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Abstract

Equity crowdfunding is increasing in popularity as an alternative to traditional financing for start-ups and growth companies to raise money for their business. This study discusses how equity crowdfunding is different from traditional financing, such as angel investors and venture capitalists. We argue this difference is brought further into focus when large numbers of crowd members invest small amounts, as opposed to fewer individuals making large investments. Building on existing research on Social Identity Theory, we look at why some crowdfunding campaigns are more likely to attract these contrasting types of investment (numerous small investments or fewer large investments). A model is presenting linking different characteristics of campaigns to total investment and average investment. This proposed model will be tested using public data gathered from Crowdcube, a leading UK-based equity crowdfunding platform. This study has significant implications for fundraisers who may wish to target different types of crowds according to the nature of their business, i.e. smaller numbers of passionate investors to provide informed input or larger numbers of casual investors to help create awareness and spread positive word of mouth.

Keywords: Crowdfunding, Equity Crowdfunding, Social Identity, Crowdcube

1 Introduction

One of the biggest difficulties that start-ups face is attracting external finance, from venture capitalists or bank loans, to launch their company (Cosh et al. 2009). Large enterprises find it much easier to get financing from banks or venture capitalists to grow their company, while many start-ups rely on their own savings or personal loans from family (Harrison, 2013). In recent years, start-ups are not relying as much on business angels or banks, but instead are looking to raise money from the general public or 'crowd' (Belleflamme et al. 2014). Crowdfunding enables a start-up to engage with a large number of individuals and use the wisdom of the crowd (Surowiecki, 2004), instead of a small group of specialized investors.

Online crowdfunding was first used by ArtistShare, where musicians could seek money for their new album (Freedman and Nutting, 2015). ArtistShare used rewards-based crowdfunding, where the crowd could pre-order a copy of the album by giving a certain amount of money. Once the musicians target was met, the album would be produced. With the launch of platforms like Indiegogo and Kickstarter in

2009, reward-based crowdfunding then spread to start-ups who were able to raise funds to develop a product or idea, without the need to go to a bank or other source of finance (Owyang et al., 2013). More recently, start-ups are beginning to use equity-based crowdfunding platforms such as Seedrs or CircleUp. These equity crowdfunding platforms give start-ups the opportunity to raise capital for their company by offering the crowd the chance to purchase a stake or an equity in the company, just like a venture capitalist or business angel would do.

There is relatively little empirical research on equity crowdfunding compared to other forms of crowdfunding (Gleasure and Feller, 2016a). Some research discussed the potential of equity crowdfunding for returns (Schwienbacher and Larralde, 2012), however, the majority of the research in this area has been related to regulation and focused on the new inexperienced investors (e.g. Fink, 2012; Stemler, 2013). These studies focused on the Jumpstart Our Businesses (JOBS) Act, a legal change that meant start-ups in the US could be funded by non-accredited investors, as well as accredited investors. This is a huge change because it is estimated that as many as 97% of Americans are considered to be non-accredited investors based on their income (Newbery, 2016; Scharpf, 2016). One of the advantages of crowdfunding is the ability for large numbers of people to invest in opportunities that may be too unconventional or high-risk for small numbers of traditional investors (Chen and Han, 2012). This implies that an equity crowdfunding campaign with large numbers of minor investments is fundamentally different to one that includes fewer, larger investors (and by extension, traditional angel or venture capital investment).

This study uses Social Identity Theory to look at the crowd and show that there can be high investments/low volume of investors or low investments/high volume of investors, depending on the interest and commitment of the crowd with the company. The first part of this study will describe crowdfunding, with particular focus on existing research around equity crowdfunding. Next, we will look at social identity theory, and how it can have an effect on a crowdfunding campaign. We then present a model and hypotheses of how different qualities of a campaign can impact its average investment. The next phase will be to look at an equity crowdfunding platform to test these hypotheses.

