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Crowdfunding Benefits For Early-Stage Entrepreneurs: Bridging The Gap Between Finance And Democracy

Ms. I.Nandhinikumari[1], Dr. J. Prabhakaran[2]
[1]*Research Scholar, Kalasalingam Business School Kalasalingam Academy of Research and Education*
[2]*Associate Professor, Kalasalingam Business School Kalasalingam Academy of Research and Education*

Abstract

By offering an alternative to equity, debt, and bootstrapping, crowdfunding has had a significant impact on the field of entrepreneurial finance. It enables entrepreneurs to leverage "the crowd" to generate financial investment and additional "value-added" benefits (Belleflamme et al., 2014; Harrison, 2013; Ordanini et al., 2011). In 2012, crowdfunding generated £2.7 billion in investment (Massolution, 2013). Although studies have started to shed light on the phenomena, they have tended to concentrate more on the dynamics of investment platform activity than the experiences of the entrepreneurs who participate in it. This study examines experimentally how early-stage entrepreneurs that participate in reward-based crowdfunding, one of the most popular types of crowdfunding, perceive the advantages.
Benefits were found, examined, and compared with existing conceptual frameworks and literature through thematic analysis of interviews with a pilot sample of five early-stage entrepreneurs and two experts. This led to the development of a new conceptual framework for "benefits" that is experimentally contextualized. The literature supported some of the expected advantages, such as resolving financial issues and establishing a foundation for future funding. The results of the interviews showed that investor involvement was more varied and wide-ranging, ranging from simple investment to ongoing engagement in the development of the business, supporting an understanding of how democratic involvement of the "crowd" actually occurs, even though the literature emphasizes democratic investor involvement through financing decisions. Additionally, several disadvantages of crowdsourcing are noted, including the significant time requirements involved. All things considered, it was discovered that each entrepreneur's strategy, interactions with investors, and realized gains were impacted by their individual goals and methods.

This study's empirically supported paradigm of crowdfunding advantages serves as the foundation for future research. This provides value by showing how crowdfunding research can be used to better understand the influence on small business development and entrepreneurial learning when choosing funding sources, rather than just platform activity. The study emphasizes that the problems with crowdfunding extend beyond easy access to project funding and that it should be viewed as a component of a larger resource development plan for initiatives in their early stages. It also shows how the entrepreneurs' personal goals and methods for venture development influence their interactions with crowdsourcing investors.

Lastly, by starting to describe the process by which a new kind of community stakeholder participation in early-stage initiatives may be evolving, the framework implies that the idea of democratic "crowd" involvement may transcend platform investment dynamics. As a pilot study, there is a chance to expand this research by carrying out worldwide cross-case analysis to further improve and contextualize the benefits framework and to go deeper into the difficulties that have been found.

Keywords: Crowdsourcing, Individual Goals, Stakeholder, Crowdfunding, Entrepreneurs, Entrepreneurs' Challenges

Introduction

"We are seeing the emergence of a new type of investor, entrepreneur, and intermediary who are collaborating to find creative ways to channel funds to innovative projects and SMEs." (Klaes, cited on page 5 of De Buysere et al., 2012). It is hard to argue against the basic tenet that a firm cannot start or continue without money (VanAuken and Neeley, 1996; Cassar, 2004; Axelson and Martinovic, 2013).However, obtaining capital is a challenge for many startups and early-stage companies. This is a major concern in a world where the establishment and expansion of SMEs have long been seen as essential to a thriving economy (Macht and Robinson, 2014; OECD, 2014; Lam, 2010; Grilo and Irigoyen, 2006; Cassar, 2004). There are a number of reasons for this, including knowledge asymmetries and a lack of experience (Ebben and Johnson, 2005). The newness, transparency, and exponential development of crowdfunding make it a recent phenomena. have captured the attention of millions of people worldwide (Mollick, 2014).This is especially true for reward-based crowdfunding, like the projects that Kickstarter made famous in 2014.Every year, millions of dollars are raised, sometimes by a single initiative, but the main question is whether money can help the entrepreneurs behind early-stage enterprises overcome the challenges they encounter.

This research examines the literature on entrepreneurial financing in order to answer this question. Early-stage entrepreneurs' challenges are taken into account, and their main coping strategies are examined. Next, we present Macht and Weatherston's (2014) theoretical framework of crowdfunding benefits, point out its shortcomings, and empirically examine it using expert and business owner interviews.

