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Special Instruments
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CROWDFUNDING SOCIAL VENTURES
A model and research agenda

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Introduction

Media and public alike recognize the promise of crowdfunding (CF) for social entrepreneurs in the news; however, few to none scholarly articles exist that address the inner workings and implications of CF in such a context. The author therefore set out to thematically analyse existing nascent enquiries by reviewing extant literature, draws up a schema as a model and derives an agenda of eight-related research themes from it.

On the very basis, CF means tapping a large dispersed audience, dubbed as ‘the crowd’, for small sums of money to fund a project or a venture. CF is typically empowered by the social media communication over the Internet, through for example embracing user-generated content as guides for investors. CF has been addressed in the literature so far mostly in the context of creative industries, such as producing Indie music records or retro software games (Belleflamme et al. 2010a; Ward and Ramachandran 2010). The context of social ventures has remained largely unexplored so far.

Improving our knowledge of CF seems especially important for social entrepreneurship (SE) as traditional means of finance have proven as subpar or sometimes even inadequate in starting and sustaining growth of the many forms of SE (Agrawal et al. 2010; Brown and Murphy 2003; Fedele and Miniaci 2010; Ridley-Duff 2008).

Differences of SEs to traditional for-profits are shown in the literature to stem from

- ambiguous and sometimes dichotomous aims of SEs (Dacin et al. 2010), torn between the social and commercial (Lehner 2011b; Moss et al. 2011),
- alien corporate governance and legal and organizational structures in SEs that are difficult to accept for traditional investors and lenders (Agrawal et al. 2011; Gundry et al. 2011),
- cultural and cognitive distance-related barriers between for-profit investors and SEs that hinder communication (Bauer-Leeb and Lundqvist 2012),
- social entrepreneurs’ narrations that are being hooked in the ‘social’ sphere (Brown and Murphy 2003) and are lacking the managerial terminology, which leads to severe scepticism in their managerial capabilities.

Such peculiarities of social ventures additionally aggravate the already difficult financing situation that many start-ups find themselves in (Cosh et al. 2009). Recent developments such
as the financial crisis also contribute to the situation and increase pressure to find alternative access to funding and financing new social ventures, as the public sector has to reduce spending to cope with the high-accumulated governmental debts (Bielefeld 2009; Ferrera et al. 2004; Lehner 2011b).

Finding alternative, tailored methods of funding and financing by innovatively combining existing factors, such as everyday people’s values and opinions, social media platforms and alternative reward systems, seems a consistent step for social entrepreneurs and fits well to the new emancipation of the crowd (Drury and Stott 2011; Reyes and Finken 2012; Valenzuela et al. 2012).

CF may offer one especially suited answer to the financing needs of social ventures, as crowd investors typically do not look much at collaterals or business plans, but at the ideas and core values of the firm (Ekedahl and Wengström 2010) and thus at its legitimacy. Aspects that are typically regarded as very positive in social entrepreneurial initiatives, and thus in theory CF and SE should match well (Dart 2004).

Such crowd-based processes may bring the additional benefit of being perceived by the public as per se democratic (Drury and Stott 2011), thus addressing critics of SE’s capitalist steering (Meyer 2009). In addition, the recent passing of the Jumpstart Our Business Start-ups (JOBS) act in the USA (Martin 2012; Parrino and Romeo 2012), which legalizes certain forms of equity CF for small businesses and start-ups based on volume criteria, shows that governments are becoming aware of the untapped potential and are trying to reduce legal barriers for entrepreneurs (Parrino and Romeo 2012).

Despite this potential for social entrepreneurs, few academic articles exist so far that address CF in this context – apart for a small stream focusing solely on donations (Firth 2012; Muller and Kräussl 2011). Even in the business-venturing domain as a whole, research on CF is only starting to emerge and is often based on anecdotal evidence with a focus on finite projects and the creative industry (Agrawal et al. 2010).

As for a definition of SE, the author addresses all kinds of ventures that have a social or environmental mission as their primal goal, which aim to be financially and legally independent and strive to become self-sustainable by means of the market. Such a broad characterization acknowledges the ongoing discussion on definitions, for example from the EMES or the social enterprise London (SEL; Defourny and Nyssens 2009a; Lehner 2011b; SEL 2001; Zahra et al. 2009), while it is open and wide-ranging enough not to exclude needlessly and perhaps even too early in this pre-paradigmatical field (Nicholls 2010c).

Addressing this void in literature, this paper thus set out to propose future research themes of CF in a social entrepreneurial context. It first debates current findings on financing and funding of social ventures. Subsequently, the small existing research canon on CF is explored in the literature and the author draws up a schema of CF.

Examining the perspectives of this schema in an SE context, eight themes are derived and proposed as a future research agenda.

**Funding SE**

As stated earlier, funding and financing in the SE domain have to deal with idiosyncrasies of social ventures (Shaw and Carter 2007). Some of these may arise from the entrepreneurs or founders themselves, as they often originate from traditional non-profit organizations and have a non-business-related educational background. The terminology thus used and the values implied in their narrations make it difficult to communicate with traditional investors and financial intermediaries (Bauer-Leeb and Lundqvist 2012). Social entrepreneurs’ presentations
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often primarily deal with the social vision, impact and outcome and at the same time neglect aspects of cash-flow liquidity, long-term financial returns and planning and forecasting (Brown and Murphy 2003; Ridley-Duff 2009). A 2003 study of the Bank of England consequently finds that social entrepreneurs indeed have a hard time accessing traditional debt finance.

