CHAPTER 7

EQUITY CROWDFUNDING AS BUSINESS STARTUP CAPITAL

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7.1 INTRODUCTION

Past research about crowdfunding (CF) has shown that, unlike venture capital and business angels, crowdfunding has the advantage of giving entrepreneurs control of their businesses. Ultimately, because the entrepreneurs raise their capital from the crowd, they maintain their right to make decisions for the company. Usually, raising capital from venture capitalists and business angels through share offers makes them part owners of the business. Eventually, venture capitalists and business angels become involved in the business's operation by participating in the decision-making process. However, raising capital from crowdfunding, particularly equity crowdfunding (ECF) safeguards entrepreneurs from ceding their rights in the decision-making process (Ordanini et al., 2011). Furthermore, crowdfunding gives entrepreneurs access to capital, which they will be unable to access from traditional funding sources. There is ample research to suggest that most entrepreneurs fail to raise venture capital because they do not qualify (Block et al., 2018). The study therefore starts with an overview of the prevailing literature on the equity crowdfunding model. Consequently, limited empirical evidence is offered precisely for the validation of the ECF model presented in our study. We also restricted our study generally to the selected crowdfunding model as an alternate source of startup capital for businesses. First, based on a review of existing literature, the study presents the various definitions of crowdfunding and further presents the diversity in these definitions. Second, the selected model of crowdfunding is critically examined and discussed, with a detailed presentation given in Section 3.

7.2 THE CONCEPT OF CROWDFUNDING

Crowdfunding is the process of raising funds from a large group of people using online platforms to fund start-up projects (fundraisers) (Mollick, 2014). This takes the form of an open call, and it is not limited by geographical boundaries (Agrawal et al., 2015). Raising money from the crowd involves certain laid-down procedures. First, there must be a fundraiser, which is usually an entrepreneur or start-up company with a business idea. The fundraiser then sells this idea to the funders (crowd) on online platforms (Mollick, 2014). The platform, therefore, becomes an intermediary between fundraisers and funders. The project or business venture is then advertised on the online platforms, and then an appeal is made to the general public (Kraus et al., 2016). The concept of CF is presented in Figure 7.1.

There are three main players involved in CF campaigns and these are the project initiators who propose the business venture to be funded Kaartemo (2017), the crowd that backs the business venture by making monetary contributions, and the internet platforms that launch the business venture (Vismara, 2018). The striking feature of crowdfunding is the platforms, which are the mediums that help to bring all three parties together (Mollick, 2014). Backers who make monetary contributions typically select and support projects that pique their interest. These could be social projects or business ventures. The backers would donate to these social projects in the form of supporting a good cause for altruistic purposes (Moon & Hwang, 2018). In the case of business ventures, the backers buy shares in the venture for capital gain or dividend purposes. Raising funds from the crowd has very little restriction in the sense that, unlike the more traditional sources like banks and equity finance (Ahlers et al., 2015), smaller amounts of money can be paid by the crowd during a call for crowdfunding appeals. The crowd plays an important role because they provide the needed funds and act as an alternate source of finance for projects or business ventures (Cumming et al., 2020).

Figure 7.1 Crowdfunding model (Source: Belleflamme et al., 2014)

This section starts with an overview of the prevailing literature on the selected CF model, consequently, limited empirical evidence is offered precisely on the validation of the CF model presented in our study. The study presents the various definitions of crowdfunding based on a review of existing literature in the subject area. It further highlights the diversity in these definitions and proposes a comprehensive definition. In addition, the selected model is presented and discussed in detail.

Within this section, the prevailing crowdfunding definitions are presented, and the definition for the study is introduced. From the viewpoint of making an appeal to the crowd for a donation in return for a reward (reward-based), according to Belleflamme et al. (2014) crowdfunding involves an appeal, mostly through the internet, for providing financial resources either in the form of a donation or in exchange for a future product or some form of reward to support initiatives for specific purposes. Wheat et al. (n.d) saw crowdfunding as an opening for entrepreneurs to raise start-up capital by describing it as a new internet-based method of fundraising in which entrepreneurs or individuals ask for donations to start business projects on crowdfunding platforms. Mollick (2014) broadens the definition of crowdfunding by stressing how nominal donations from a large crowd could create significant capital for start-ups. He defines crowdfunding as;