Investor Communication in Crowdfunding: A Qualitative-Empirical Study

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Agenda

1. Motivation
2. Data and Method
3. Results
4. Conclusion
1. Motivation

How should new ventures communicate with the crowd to be successful in crowdfunding?

Source: http://flipcomic.net/comic/crowd-funding/#.UzwG8Vc0-Ac
1. Motivation

• Crowdfunding democratizes **venture financing**

• What is the **crowd**?

  → a large, heterogeneous and anonymous population with different backgrounds, characteristics and motivations

• **High information asymmetries** in crowdfunding

• **Investor communication** as a way to reduce information asymmetries

**Challenge in crowdfunding markets:**

Communication with a large, heterogeneous and anonymous crowd to reduce uncertainties with very limited verified information about the venture.
2. Data: Interview partners (1)

- Crowd investors: 6
- Platforms: 3
- Market experts: 2
- New ventures: 6
2. Data: Interview partners (2)

**Gender**
- Male
- Female

**Age**
- 20 - 40 years
- > 40 years
2. Data: Interview partners (3)

**Industry**

- Services
- Finance, Insurance, Real Estate
- Retail Trade
- Transportation
- na

**Education**

- University degree
  - Bachelor
  - Master
  - Dipl.
  - PhD
- Other
- na
2. Method + Data Analysis

Semi-structured interviews

Transcription and analysis

Coding and categorization (using MaxQDA)

Theoretical framework

Market cases of completed and ongoing crowdfunding projects
3. Results: Investor communication (1)

• Investors seem to appreciate personal communication but the investments are too small for time and effort required

“As I said, I would like to have a more personal contact with entrepreneurs, but I can’t due to time restrictions“(Investor 4)

“I would prefer to meet entrepreneurs in person, but regarding the investment sizes it is not profitable.“ (Investor 6)

• New ventures do not have the resources to communicate on a personal level with (all) investors

“10% of our investors are active investors, they want to be involved and maintain a personal and direct contact, but this is extremely time consuming. We have to steer them into channels so that we do not have to spend the whole day on the phone.“(Venture 4)
3. Results - Investor communication (2)

- Personal contacts seem to be replaced with alternatives
- Anonymous information (i.e., business plans) have to be available but the content seems not to be crucial for the decision
- Crowd investors appear to focus on the evaluation of the management team
- Hard facts are considered but the overall impression esp. soft facts like sympathy and the perceived trustworthiness seem to be more important

Crowd investors seem to rely on pseudo-personal communication to reduce information asymmetries
3. Results - Investor communication (3)

We propose:

**Proposition 1:** Pseudo-personal communication by a new venture increases its credibility and legitimacy and thus reduces the perceived information asymmetries of crowd investors toward the venture.
• In crowdfunding markets communication between new ventures and investors is often **transparent**.

• Our data reveal that **third party communication impacts** the investment decision of crowd investors.

• Two different influence groups emerged:
  - **Peer principals**: other crowd investors
  - **Superior principals**: other market participants like venture capitalists (VCs), business angels, customers or business associates
3. Results – Third party communication (2)

Peer principal endorsements:

- The crowd seems to believe, that others know more than the individual and believes in the intelligence of the crowd

  “And there is the intelligence of the crowd as an important part of crowdfunding… and if the crowd states that it is not convinced, I reevaluate my opinion or even decide against an investment due to my gut feeling… if the crowd is not convinced, perhaps I shouldn’t be as well.“ (Investor 4)

- Peer investments as signals of quality

- New ventures and other market participants are convinced of hype effects and social contagion processes

  „… the whole thing is very much driven by the current hype; it is a new trend which is enforced by the different market participants.“ (Venture 2)

- Importance of a positive funding momentum
3. Results – Third party communication (3)

We propose:

**Proposition 2a:** Endorsements by peer principals (i.e., peer investors) reduce the perceived information asymmetries of crowd investors.

**Proposition 2b:** Endorsements by peer principals decrease the importance of pseudo-personal communication to reduce the perceived information asymmetries of crowd investors.
3. Results – Third party communication (4)

Superior principal endorsements:

• The crowd seems to reduce its perceived information asymmetries if they receive **positive signals** through third parties which they expect to have more information about the venture

  “External references. Someone must help them to make the decision and to say, yes, this is good.” (Third party 3)

• Third party quality signals in crowdfunding:
  – Participation of experienced or professional investors (VCs, business angels, opinion leaders)
  – Positive customer experiences
  – Reputable business associates (i.e., promoting platform)
  – External credentials (i.e., granted awards)
3. Results – Third party communication (5)

We propose:

**Proposition 3a:** Endorsements by superior principals such as business angels, VCs, customers, and business associates reduce the perceived information asymmetries of crowd investors.

**Proposition 3b:** Endorsements by superior principals decrease the importance of pseudo-personal communication to reduce the perceived information asymmetries of crowd investors.
3. Results – Opinion leaders (1)

Opinion leaders and investor communication:

• Opinion leaders as a specific group of crowd investors
  “I have noticed investor X because he is a very active investor… He often has more information as he is in direct contact with the entrepreneurs and sometimes he recommends an investment.” (Investor 4)

• Different investor communication strategies are required
  “I think that there are different types of investors who require different communication strategies. But the questions asked, came from a small group of investors.” (Venture 2)

• Opinion leaders are less influenced by peer behavior
  “I prefer to take some time to have a look at the venture, at the business plans and I ask questions. The pressure to invest is not so pronounced anymore so I can take my time to decide.” (Investor 3)
3. Results – Opinion leaders (2)

We propose:

**Proposition 4:** The importance of the pseudo-personal communication of new ventures and peer principal endorsements to reduce perceived information asymmetries is less pronounced for opinion leaders.
3. Theoretical Framework

Perceived information asymmetries of crowd investors

- Superior principal endorsements (e.g., VCs, business angels, customers)
- Peer principal endorsements (i.e., other crowd investors)
- Third party endorsements

Pseudo-personal communication by new ventures

- P1a:
- P2a:
- P2b:
- P3a:
- P3b:

Likelihood of investment
4. Conclusion – Theoretical contributions

We contribute to the entrepreneurial finance literature in three aspects:

• Investor communication of new ventures

• Signaling in entrepreneurial finance

• Crowdfunding research
4. Conclusion - Practical implications

• **Investor communication** to convince crowd investors of the ventures’ legitimacy and credibility and to **reduce the crowds’ perceived information asymmetries**

• New ventures need to be aware of the **specific characteristics** of communication requirements in crowdfunding

• They need to consider the impacts through **third party communication**

• Crowd investors might be driven by the **personal impression** of entrepreneurs instead of **success potential** of the venture

• Trusting the crowd might lead to a **lack of analysis**
4. Conclusion: Limitations

- Results are limited to a qualitative and explorative research design
- Identification of boundary conditions (i.e., opinion leaders)
- No information about impact sizes
4. Conclusion: Future research

- Quantitative studies to test propositions and to generate statistical evidence that can be generalized
- Investigation of interrelation effects
- Selection process of crowdfunding platforms
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