In addition to these idiosyncratic hurdles for social entrepreneurs, many of the known problems for start-ups also hold true in SE (Berger and Udell 2006; Dushnitsky and Shapira 2010; Irwin and Scott 2010; Lam 2010) – for example the effectuation principles used by entrepreneurs are barely compatible with the traditional rationales of banks, basing their financing decisions in project finance upon the long-term planning of stable cash flows (Chandler et al. 2011; Perry et al. 2012).

Centred upon these specifics, a specialized financial market has started to emerge for social entrepreneurs (Bull and Crompton 2006; Fedele and Miniaci 2010; Ridley-Duff 2009; SEC 2004). It includes very different forms of rewards, narrations and discourses as a whole, compared to traditional financial markets. Instead of focusing on financial returns on investments, for example, entrepreneurs have to participate with their social ideas in competitions organized by foundations such as Skoll or Ashoka, or increasingly by traditional for-profit companies as part of their CSR activities (Baron 2007; Cornelius et al. 2008; Gallego-Álvarez et al. 2011; Janney and Gove 2011). Specialized investment and performance metrics such as the social return on investment (SROI) have been proposed as instruments in decision-making and legitimization of investments (Flockhart 2005).

Many social ventures, however, still rely at least partially on donations and public grants (Bull and Crompton 2006; Fedele and Miniaci 2010; Ridley-Duff 2009) despite their aim of financial independence. This is especially true for developed countries with a corporate-statist welfare regime (Esping-Andersen 2006), where social enterprises often act as intermediaries between the public and private sectors in the provision of social welfare support (Lehner 2011a). However, recent cut-downs on welfare spending make it increasingly difficult for SEs to access public money, and on the other hand, donations are already highly competed for.

On the progressive side, several special banks, such as Kiva (Larralde and Schwienbacher 2012; Pope 2011; Rubinton 2011) or the Grameen Bank (Yunus and Weber 2007), have emerged, dealing with micro-financing of socially desirable and sustainable investments, especially in the realm of local micro-loans. In addition, several philanthropic venture capital funds and related investors/donors have surfaced, delivering funds, and also other resources such as networks and advice to social ventures (Scarlata and Alemany 2012). Investors’ rewards often lie in a certain social impact, and amongst the tailored management performance measurement instruments, the SROI plays an important role, in which cascading social effects of the (social) venture are computed as monetary impact on public spending and income (Flockhart 2005).

Reporting practices of social entrepreneurs have been examined by Nicholls (2009, 2010b) in the context of the community interest company (CIC) in the UK. He found that the reporting practices not only account for financial performance but also include discussions on the social and environmental impacts, a logic that seems necessary when dealing with a multitude of stakeholders with differing aims, some driven by the social mission, others by financial sustainability.

One important aspect for financing social ventures has been almost neglected so far in literature; the trustworthiness of social entrepreneurs is regarded to be much higher due to the primacy of the social aim, and thus the costs of fraudulent risk should be reduced in theory (Lambert et al. 2012). We see early empirical claims for this based on the traditional non-profit literature (Frumkin and Kim 2001; Hansmann 1987; Haugh 2006; Herman and Renz 2008;
Kerlin 2006; Laratta 2010), but so far it has not improved social entrepreneurs’ situation when seeking money from traditional sources.

Nicholls (2010a) examines types of social investors and their respective investment logics based upon a Weberian analytic lens between value and purpose. He creates a matrix of nine distinct models and captures early evidence of the actual flow of capital within the social investment landscape in the UK. His conclusion, based upon the dominance of a singular investor reality, will provide an interesting counterproposition to the rationale of the crowd, consisting of equal investors with various logics.

In Tables 9.1 and 9.2, the author presents a list of investor types, clustered by debt and equity claims, based on the literature as examined earlier and adapting and enhancing previous work by Larralde and Schwienbacher (2012). These tables specifically address the stage in which the various means are most applicable. Although previous literature hints that CF may be especially suitable in the start-up phase (Firth 2012; Lambert and Schwienbacher 2010; Ward and Ramachandran 2010), its potential for funding growth and expansion (Hynes 2009) has yet to be empirically examined.

**CF literature in an SE context**

Widespread Internet access and functioning social networking platforms together with the emancipation of the crowd (Drury and Stott 2011) propose interesting opportunities (Reyes and Finken 2012). Leveraging these phenomena in a process called CF can help entrepreneurs gain necessary start-up capital. Such a quest for alternative start-up capital is relevant as new ventures do not easily gain access to the necessary external finance at their early stages (Cosh et al. 2009). In later periods, business angels and venture capital funds may fill gaps for larger amounts; however, costs for proof-of-concepts and the first entrepreneurial steps are often only financed by the entrepreneur, family and friends (Cumming 2012; Dushnitsky and Shapira 2010; Irwin and Scott 2010). Early debt finance in such ventures is often brought up through a process identified in the literature as Bootstrapping (Lam 2010).

So, instead of relying on decisions made by a small group of relatively high-sophisticated investors and bank managers, the idea of CF is to tap and motivate a large audience, with each individual member of the crowd contributing only little (Belleflamme et al. 2010b) but with a high combined impact.