Finally, a novel empirically based paradigm that illustrates the advantages of reward-based crowdfunding as viewed by interviewees in the context of early-stage firms is presented. The phrase "early-stage entrepreneur" refers to someone who has not secured outside finance for their current project through crowdfunding and has used business development as a means of creating or seizing an opportunity.

Factors influencing the rise of crowdfunding

Business financing

It has long been acknowledged that obtaining financial capital is one of the biggest challenges faced by individuals launching new businesses, and there is a plethora of literature aimed at comprehending, analyzing, and formulating recommendations for companies in need of capital (Denis, 2004; Ho and Wong, 2006; Klein et al., 2014; Macht and Robinson, 2009; Wong, 2002; Kerr et al., 2011; Kerr, 2010; Lam, 2010).

There are still gaps in this field despite the attention it receives in both academia and practice. There are typically two choices available to new venture enterprises that need early-stage or "seed" investment: self-financing or outside funding sources. Particularly, external finance—including debt and equity—has garnered a lot of research interest in order to comprehend its distinct advantages and disadvantages (e.g., Baeyens and Manigart, 2006; Berttel, 2003; BVCA, 2009; Cassar, 2005; David, 2012; Denis, 2004; Fried and Ganor, 2006; Harding and Corwling, 2006; Howorth and Moro, 2006; Hsu, 2002; Mahmud, 2013; Mason and Harrison, 1999; Stiglitz and Weiss, 1981; Van Osnabrugge and Robinson, 2000; Wong, 2009), but frequently there is not enough of either (Lam 2010).

The "fundinggap"

Just 5.8% of the $600 million in startup finance in the 42 nations evaluated by The Global Entrepreneurship Monitor came from banks and venture capitalists, while more than 60% came from the entrepreneurs themselves (GEM, 2006; Lam, 2009). Furthermore, according to Bygrave et al. (2003), pp.114, less than 0.5% of new enterprises are thought to be founded with business angel (BA) or venture capitalist (VC) financing.Access to finance has become a priority for governments, business owners, and subsequent research because, with an average of $65,000 needed for a business's start-up capital (GEM, 2006), a lack of funding can severely limit business start-up activity (Hill et al, 2006; Department for Business, Innovation and Skills, 2012).

It is generally acknowledged that there is a significant gap between the supply and demand for entrepreneurial finance, even though it is challenging to pinpoint the precise demand at any given moment (GEM, 2006; Winborg, 2005 quoted in Winborg, 2009; Lam, 2010; Macht and Weatherston, 2014). According to the Breedon Report (2012), the gap between the supply and demand of bank loans to small and early-stage enterprises in the UK was £27 billion in 2007–2012 and is expected to rise to £106 billion by 2017. This phenomenon, commonly known as the "funding gap," is cited as the main reason why many entrepreneurs try to succeed with little to no outside funding at all (Ebben and Johnson, 2006). This requires the entrepreneur to engage in a variety of activities known as "bootstrapping" (Carter and VanAuken, 2005; Winborg and Landstrom, 2000).

Crowd funding as an alternative

In the realm of capital acquisition, crowdfunding is a new paradigm that allows charities, start-ups, and other projects to raise money online from a variety of possible private investors. The aim is to makes use of this "crowd" by soliciting tiny donations from a huge number of people.

Crowdfunding is growing steadily at a time when the market for SME financing is contracting.2012 saw an 81% rise in investment, reaching $2.7 billion through online crowdfunding platforms that were dispersed among more than a million projects. This increased from $530 million in 2009 to $5.1 billion worldwide in 2013 (Massolution, 2013). Even while these numbers include all three forms of crowdsourcing as well as a variety of international sites, it is logical to believe that reward-based crowdfunding for startups has grown significantly as well.

It is evident that new businesses need financial resources to be successful, and those without money from more conventional sources turn to other possibilities, which frequently provide less than ideal outcomes (Mosey and Wright, 2007). The post-2008 worldwide recessions have also made it more difficult for small and early-stage enterprises to obtain financing (Harrison, 2013), and the "funding gap" is still very much in place.
However, crowdsourcing has emerged as a credible source of funding for companies of various sizes, stages, and industries in post-2008 economies (Schweinbacher and Larralde, 2012).
"[Crowdfunding]involves an open call, mostly through the Internet, for the provision of financial resources either in the form of donation or in exchange for the future product or some form of reward to support initiatives for specific purposes," according to Kleeman et al. (2008) and Cumming (2012), who discuss the financial aspect of the larger crowdsourcing movement.

(Page 588, Belleflamme et al., 2014).