2 Crowdfunding

Crowdfunding is related to the concept of crowdsourcing, which involves utilizing a multitude of humans to gather ideas, and solutions to solve a wide variety of problems. First coined by Jeff Howe in the June 2006 issue of Wired magazine, he describes crowdsourcing as a new web-based business model that uses the creative solutions of a large network, through the use of an open call for proposals (Howe, 2006). However, long before the term was coined crowdsourcing was being used to create new products, and engage customers. In 1949, Pillsbury, a beloved baking brand, held a mail-in cooking competition, called Bake-off (Parvanta, Roth and Keller, 2013). Customers would send in their recipes, and the best recipe would receive a prize. Pillsbury would create a cookbook with the best recipes, and send it to their customers, who received crowdsourced cooking tips. Like crowdsourcing, the idea of gathering money from a large network is not new. A very early example of crowdfunding occurred in 1884, when the pedestal for the Statue of Liberty was funded by Joseph Pulitzer through micro-donations by the American people (Bannerman, 2013). Online crowdfunding is relatively new, with new platforms such as Kickstarter and Indiegogo providing small to medium businesses with a new way to access capital.

According to a number of studies, (Belleflamme et al 2013; Gleasure and Feller, 2016a; Bradford, 2012) there are four paradigms of crowdfunding. These four categories are:

1)   Crowd Charity: With this type of crowdfunding, donors receive nothing for their contribution. This type of crowdfunding is used mainly by non-profit and NGO organisations to raise money. Charity crowdfunding platforms include Razoo, Crowdrise, and GoFundMe.

2)   Rewards-based Crowdfunding: Here, backers typically contribute small amounts of money in exchange for benefits from a proposed product or service (e.g. provision of that product once it is developed). Kickstarter, PledgeMusic and Indiegogo are all platforms that enable rewards- based crowdfunding.

3)   Debt-based Crowdfunding: This model is also referred to as peer-to-peer lending. Lenders give money to entrepreneurs or organisations, and expect repayment at some agreed upon time. Depending

on the platform used, some lenders will receive interest, while others do not. Examples of peer-to-peer crowdfunding platforms include Kiva, Lending Club, and Funding Circle.

4)   Equity Crowdfunding: This type of crowdfunding offers investors a stake (or equity) in the company in return for their funds. This form of crowdfunding is usually used to fund the launch or growth of a company. CrowdCube, Seedrs, and CircleUp are some of the most popular equity crowdfunding platforms.

Equity crowdfunding offers backers the opportunity to become more than just donors. Instead of fixed instant rewards with rewards-based crowdfunding, backers are given a share of the company in return for their contribution (Griffin, 2013). These backers are looking to get a return on their investment in the form of future dividends, company sale, or a public offering. In a short period of time equity crowdfunding is becoming more important in the world of finance. In the UK alone, equity crowdfunding has grown from £28 million in 2013, to over £215 million in 2015, making equity crowdfunding the second fastest growing sector within the UK alternate finance sector (NESTA, 2016).

Much of the existing research around equity crowdfunding has been non-empirical and legal literature about protecting the new investors, and research focused on the laws and regulations surround equity crowdfunding. (e.g., Stemler, 2013; Cohn 2012; Gabison, 2015). While there have been some quantitative studies done on equity crowdfunding, (e.g., Agrawal et al. 2015; Burtch, 2011) there is still very little quantitative research compared to rewards or debt based crowdfunding. Until recently, in many countries equity- based investment was restricted to accredited investors, who were usually wealthy business angles or venture capital funds. However, new legislation, such as Title III of the JOBS Act in the USA, as well as the FCA's regulatory approach to crowdfunding, has begun to open up the potential for equity crowdfunding among non-accredited investors (Griffin, 2013; Gordon, 2016; FCA, 2014).