CF may thus provide a much-needed alternative for raising start-up capital for ventures seeking donations, debt or equity finance. CF as a constructed term is often considered in the literature as project-based funding only and so the term in its current usage does not fully comprise its full potential, which would also include more long-term commitments such as debt or equity shares (Crowdsourcing 2012). Also a distinct focus on donation-based CF for social entrepreneurs leaves out important market alternatives, where crowd members actually become shareholders. Especially equity-based CF will thus inevitably cross the border of simple project financing (Larralde and Schwienbacher 2012).

Scholars see the roots of CF in a movement that has been labelled as crowdsourcing, which comprises using the crowd to obtain ideas, feedback and solutions in order to develop corporate activities (Brabham 2008; Howe 2006; Kleemann et al. 2008). A distinct feature of the ‘crowd’ is seen in the literature as consisting of a large number of people, each contributing little, but with a possible high combined impact (Belleflamme et al. 2010b). However, such a crowd is supposed to behave in unforeseen, chaotic and complex manners (Drury and Reicher 1999; Drury and Stott 2011; Ivancevic et al. 2010; Massink et al. 2010), and therefore, a careful examination of the influential factors and functions is necessary.
Table 9.1 Equity investor types, SE accessibility and stages

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
<th>Accessible for SE</th>
<th>Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Entrepreneur and Family</td>
<td>Investing his/her own money into the social venture, or money borrowed privately from friends and family.</td>
<td>+++</td>
<td>Early start-up.</td>
</tr>
<tr>
<td>Social Target Group</td>
<td>A form of crowd sourcing by tapping the beneficiaries. Successful when the entrepreneurial innovation is understood and the leverage is perceived high enough. Suitable when many people are involved with small contributions from each individual. Complex forms of governance.</td>
<td>+++</td>
<td>Innovating, perhaps after some initial proof. Great impact on Corporate Governance.</td>
</tr>
<tr>
<td>Business Angels</td>
<td>Wealthy individuals, willing to invest in small social projects that fit to their intrinsic values and agenda.</td>
<td>++</td>
<td>Early stages, difficult to tap and scarce.</td>
</tr>
<tr>
<td>Venture Capitalists</td>
<td>Specialized investors, placing their fund-investors’ money into larger projects for a longer period of time, but with a clear exit strategy. Fiduciary duties, lots of reporting necessary.</td>
<td>+</td>
<td>Growth. More specialized VC firms for SE emerge, not suitable for early start-ups.</td>
</tr>
<tr>
<td>Other Companies</td>
<td>Decide to invest in projects that have a strategic value for them. Perhaps from a Real-options logic to secure certain environmental patents, or as part of their CSR activities. Strategic Entrepreneurship.</td>
<td>–</td>
<td>All stages, but only as addition. Often highly selective, and with a negative impact on ventures’ reputation.</td>
</tr>
<tr>
<td>Stock Markets</td>
<td>Public offering to invest in the company. Often problematic in social ventures due to the expected risk-adjusted return on investment. Some specialized funds targeting ‘ethical’ investments exist however. Possible negative consequences due to loss of control and high regulative efforts.</td>
<td>–</td>
<td>Globalization and tremendous scaling up of established and recognized social solutions.</td>
</tr>
</tbody>
</table>

Source: Adapted from Larralde and Schweinbacher (2012).

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CF in an SE perspective can provide additional legitimacy to the venture, as the selection process by the crowd is perceived as per se democratic, and the crowd will thus select the social ideas it deems worthy and needed (Belleflamme et al. 2010b; Drury and Stott 2011; Rubinton 2011).

The concept of CF has been demonstrated in cases to work miraculously well. The amounts of money obtained even reach GBP 1 million, as in the case of Trampoline Systems UK, a high-tech start-up (Belleflamme et al. 2010b). The involved processes, from communication, utility functions to legal aspects, however, are far from being clear. Much need for experimentation, last minute changes and unforeseen legal hurdles have put the effort of Trampoline almost in jeopardy.

Belleflamme et al. (2010a) examine CF from an industrial organization perspective and associate CF with pre-ordering and the resulting price discrimination. Such a model may not hold well in an SE context as the investors’ motives for investment may differ in that they are less concerned about costs but the outcome (Delanoë 2011; Fayolle et al. 2005; Shaw and Carter 2007). Belleflamme et al. also provide some theoretical underpinnings why non-profit organizations tend to be more successful in using CF by examining the literature on contract failure theory. This theory is based on the view that limiting monetary motivations of owners, such
as prohibiting or limiting dividend payouts in some forms of SE (Lehner 2011b), attracts donations more easily and invites other forms of participation, such as voluntary work. Such a limit on monetary motivation for owners can also be seen as a strong signal that the owners put a significant weight on the quality of the outcome and less on monetary gains (Chillemi and Gui 1991; Van Slyke 2006). This invites perspectives from information economics and signalling on CF (Akerlof 1970; Balakrishnan and Koza 1993; Lambert et al. 2012).

