfunding platform ASSOB to assess the impact of selected start-up features, such as the board, risk factors, and planned exit strategies, on campaign success. In addition, Agrawal et al. [1] analyze data from the Netherlands-based platform Sellaband, which previously allowed for equity-like crowdfunding in the form of revenue sharing. (See also [32].) Kim and Viswanathan [31] study the role of early investors in the success of crowdfunding campaigns in which investors receive a monetary benefit from the success of targets they have funded. Cholakova and Clarysse [10] study the motivations that determine individuals' decisions to invest in equity crowdfunding or to contribute through rewards-based crowdfunding. Bernstein et al. [7] conduct an experiment on the importance of the availability of different types of information to accredited early-stage investors.

Due to its limited amount and scope, the contribution of existing research towards explaining variation in the success of equity crowdfunding campaigns remains small. We address this gap with the following research question: *What are the key success drivers of online equity crowdfunding campaigns*?

We address this question by drawing on research from two forms of funding adjacent to equity crowdfunding. In the funding life cycle, companies in different growth phases typically gain access to capital from different sources [43,53]. At the very beginning of its existence, a startup typically uses its founders' money, followed by funds from friends and family. As these resources are usually scarce, the startup soon needs to turn to outside investors [44]. In the initial concept and seed phases, companies can use donation- and rewards-based crowdfunding [43,53]. Later, during the expansion phase, more mainstream forms of financing become topical [53]. Many entrepreneurs turn to business angels. Startups can also seek funding from venture capital (VC) companies, who tend to enter at a later stage, conduct more systematic due diligence, and invest larger amounts than business angels [44,48]. Finally, companies with a sufficient track record may seek funding from institutional investors [53]. In addition, companies can use debt to finance their early operations and growth.

However, there exists a funding gap between donation- and rewards-based crowdfunding and mainstream forms of financing. Investors in mainstream forms tend to be risk averse, which may leave the funding needs of innovative early-stage companies unattended [53]. Equity-based crowdfunding is, together with debt-based crowdfunding, beginning to bridge that gap, as illustrated in Fig. 1 [43,53].

While it shares some similarities with some other forms, crowdfunding "represents a unique category of fundraising, with different vehicles, processes, and goals." [53, p. 17]. Furthermore, the goals of contributors in equity crowdfunding differ from those in other forms of crowdfunding. While equity investors' primary reason for participation is to reap financial benefits, contributors to rewards-based campaigns are also driven by other motives, such as the wish to be part of a community and to help others [10]. As funders' goals differ, the drivers and criteria of their funding decisions can also be expected to differ. Consequently, campaign success factors in equity crowdfunding can be expected to differ from those of rewards-based campaigns. Equity crowdfunding therefore merits research specific to it.

Due to a lack of theory on equity crowdfunding, we build on research from the two forms of funding closest to equity crowdfunding in the funding life cycle: business angels and venture capital, on the one hand, and non-equity-based crowdfunding, on the other. As they all address growing companies' funding needs, equity crowdfunding, angel investing, and venture capital investing are often assessed together and compared to each other (e.g., [14,28,52]). Investors in the three forms of financing share similarities with each other [14]. Similarities between equity crowdfunding and angel investing include similar motivations for investing, the absence of active financial intermediaries, and the investing individual's own decision making power [52]. The boundary between equity crowdfunders and business angels is sometimes vague, and the two groups of investors may compete for the same investments [28]. On the other hand, equity crowdfunding can be addressed in the context of rewards-, donation-, and debt-based crowdfunding, with which it also shares similarities (e.g., [6,39]).

We develop four hypotheses. The first one hypothesizes that the investment criteria traditionally used by venture capital and angel investors can be used to predict the success of equity crowdfunding campaigns. The other three draw on research on non-equity based crowdfunding to hypothesize that different campaign and company characteristics can be used as predictors of success.

The results are relevant to entrepreneurs, investors, and crowdfunding platforms alike, as understanding campaign success factors is in the interest of each group. In countries where equity crowdfunding for unaccredited investors is beginning to emerge, industry actors can benefit from the experiences of those in countries where the field has already been operational for several years.

The rest of the paper is organized as follows. In Section 2, we present a review of literature on the success drivers of early-stage company financing. Our hypotheses are described in Section 3. Section 4 discusses the market and company context of our sample. Section 5 describes the variables. Section 6 presents and discusses the results. Section 7 concludes the paper, and discusses limitations, as well as future research opportunities.

2. Literature review

Due to a lack of literature on the success drivers of equity crowdfunding campaigns, this paper draws on research on the forms of funding adjacent to equity crowdfunding on the funding life cycle

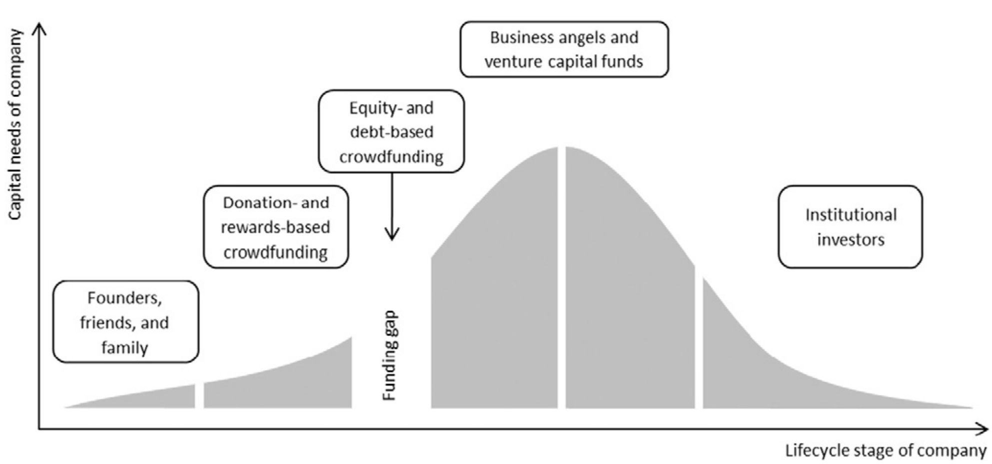

Fig. 1. Typical funding providers across a company's life cycle. Modified from Rossi and the World Bank [43,53].