There are a number of differences between equity crowdfunding and traditional means of financing. Most notably, a major benefit of equity crowdfunding is that start-ups are able to reach a much larger group of investors, rather than just a small number of angel investors (Rose, 2016). Equity crowdfunding enables a company to raise funds, while also building awareness of themselves among consumers. Documented benefits of using crowdfunding over angel investment can include market development and opportunities for feedback (Schwienbacher and Larralde, 2012). This means that SMEs can reach out to like-minded individuals who would be much more willing to invest in their company. However, there also is less opportunity for specialised feedback or sophisticated support ecosystems with equity crowdfunding (Gleasure, 2015). Venture capitalists and business angels often specialise in a certain sector, which means that if you can secure funding from an investor, they will also bring sector-knowledge, support and expert advice to the table, and will open connections that would have been impossible without them (Van Osnabrugge, 2000). This presents an important but overlooked question about equity crowdfunding and the type of crowd participating in a campaign – what characteristics of a crowdfunding campaign are more likely to attract small investments from large numbers of investors, as opposed to larger investments from fewer investors?

3   Social Identity Theory and Equity Crowdfunding

Social identity theory (SIT) was introduced by Henri Tajfel and John Turner in the 1970s and 80s as a means of explaining intergroup behaviour (Tajfel and Turner, 1979). Social identity is a person's sense of 'whom they are', based on the social group to which they belong. According to SIT, we adopt the identity of the group that we belong to, and we act in ways that we perceive members of that group act (Tajfel and Turner, 1986). As a consequence of your identification, you will develop emotional significance to that identification. SIT suggests a person does not have one 'personal self', but rather multiple selves and identities associated, each associated with different social groups in which they perform some particular role (Tajfel and Turner, 1986). SIT has been applied to explain behaviours in a number of different domains, including why we choose entertainment media in accordance with certain group memberships (Trepte and Kramer, 2008), how we categorise ourselves in our organisation context (Hogg and Terry, 2000), and how we make economic decisions that may appear irrational (Akerlof and Kranton, 2000).

The groups to which people belong are an important source of pride and self-esteem (Abrams and Hogg, 1988). Individuals perceive others as part of 'ingroups' with which they socially identify, or 'outgroups' with which they do not (McLeod, 2008). Central to this are shared norms and attitudes, which determine how members of an ingroup interact (Mead, 1934; Blumer, 1969). In relation to crowd behaviour and crowdfunding, it has been seen that a person's identity influences what people do and why they give (Gerber and Hui, 2013). Research has shown that fundraisers who are able to convey their personality and identity are more likely to succeed (Theis et al., 2016). Investors pay close attention to the project creators themselves, meaning fundraisers have to get their identity across to the investors in order to engage the crowd (Gleasure and Feller, 2016b). Most importantly for this study, SIT suggests that people will invest more of their personal time and effort to support ideas that resonate with their social identity (Aaker and Akutsu, 2009). Clearly, this is not the first paper to apply SIT to crowdfunding (Kromidha, 2016; Feller et al., 2016) but we want to take it further, and explain the similarities and differences between crowd-funding and the traditional investments approach to fundraising.