Pope (2011) identifies legal hurdles for equity-based CF in the USA, asserted by the Security Exchange Commission, which can be transferred to some extent also to Europe and many other countries with a regulated capital market. He scrutinizes difficulties for micro-start-ups in gaining necessary equity capital and their willingness to bootstrap, using their own available resources. As the public offering of equity is highly regulated, it brings tremendous costs for auditing, creating prospectuses and consulting law firms and financial intermediaries. Pope thus observes

Table 9.2 Debt investor types, SE accessibility and stages

<table>
<thead>
<tr>
<th>Type</th>
<th>Description</th>
<th>Accessible for SE</th>
<th>Stage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>Loans. Special banks for social ventures exist. Often Project finance with little mutual understanding between (social aim) seeker and provider. Problems in terminology and cultural distance.</td>
<td>++</td>
<td>All stages, depending on the entrepreneurs’ preferences for control and risk-taking. Increasing importance due to specialized banks.</td>
</tr>
<tr>
<td>Leasing</td>
<td>Providing machinery and equipment to entrepreneurs against lease payments. Suitable for all types of ventures, when cash flows are stable and investment is relatively standardized.</td>
<td>+</td>
<td>Start-up and Expansion, for certain types of investment only. Often investment as collateral.</td>
</tr>
<tr>
<td>Government, Agencies</td>
<td>Subsidies, grants and credit to improve rating. Perhaps forms of PPP (public–private partnerships). Also service-based public funding. Highly competed for, problematic in times of government austerity.</td>
<td>++</td>
<td>High importance for socially desirable projects that can be run sustainably with a managerial attitude, but would not be attractive for traditional investors and entrepreneurs.</td>
</tr>
<tr>
<td>Customers/ Suppliers</td>
<td>Trade credit and upfront payments for future goods and services. Sometimes used in crowdfunding for special niche products.</td>
<td>++</td>
<td>Operational Expenses, depending on industry.</td>
</tr>
<tr>
<td>Bootstrapping</td>
<td>Clever use of working capital management (WCM) and Bricolage to start a business, together with a strict eye on expenses. Often used by small social entrepreneurial initiatives.</td>
<td>+++</td>
<td>Early stages, when motivations of stakeholders and entrepreneurs are high. Perhaps based upon personal traits.</td>
</tr>
<tr>
<td>Donations</td>
<td>While given for free, donors expect a certain type of reward, for example through achieving a certain social impact. This reward can also be personal, for example through creating a noble feeling or a better standing in society.</td>
<td>++</td>
<td>Still many social ventures rely partly on donations. Will become scarce with more competitors. Often used in crowdfunding initiatives with a honorary element.</td>
</tr>
</tbody>
</table>

Source: Adapted from Larralde and Schweinbacher (2012).
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equity-based CF in start-up ventures as being severely limited in the current legal situation. It is therefore logical that many forms of CF so far do not offer equity shares but other forms of rewards, for example early access to products, honorary recognition or some interest payments. However, to reflect on CF origins in crowdsourcing, equity stakes may on the one hand provide a pronounced democratic corporate governance (CG) model for social ventures, and on the other hand be the one missing opportunity for small investors in the crowd, seeking for ethical investments and rewards on alternative financial markets (Fox 2012). As reported earlier, legal and regulatory hurdles for equity CF are addressed in a perhaps ground-breaking manner by the recently passed JOBS act by the US President Obama. It lowers restrictions on Rule 506 offerings and frees seekers for small CF volumes, 100k USD, and to a lesser extent, 500k USD, from several costly regulations (Heminway and Hoffman 2011; Pope 2011; Rubinton 2011).

Larralde and Schwienbacher (2012) identify business models for CF, namely donations, passive and active investments by the crowd. Donation-based CF has been a long-established means of finance for NPOs and NGOs (Hansmann 1987; Nyssens et al. 2006). However, as the number of CF initiatives and platforms rises, the resource ‘crowd’ for donations becomes highly competed for and thus scarce. Larralde and Schwienbacher distinguish between active and passive CF. Passive CF sees some reward for its investors, for example tailored products, honorary recognition or other forms of revenue sharing. However, the interaction between the company and its crowd investors is limited to the rewarding function. Active CF differs in that aspect, as its investors are not only supplying money but are also in the best manner of crowdsourcing included in a constant dialogue with the company, helping for example in designing new features, testing products, suggesting paths for the company and supplying their network scope and individual expertise. This active form of CF is also very fruitful in providing a means for corporate communication and public relations, and through the dispersed positive discourse, dubbed ‘buzz’, it ultimately improves a company’s legitimacy.

Such a quest for legitimacy is of high value especially for social ventures because of their dealing between the market, civil society and public sphere (Kerlin 2006). Social entrepreneurs on one hand address social voids by market activities but on the other hand also work as social change makers by influencing systems and policies (Cho 2006; Drayton 2006; Gunn et al. 2008). Such attempted policy change, however, may inevitably see resistance from incumbent powers and institutions (Ahlstrom and Bruton 2010; Bonoli and Palier 2009; Levander 2010; Lim et al. 2010; Mair and Marti 2009; Meyer et al. 2009), and therefore, needs to be backed by the power of the people in what they perceive as a legitimate case.

CF activities are also demonstrated to have a true global outreach through the means of the Internet and specialized social media platforms. Agrawal et al. (2011) examine this on the case of the record industry, and find that CF indeed shows a broad geographic dispersion of investors and that the negative impact of distance-sensitive costs is mitigated; a finding standing in contrast to traditional finance theory, which would hold a perspective of a rising distrust with distance. This broad geographic dispersion, however, also reflects well on SE, which is also designated as a truly global phenomenon (Zahra et al. 2009, 2008), and in which many initiatives work on a very international level even from the beginning (Korsgaard 2011; Meyskens et al. 2010; Zahra et al. 2008).

A proposed schema of CF

Based on the previously examined literature and some early empirical evidence as discussed in the previous sections, the author presents an early schema of the inner workings of CF, which is then applied and discussed in an SE context (Figure 9.1).
Overview of the schema

This schema displays the matchmaking process between the venture, offering debt or equity investments, and the crowd. Opportunity recognition (OR) in this schema is essential, as not only the entrepreneur but also the crowd has to recognize it, informed through communication channels and the user-generated content on the Web platforms. Matchmaking takes place when members of the crowd decide to participate in the exploitation of this opportunity based upon its perceived legitimacy. This participation in the venture can take place within one of the four quadrants, spanning business models (active–passive) as well as type of capital (debt–equity). Communication and business strategies of the Web-based CF platforms as intermediaries; networks of crowd members pointing to these and aspects of information economics (reducing the asymmetry) together with the crowd members’ individual risk equivalents will form the so-called motivational block (based upon utility functions). The outcome will be moderated by reward, levels of control and participation offered, but more so by the intermediary platform’s business model. Laws and regulations (including related costs) finally will form a strong mediator block between the crowd, the CF platform and the desired participation in the venture.

The enthusiasm of the investing group regarding the desired outcome (Duckett and Swerissen 1996; Qiongzhi 2007; Ruebottom 2011) of the crowd-funded venture seems to be a much higher motivation for an active participation than to ensure monetary, interest-like incentives and influence risk taking. As has been seen in the cases of Kittur (2010), Kleemann et al. (2008)
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and Whitla (2009), such active participation can take many forms of crowdsourcing (Brabham 2008), from testing early prototypes to advertising and viral marketing and from volunteering work such as translating texts to serving at events. It seems beneficial even to the funding process itself to offer and invite some form of investors’ partaking. Participation of the crowd will typically create ‘buzz’ in the social media that may draw even more future potential investors to the CF platform site (Belleflamme et al. 2010b). However, previous literature by Larralde and Schwienbacher suggests there will be a recurring shift between active and passive involvements, depending on the individuals’ circumstances as well as on the stage of the venture.

Capital formation is essential to economic developments, as it enables entrepreneurs to create new solutions to opportunities (Cumming 2012; Seghers et al. 2012). This also holds true for social entrepreneurs in their opportunity seeking and exploitation strategies (Cha and Bae 2010; Korsgaard 2011; Lehner and Kaniskas 2012).

Due to legal restrictions, so far few long-term maturing, crowd-funded bonds have been issued outside of the traditional regulated market, so we can only guess on required interest rates or the level of control and reporting expected from long-term lenders in CF (Larralde and Schwienbacher 2012; Pope 2011; Rubinton 2011). Most cases of debt financing so far have been of the type of advance payments (Agrawal et al. 2010; Firth 2012; Larralde and Schwienbacher 2012; Ward and Ramachandran 2010) for future goods or services; however, another interesting aspect of debt may be crowd-funded donations and grants.

Equity financing may provide the greatest challenges but also the greatest opportunities for crowd-funded social ventures (Artiach and Clarkson 2011). Typically, equity investments are legally linked with several rights, among the rights of information and control, and the right to participate in the earnings or added value of the company (Berger and Udell 1998). Selling shares of equity is ultimately a means of distributing risk onto the shoulders of many investors, compared to debt finance, in which the entrepreneur shoulders all risk himself/herself (Amit et al. 1990; Sharffman and Fernando 2008). Equity-based CF does therefore come at a much higher cost for the ventures, but perhaps contrary to the traditional theories less in a monetary sense but more so in terms of control, governance and stewardship (Meuleman et al. 2009; Williamson 1988).

Dispersing control is counted as a detrimental aspect in traditional for-profit financing; however, this impact on CG may hold positive merits in social ventures, as increased shareholder participation will improve legitimacy in the eyes of the public and may also refine the actual approach to the social needs towards higher effectiveness (Beckmann 2011; Bull et al. 2010; Ridley-Duff 2009, 2010). However, besides the positive, an increased dispersion of control may well hinder thoughtful experimentation and necessary changes of strategy by the founders, lessening the chances of entrepreneurial innovation (Huarng and Yu 2011; Ruvinsky 2012; Vaccaro et al. 2012).

The challenges for equity-based CF are thus multi-faceted; they comprise legal and regulatory hurdles (Heminway and Hoffman 2011; Larralde and Schwienbacher 2012; Pope 2011; Rubinton 2011; Schwienbacher and Larralde 2010), as well as considerations about governance and control. Public offering (exceeding to a certain amount of people) of a company’s equity is highly regulated in most developed countries – the main reasons given to prevent fraud (Altman and Sabato 2007; Hmieleski and Baron 2008) and to enable an efficient market through reducing information asymmetry (Deakins and Hussain 1994; Lambert et al. 2012; Schnatterly et al. 2008). Even the sharing of net revenues to investors is seen as a security offering and thus highly regulated. Therefore, CF platforms in various countries such as the UK or the Netherlands, which allow CF for equity, need to use complex schemes of partaking and control in the entity to avoid legal pitfalls.
Concerning the traditional reward systems of shareholder value and dividends, possible utility functions of equity investors in crowd-funded social ventures may differ from those of traditional for-profit investors, such as business angels or venture capital funds. Several legal forms, tailored for social enterprises, such as the CIC in the UK or L3C in the USA, have some kind of dividend pay-out prohibition (Nicholls 2009, 2010b; Ridley-Duff 2008, 2009) and any accumulated wealth cannot be paid out to shareholders, even after closure of such a firm. These rules may thus prevent interest from many investors and the ongoing discussion on the usefulness of distinct SE legal forms has a new facet (Galera and Borzaga 2009).