4 Hypotheses and Model

Figure 1 illustrates five explanatory constructs divided into two over-arching explanatory mechanisms, I.e. company articulation and company specificity. Many of the disclosures that may assist in image construction and social identification could also impact on investment for other reasons, e.g. additional information could be seen as an attempt to reduce information asymmetry and increase trust by convey-ing fundseekers' benevolence (Pötzsch and Böhme, 2010).
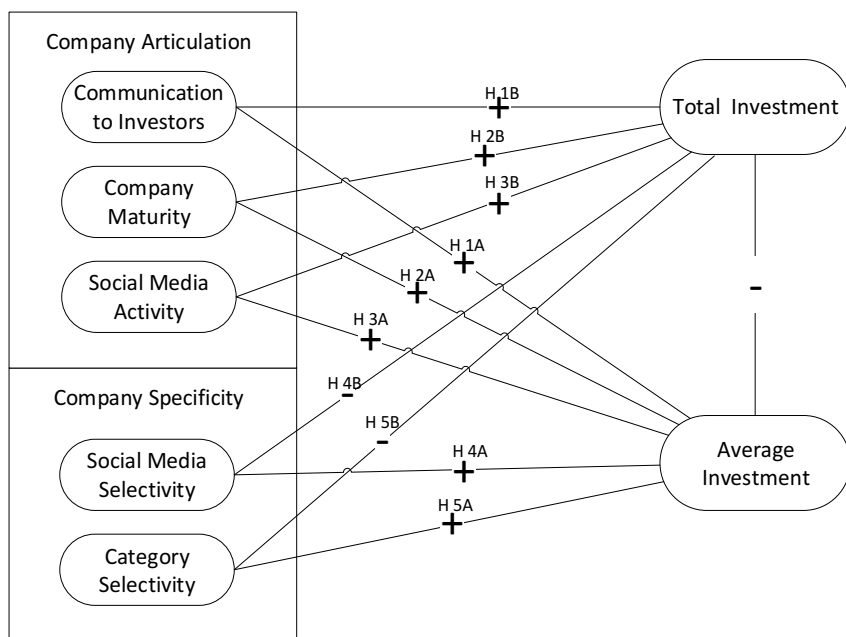

Figure 1.   *Factors influencing the total and average investment in a crowdfunding campaign*

Hence, both of these measures are important to understand the impact of different campaign characteris-tics. If campaign has a low average investment, it is likely that it is of interest to many people, but the company's social identity did not resonate strongly with the crowd. Oppositely, if a campaign has a high average investment, it may be of interest to a smaller number of investors, but those investors are more engaged with the company.

4.1 Company articulation

To relate to someone, or something, we need to first understand it. The more detail a company provides, the easier it will be for the crowd to find elements to which to identify (Scott and Lane, 2000). From

existing research on organisational identity, we know that upper management are responsible for defining and communicating what is attractive about the organisation to other stakeholders (Dutton and Dukerich, 1991; Elsbach and Sutton, 1992). Stakeholders often relate to an organisational image, or identity, by using personal characteristics and interpersonal relationships to determine organisational characteristics (Zott and Huy, 2007). Thus, three types of disclosure are likely to articulate a company in a manner that lends to social identification.

One way a company can define itself more is to provide the crowd with more information in the form of documents and financial records. Companies can use a crowdfunding platform to communicate with the crowd, telling them more about their company and giving them any updates. Communication in a start-up is important, especially between the company and its investors. Without this honest communication, the start-up can easily lose the confidence of the investors (Blair, 1998; Beier and Wagner, 2015). By regularly sharing updates and all relevant documents, the company will become more defined to potential investors and demonstrate a willingness towards transparency. Thus, we hypothesise that companies who communicate more with potential investors will be defining their business more and more, and so, they will have a higher average investment and total investment. The number of documents will be gathered from the crowdfunding platform, which have been provided from the Companies House.

H 1A: *Companies that provide more documents will have a higher average investment.*

H 1B: *Companies that provide more documents will have a higher total investment.*

The length of time a company has existed can also tell a potential investor more about the company, so helping to socially identify with different aspects of it. Much of the perceived image of a person or company is built up over time through ongoing interaction with various stakeholders (Swann, 1987; Brewer and Gardner, 1996). However, there are also other reasons why companies that have been in business for a number of years may attract investment, e.g. because they are perceived as stable or because they are perceived to be making an effort to keep potential customers engaged (Owyang, 2013). Thus, as with the provision of documentation, we hypothesise that longer business histories will have a higher average investment and total investment. The length of time a company is in business will be gathered from the crowdfunding platform, which have been provided from the Companies House

H 2A: *Companies that have a long business history will have a higher average investment.*

H 2B: *Companies that have a long business history will have a higher total investment.*