There are also the more strategic and for-profit considerations based upon real-options logic (Levitas and Chi 2010; Scherpereel 2008; Tong and Reuer 2007) that may bring crowd-investors to fund social ventures with equity finance. Some relatively small financing early at the beginning may provide access and control over the investment if it turns out to be successful later (Husted 2005; Levitas and Chi 2010; Scherpereel 2008; Tong and Reuer 2007; Wang and Lim 2008). In an SE context, this option may well be embedded in the CSR strategy of larger companies and can also provide a very tangible competitive advantage later for example through access to patents that may come in handy in ever changing energy and other environmental regulations (Block 2012; Brettel et al. 2012; Cuervo Cazurra and Annique Un 2010; Husted 2005; Mcwilliams and Siegel 2010).

Proposing a research agenda

Derived from the proposed schema, eight themes are identified (see related numbers in Figure 1) to further the field by using a stepwise refinement research methodology based upon the maturity of the theory (Edmondson and Mcmanus 2007). The first steps need to be descriptive in nature, to assess the relevance of the individual blocks, find variables and come up with theories of quantification, subsequent correlation and ultimately explanation (Bluhm et al. 2011; Connelly et al. 2010). It is these explanations that can later be put into recommendations for policy-makers and businesses alike.

Types and utility functions of crowd investors

Using the ‘crowd’ to obtain ideas, feedback and solutions in order to develop corporate activities (Brabham 2008; Howe 2006; Kleemann et al. 2008) is nothing new. The widely available access to social media and networks makes it easy to tap a large number of people instantly. A distinct feature of the crowd was carved out in the previous paragraphs as consisting of a large number of people, each contributing little, but with a possible high combined impact (Belleflamme et al. 2010b; Whita 2009). It has been examined that such a crowd is behaving in unforeseen, chaotic and complex manners (Drury and Reicher 1999; Drury and Stott 2011; Ivancevic et al. 2010; Massink et al. 2010) and that small activities by the company (including the omission of certain actions) can lead to a hyperbolic response by the crowd. However, what we do not know is what motivates the individuals being part of the crowd. Do these motivations differ for certain types of offered crowd investments? Previous research seems to hint at that, as there is a distinctiveness in the handling of investors between CF for donations, projects or equity (Larralde and Schwienbacher 2012).

Kozinets et al. (2008) distinguish between four types of online consumer communities, Crowds, Hives, Mobs and Swarms, and find that collective innovation is produced both as an aggregated byproduct of everyday information consumption and as a result of the efforts of talented and motivated groups of innovative e-tribes. Their proposed typology may provide a
starting point to address types of collective investors from a macro-marketing perspective, as the difference between crowd consumers and investors in CF is often only marginal.

Motivational factors, such as financial reward systems or personal involvement, may well be positively correlated to one type, but deter others. Nicholls (2010a) identifies types of social investors and their respective investment logics and creates a matrix of nine distinct models. His scenarios, each based upon the dominance of a singular investor reality, will provide an interesting counterproposition to the rationale of the crowd, consisting of equal investors with various logics.

Research in this area should therefore look into the perspective of the crowd as an emancipated entity, as well as on the individual members and their motivations stemming from the psychological to the economical. Answers will allow SEs to serve a broader spectrum of approaches to attract and retain crowd investors and to increase efficiency through tailored approaches for target audiences.

**Opportunity recognition and matchmaking**

OR is at the very heart of venture creation; some scholars regard OR even as the basis of entrepreneurship (Short et al. 2010). As Lehner and Kaniskas (2012) and Corner and Ho (2010) examine, existing SE literature on OR draws upon a multitude of theoretical frameworks for their research. Among others, theories from Austrian School economists such as Schumpeter, Kirzner and Hayek (Murphy and Coombes 2009; Zahra et al. 2009) are employed and the behavioural theory of the firm (Zahra et al. 2008) is applied. In addition, closely related concepts to OR, such as Bricolage or innovation, are used to integrate OR and exploitation into a broader perspective of SE (Archer et al. 2009; Corner and Ho 2010; Di Domenico et al. 2010; Fuglsang 2010; Nicholls 2010c; Shaw and Carter 2007). Some scholars maintain that SE opportunities are different from those found in for-profit ventures (Corner and Ho 2010; Mair and Noboa 2006; Robinson 2006). Different views on OR exist, depending on the activeness of the entrepreneur and the dispersion of available information. In CF, another perspective is added. Not only the entrepreneurs have to identify an opportunity, but also the crowd has to recognize and evaluate it. This brings an additional hurdle to the actual exploitation. In traditional financing, entrepreneurs have to deal with few, relatively sophisticated investors and need to convince them, often using business plans and forecasts. In CF, opportunities need to be communicated to a great mass of heterogeneous people, using different instruments and strategies. The individual crowd members in this model can be either (a) passive listeners acting on the available information or (b) active seekers looking for opportunities. Future research in this area will need to address this dual OR of the entrepreneur and the crowd alike, and take an eye on the SE context of OR. Findings will deliver insights on how an OR transfer can take place, from the entrepreneurs’ alertness or informedness, to the crowd.

**Business models and corporate governance**

A distinct CG with a broad stakeholder inclusion is seen as one central and defining element in the SE literature (Beckmann 2011; Nicholls 2010b). Stakeholder participation, the division of control power not based on the number of shares, and community-based decision-making processes are part of everyday life for many social ventures (Borzaga et al. 2008; Defourny and Nyssens 2009a, 2009b; Mason et al. 2007; Travaglini 2009).