One of the most popular means of interacting with external stakeholders is social media (Walters et al., 2009; Wilson, 2011). A company that regularly communicates and interacts with external parties via social media offers the crowd an opportunity to get to know what the company is about (Rapp, 2013). For example, a fundraiser can set up a Facebook page to engage the crowd even before they decide to use a crowdfunding platform. Studies have shown that the greater number of Facebook friends, the more successful a crowdfunding project is in terms of amount of money raised (Mollick, 2014). Research has also found that the fundraiser's ability to demonstrate their identity in larger social networks is associated with success, in terms of a pledge/backer ratio (Kromidha and Robson, 2016). Thus, we hypothesise companies that are active on social media will have a higher average investment and total investment. Social media activity will be collected from each of the crowdfunding campaigns that are analysed. We will look at the number of social media posts of each crowdfunding campaign.

H 3A: *Companies that are more active on social media will have a higher average investment.*

H 3B: *Companies that are more active on social media will have a higher total investment.*

4.2   Company specificity

While communicating personal and corporate values is important to establish a relatable identity, it is also important for to establish the values or norms that are excluded (Elsbach and Kramer, 1996; Humfreys and Brown, 2002). The networks and groups that a company belongs to will have an impact on how the crowd view their social identity and ultimately, if they will invest in the company and how

much they invest. However, while clearly articulating the company tells the crowd who that company is, the interactions with different social groups and the media they use will tell the crowd who they are not (Gleasure and Feller, 2016b). This can be related back to existing research on 'symbolic interactionism', which tells us that the goals of our interactions with one another are to create shared meaning (Mead 1934). People act toward things on the basis of the meanings those things have for them, and the meaning of such things is derived out of the interactions one has with one's fellows (Blumer, 1969). Smaller and closer social groups will be more cohesive than a larger group, and will have a stronger sense of shared meaning. From this we will argue that those smaller social groups will invest more in campaigns that have meaning to them, and whose identity is in line with their own.

The first route towards establishing specificity in a company's identity is the social media that company chooses to use. This selective use can tell a great deal about a company's social identity and whom they are targeting (Kaplan, 2010). Research suggests that a user's preference for choosing a social media, such as Facebook over Twitter, is related to the user's personality (Hughes et al., 2012). As a result, companies use different platforms depending on their target market (Stelzner, 2012). For example, figures from September 2015 showed that Facebook appealed to adults, with 79% of adult internet users who are aged 30-49 are using it. Facebook is also popular with women who are online, with 77% using it. Instagram is more attractive to younger users as to opposed to an older crowd, with 55% of online adults aged 18-29 using it (Duggan, 2016). This suggests companies that are more selective with their social media will have fewer backers, however they will be more passionate, meaning they will have a higher average investment. However, because they are lowering the number of potential investors with whom they are interacting, there will be a smaller crowd, which means they will have a lower total investment. Thus, we hypothesise companies that are more selective of the social media they use will have a higher average investment and lower total investment. To measure a company's social media selectivity, we will analyse their usage of different social media and look at which social media they are more active on.

H 4A: *Companies that are more selective of the social media they use will have a higher average investment.*

H 4B: *Companies that are more selective of the social media they use will have a lower total investment.*

Conceivably, the same principles are true of the category in which a campaign is positioned. Depending on the crowdfunding platform, there will always be categories, or sectors, that are more or less popular with the mainstream crowd. For example, according to the Seedrs portfolio update in September 2016, the Food & Beverage and the Home & Personal sectors were the most popular, while the Games sector was the least popular (Seedrs, 2016). This lends itself towards more intense social identification in the less popular categories, as relationships in smaller groups tend to be more personal (Kely and Barsade, 2001). Arguably, this suggests that a less popular category tells the crowd more about the social identity of the company and creates a deeper, albeit less widespread connection. Thus, we hypothesise companies that are fundraising in less popular categories will have a higher average investment and lower total investment. To measure category popularity, we will rank the categories of the sample of crowdfunding campaigns.

H 5A: *Companies that are in a less popular category will have a higher average investment.*

H 5B: *Companies that are in a less popular category will have a lower total investment.*
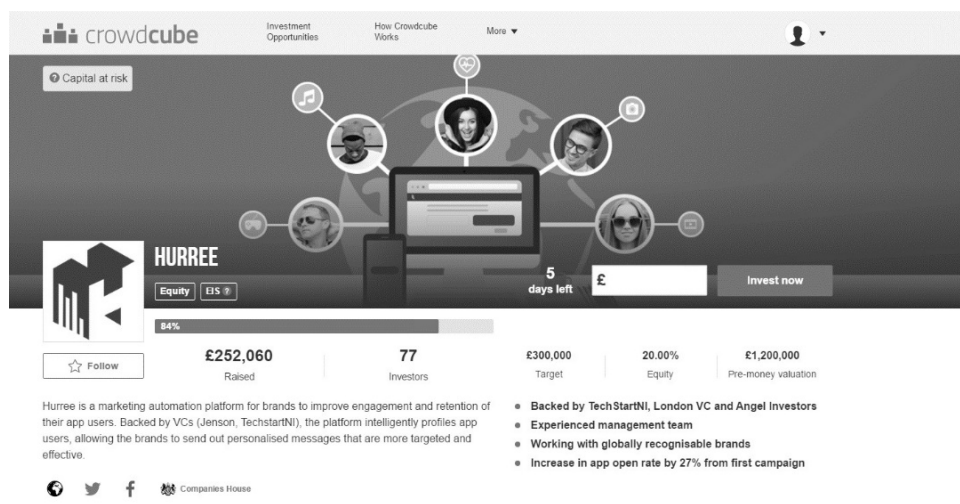
5   Proposed Method

Figure 2.   Screenshot of a crowdfunding campaign on Crowdcube

In order to test the proposed research model, we intend to gather public data from an established equity crowdfunding platform, namely Crowdcube. Crowdcube is a UK-based online equity crowdfunding website that enables members of the general public to invest in start-ups, early stage and growth businesses, alongside professional investors. Launched in 2011, Crowdcube has become one of the leading equity crowdfunding models, having raised over £195 million to fund over 460 campaigns. Crowdcube is growing at a rapid rate and is continuing to attract new members, currently with over 300,000 registered investors on the platform.

Crowdcube is selected for two key reasons. First, Crowdcube is an established platform which has been operating for over five years at the time of writing. This means the dynamics of the platform are relatively mature and allows analysis to focus on completed campaigns, rather than trying to predict outcomes of ongoing fundraising. There have also been a number of high profile successes, creating a level of public awareness (hence, possible investor diversity). Companies like JustPark and Sugru have both raised over £3 million using Crowdcube. JustPark raised over £3.7 million from 2,900 investors in just 34 days. Sugru raised over £3.3 million, and did not just benefit from small investors, as a single investor dedicated £1 million. This was the largest single investment on the Crowdcube platform. In July 2015, E-Car Club was the first successful exit from Crowdcube. The company received a significant investment from Europcar, which meant that 63 original investors in E-Car Club via Crowdcube benefited from a multiple return on their investment.

Second, Crowdcube caters to investors of varying experience. Investors on Crowdcube are divided into four groups; 1) Everyday Investors, 2) Advised Clients, 3) Self-Certified Sophisticated, and, 4) High Net Worth Investors. Both professional and non-professional investors can give as little as £10 to fund a company. Crowdcube is a good platform to test our hypotheses because it is one of the leading companies in the equity crowdfunding space, with a diverse crowd made up of mostly new investors, but also many experienced investors.