With the inclusion of the crowd, consisting of a multitude of (partly anonymous) individuals as stakeholders or even shareholders, new approaches to CG models in SE need to be addressed.
It may be difficult to include the crowd in traditional decision-making processes; therefore, communication means and forms need to be created and adapted, often powered by Web-based services over the Internet. The impact of such a large number of involved people can nevertheless have several beneficial aspects. Among them are an increased legitimacy, bringing with it a higher acceptance and attractiveness to invest and work for such a company (Lumpkin 2011; Patriotta et al. 2011), or a refined outlook of what is really needed through the feedback of the many. The interplay of organizational forms, types of involvement, stakeholder tailored reporting (Nicholls 2009) and means of participation in CF may be the foremost questions to be asked in this context.

CG structures differ between countries, based upon legal requirements as well as different cultures and mindsets. Therefore, careful longitudinal enquiries in the CG structures of crowd-funded social ventures, scrutinizing the hurdles and opportunities for CF within existing CG structures, as well as respective public acceptance in a comparative fashion, will provide further insights into this theme. Carmel and Harlock (2008) examine governance in the ‘third sector’ and bring new perspectives on the governance of what they call the ‘dispersed state’, which may provide an interesting starting point in such discussions.

Information economics, reporting and risk

A growing body of research literature on communication strategies in the field of investor relations (IR) is available (Bassen et al. 2010; Kirchhoff and Piwinger 2009). Different approaches to potential and existing investors are laid out, united by the commonly accepted ambitions to attract new and keep current investors, fulfil legal requirements concerning reporting and disclosure and reduce the perceived idiosyncratic risk (differing from systemic risk stemming from industry). Ultimately, the intent of these measures is to reduce the cost of capital (Millo and Mackenzie 2009) and provide a true and fair view on the risk/return ratio.

Specialized platforms on the Internet, such as Kickstarter, have been brought to life as distinct business models, addressing the perceived communication needs of ventures seeking for CF and slowly taking over the role of financial intermediaries. IR literature holds much about communication in the web-age (Singer and Cacia 2009) including the importance of network domino effects for the dispersion of information. The primacy of the simply understood socially desirable mission of a venture, however, is unique in CF IR, compared to the more ample capital market stories typically drawn up in traditional companies (Bassen et al. 2010).

Reporting practices of social entrepreneurs have been examined by Nicholls (2009, 2010b), which he describes as ‘blended value accounting’. Not only financial performance is disclosed, but the reports also include discussions on the social and environmental impacts. Exactly how reporting will take place in the area of highly dispersed investors remains unclear so far. Research in this theme therefore needs to look at the role of risk and information dispersion, enquire about legal proceedings, examine the risk equivalents of crowd-investors and perhaps challenge agency theory as a whole (Heracleous and Lan 2012).

Networking and the role of platforms

Crowd-funded ventures rely heavily upon networks, mainly brought together by the Internet. Networking theory has already proven to be highly predictive in modelling the flow of various resources, such as materials and workforce, but also more generally capabilities, information, business partners and opportunities in various situations (Dobrow et al. 2011; Hoang and Antoncic 2003; Mahmood et al. 2011; Martinez and Aldrich 2011; Soh 2010; Sullivan and
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Marvel 2011). Early research in CF for example sees a distinct approach to geographical closeness, compared to other forms of venture financing (Agrawal et al. 2011). Geographical distance does not come with the expected risk premium in CF. Also the importance of structural holes in linking cycles of crowd investors (Batjargal 2010) in order to globally disperse information about the investment opportunity may provide a fascinating lens for enquiry.

Nodes in these networks will be the individual crowd members but more so the platforms and their respective followers. The examination of the role of these platforms as amplifiers and mediators, creating quasi super-nodes, as well as of the ties, ruled and regulated by payment providers, will be crucial in getting the whole picture. Research thus would take existing networking theory and adapt it where possible in order to model the flow of communication and resources.

Discourse and legitimacy of CF

Higher legitimacy of a venture (or better of its respective opportunity) increases acceptance of its activities and helps accessing resources such as materials or workforce. In the case of CF, the legitimacy of a venture will ultimately moderate the crowd’s willingness to invest in it. Legitimacy, however, is built up in a complex, recursive process, involving the individuals’ values, self-pictures, needs and wants and the perceptions of the venture created by public discourse (Cornelissen and Clarke 2010; Dart 2004; Nicholls 2010c; Patriotta et al. 2011), which is difficult to predict when targeting a large heterogeneous audience.

The success of social entrepreneurs dealing in between the market, civil and public sector already depends on positive communication and thus ultimately on perceived legitimacy of their doings (Di Domenico 2009; Di Domenico et al. 2010; Lehner 2011b).

Are crowds then per se democratic, and is the dispersion of control in such ventures therefore always a positive thing (Drury and Reicher 1999)? Does CF for example help overcome the criticism of leaving social welfare provision in the hands and decisions of a few, as has been raised in the literature (Meyer 2009; Palier 2010)?

Research in this theme needs to be downright interdisciplinary, borrowing from the interplay between the domains of sociology and psychology, looking at the diverse fields of politics, law, international relations, communication and business, applying and modifying a diverse range of theories such as new institutionalism or contract failure theory.