It should be noted that Crowdcube has two basic models. The first is the debt-based, or bond, model. With this model you are giving a loan to a company in return for a fixed amount of interest every year. The second model, and the most popular on the platform, is the equity-based model, where investors give money in return for a share in the business. Consistent with the focus of this study, data gathering and analysis will focus on campaigns adopting the equity-based model. Figure 3 shows empirical indicators for each of the theoretical constructs described in each hypothesis in the research model.
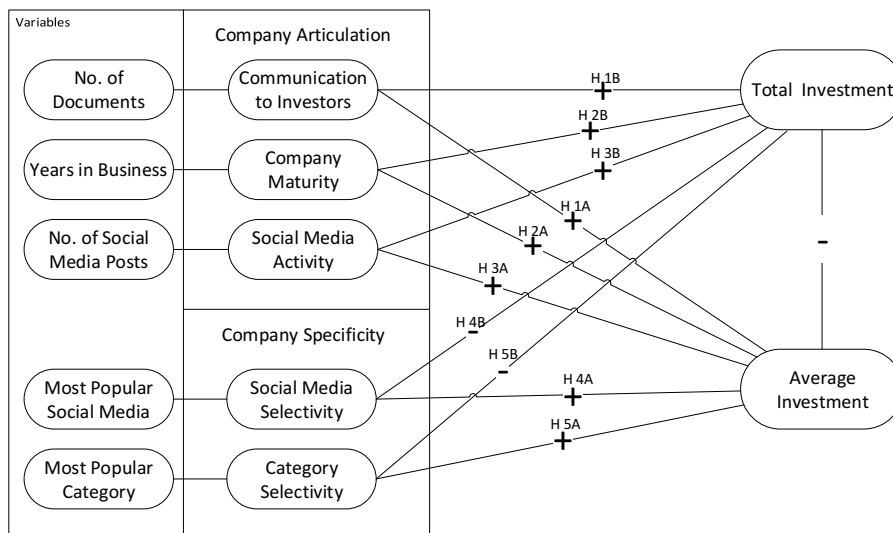
Figure 3.   *Research model with empirical indicators for Crowdcube.*

6   Discussion and Expected Contributions

This study has discussed the emergence of equity crowdfunding and why it differs from both other forms of crowdfunding and traditional financing. We have identified a gap in existing research concerning the features of equity crowdfunding campaigns that are more likely to attract large individual investments, as opposed to large numbers of small investments. A research model was developed that builds on social identity theory (SIT) to link five key constructs to the average investment size a campaign may expect. Ongoing research proposes to test this model using a field study of investment on Crowdcube, an established UK-based investment platform for equity crowdfunding.

From this study we hope there will be three main contributions. First, we identify the average donation received by a campaign as an important metric for the type of crowd attracted to specific campaigns. Other studies have used the average investment/pledges to determine success (e.g. Pitschner and Pitschner-Finn, 2014; Walsh and Solomon, 2014; Beier and Wagner, 2015). However, unlike these previous studies, we are not using the average investment as a measure for the overall performance of a campaign. Instead, we suggest it can be used to measure how successful the company was in getting their identity across to the crowd and locating investors with particularly strong engagement in the company and/or domain.

Second, this study contributes to SIT by applying it to help explain how investors act, and why they invest in different companies at different levels. Fundraisers will observe that social identity plays a big role in why a campaign succeeds or fails. Several others studies have applied SIT to explain crowdfunding and crowd behaviours (e.g. Kromidha and Robson, 2016; Gerber and Hui, 2013; Theis et al., 2016, Feller et al., 2016). However, by linking SIT with deeper aspects of engagement we propose to explain more than investment; we propose to explain how crowds become more or less different from traditional few investors/large investments approaches to fundraising.

Third, the study presents a model of the variables that can predict the average investment received by an equity crowdfunding campaign. Much crowdfunding research focuses on creating models that will help the fundraiser to run a more successful campaign (e.g., Greenberg et al., 2013; Mitra and Gilbert, 2014). Unlike these studies, the model presented in this study will allow companies to design campaigns that not only maximise fundraising, but also determine the type of fundraising that best suits the needs of the company. Those companies who are seeking to spread awareness among large numbers of potential customers may prefer a different strategy to those seeking to attract smaller numbers of engaged and collaborative investors to assist in business development

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