There is also a methodological challenge included, as Büscher and Urry (2009) see the need for new strategies of enquiry in the age of mobile devices, which allow access to ‘information at your fingertips’. This information is however condensed and often reduced of the richness of context specifics. They examine and propose the ‘mobilities’ paradigm in how to conduct empirical studies that better grasp the nature of movements of people, objects, information and ideas.

Challenging finance metrics and instruments in a CF environment

The capital asset pricing model (CAPM) in its various forms is still seen as a basis to many of the finance-related metrics and instruments (Andersen et al. 2007; Berger and Udell 2006; Hovakimian et al. 2001; Millo and Mackenzie 2009). The assumptions in the calculation of the weighted average cost of capital, influenced by the costs of equity based on CAPM, are still widespread accepted (Artiach and Clarkson 2011; Brown 2011; Kunc and Bhandari 2011) and serve as a guiding principle in making traditional investment decisions.
Theory claims that investors will make use of derived models to compute the necessary return on investment based on risk comparisons. However, early empirical evidence shows that in CF, most members of the crowd are more motivated by the either explicitly or implicitly proposed non-monetary value and return (Belleflamme et al. 2010b; Drury and Stott 2011). Literature suggests the further development and inclusion of the SROI as a metrics in social ventures (Flockhart 2005) to help investors choose the highest leverage of their (social) investment.

However, so far, it has remained unclear whether such complex investment metrics really provide a decision-making tool, or are rather used to maintain some form of rationalization after the investment – which was in fact originally based upon more intrinsic choices. Especially the public sector, however, needs such tools to have a rational answer to questions about their investments and grants to social initiatives (Hennala et al. 2011; Hood 2011; Patriotta et al. 2011).

In the CF field, especially when investing in equity shares, real-options logic (Husted 2005; Levitas and Chi 2010; Scherpereel 2008; Tong and Reuer 2007), which is derived from financial markets, can provide another frame of thinking to explain investors’ choices. Such thinking leads to limiting potential losses to the price of the option (the small initial investment), allows holding a bundle of strategic investment options as an answer to uncertainty and ultimately enables investors to claim their stakes when some of the ventures later gain movement and the proof of concept has been made.

Research in this theme needs to address the adaption of traditional metrics and explore new ways to measure and predict investment decisions. Perspectives from Behavioural Finance, such as ‘herding’, may also provide insights into the inner rationale of crowd investors (Fairchild 2011; Lehner 2004; Shleifer 2000).

**Legal and regulatory perspectives in CF**

Platforms addressing equity-based CF often come up with a complex scheme of control and partaking in order to avoid costly rules and regulations. Due to high public pressure in a reining economy, the recently passed JOBS act is celebrated in the media as a giant step for entrepreneurship in the USA, as it exempts some equity CF from excessive regulatory schemes (Heminway and Hoffman 2011; Parrino and Romeo 2012; Pope 2011). Such a scheme, as suggested in this act, allows smaller ventures to offer equity or securities via crowd activities, while the necessary regulations are held at a minimum. It is thus seen as a big alleviation for entrepreneurs and newly founded ventures to travel further down the growing path after the initial steps – before venture capitalists of all sorts would find the investment attractive.

Research in this theme needs to address the implications of such rules and regulations, costs being one side, but the diminished value of reporting and auditing may well be a backlash for the efforts to attract crowd-based equity investors due to rising information asymmetry, and the fear of moral hazards.

Besides international legal and comparative studies, it might also be fruitful to apply agency theory and identify for example lobbying groups and their motives (Heracleous and Lan 2012). Also the long-term impact of these new rules and regulations for crowd-funded initiatives on traditional finance market rulings for small ventures may provide further perspectives.

In addition, the role of intermediaries in CF, for example the platforms themselves, with their perceived fiduciary duties, needs to be addressed in order to provide guidance to both investors and ventures (Rubinton 2011). It will be interesting to see case studies on how courts decide on the role of these intermediaries when the first moral hazards and cases of fraud appear.
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Is the legal system prepared for the complex scheme of CF with so many and often globally dispersed participants? A special focus might also be necessary on the payment providers. Besides taxation and currency exchange issues, their activities are under strict oversight and control by individual governments and thus politics may exert influence.

The choice and interplay of legal business forms with their inherent organizational forms has been seen to matter in capital formation (Belleflamme et al. 2010a; Dushnitsky and Shapira 2010; Edwards and Edwards 2008; Lambert et al. 2012). The SE sector shows tailored and often highly complex legal forms such as community interest companies (e.g. the CIC or L3C) with unusual organizational structures (Hill et al. 2010), providing interesting perspectives for future research in how the crowd perceives these as investment opportunities.

Conclusion

This paper has reviewed extant literature on CF and its financial underpinnings in an SE context, and has outlined eight CF-related research themes that would provide valuable information for academics, policy-makers and practitioners.

Once more we see that the complex and ambiguous nature of SE provides a fascinating playground for researchers from various disciplines (Mair and Marti 2006). The almost undefined and disputed field of CF for donations, equity or debt, even increases this convolution of terms, concepts and actions. The proposed schema of the inner workings of CF shall thus reduce ambiguity and provide a framework for researchers to find a common ground.

We need to see rigorous and robust conceptual and empirical research, drawing and developing from existing proven theories from a multitude of disciplines. Such solid research endeavours ultimately need to address and inform policy-makers and practitioners likewise in order to increase the success of CF of new (social) ventures – a worthwhile scholarly pursuit.

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References


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