Any of the three crowdfunding models—equity, debt, and donation or reward (i.e., no financial or ownership rights)—can be used as the "reward" in this case. These models are both separately and collectively having a significant impact on conventional forms of entrepreneurial finance (Belleflamme et al., 2014; Harrison, 2013; Ordanini et al., 2011). Globally, crowdsourcing raised $2.7 billion in 2012, an 81% increase over 2011, which witnessed a 64% increase in volume (Massolution, 2013).Donation and prize-based crowdfunding, sometimes known as "reward crowdfunding," contributed $1.4 billion of this total, indicating the unique power of this form of crowdsourcing.
Although the idea of crowdfunding is not new—the Statue of Liberty's pedestal was awarded in 1885 (Harrison, 2013)—its current incarnation as an online financial platform gained traction in 2009 with the introduction of Kickstarter, and by 2012, more than 1.1 million projects and ventures had been successfully funded (Massolution, 2013).

Research is naturally sparse because crowdfunding is a relatively new phenomenon, especially when it comes to empirical investigations. Macht and Weatherston's (2014) paper, which examines the crowdfunding literature to identify the possible advantages and disadvantages that fund-seeking companies may encounter, is the most immediately pertinent study in this field. Building on Macht's earlier empirical research on the advantages of business angel (BA) investment, they create a theoretical framework of benefits (Macht and Robinson, 2009; Figure 2). All three forms of crowdsourcing are taken into consideration in this research.

The four general benefits of both BA and VC investment were considered possibly applicable to crowdfunding, with significant distinctions added. The framework is based on Macht and Robinson's 2008 analysis of the benefits of BA.

Macht and Wetherston's conceptual framework is based on a literature review and is an exploratory study without any empirical support. Another shortcoming of the framework is that it uses the firm as the unit of study rather than the entrepreneur.Since the entrepreneur is likely to make financial capital decisions, particularly in small, startup businesses, it is critical to comprehend the perspectives of those engaged (Winborg, 2009).

Methodology

An early pilot study was carried out to look into the research question. We first conducted semi-structured interviews with two incentive-based crowdfunding experts: Foxtrot, the Chief Software Officer of a reward crowdfunding platform based in the UK, and Golf, a co-founder of an equity crowdfunding platform based in the UK. Many of the features discussed in the literature were confirmed by the experts.In terms of business industry and stage, they both emphasized the unconstrained nature of crowdfunding as well as the advantages of visibility for fundraisers created by this medium's connection to social media.

Golf, whose own platform facilitates equity, debt, and reward crowdfunding, places special focus on how quickly business owners can raise money:

Without a doubt, the primary advantage is that you can raise the funds quickly.The money is yours as soon as it is raised. (Golf) Foxtrot also saw how quickly and relatively easily a company can get financing, primarily because there isn't much due diligence required. The fact that these two characteristics were proposed to allow the entrepreneur to obtain capital without a strategy or post-investment monitoring was a major worry for this respondent. Although this is seen as advantageous in the literature (Schwienbacher and Larralde, 2012), Foxtrots proposed that this partially diminished the entrepreneur's obligation to use the funds as efficiently as possible. In reward crowdfunding, where there are no repayment obligations, this was deemed to be overstated.

It's interesting to note that neither expert brought up the crowd's involvement in the methods Macht and Weatherston (2014) discuss, or their possible use as a type of market research to validate a market product before to launch. Instead, both respondents favored emphasizing how simple it is for business owners to raise capital.

The differences between the experts' opinions and the body of existing literature served as the basis for the first stage of the pilot research and informed the entrepreneurs' future interviews. It is acknowledged, although, that neither of the experts has personal experience in crowdsourcing a firm. Furthermore, although expert perspectives and scholarly study on platforms, industry, and the "crowd" are helpful in answering the research question, little is known about the people at the heart of the movement: the entrepreneurs themselves. Consequently, direct interviews with entrepreneurs were conducted as part of the subsequent phase of the pilot study.

Perceptions of the entrepreneurs

Five entrepreneurs were interviewed as part of this empirical study phase regarding their experiences with reward-based crowdfunding campaigns for early-stage firms. The names Alpha, Beta, Delta, Epsilon, and Gamma are used to describe these participants. Since early-stage companies were thought to be more likely to encounter crucial startup development challenges than established small businesses looking for finance for new product lines, they were selected as the focus. Four major topics came to light, two of which had to do with the direct acquisition of entrepreneurial funding and two of which had to do with the "crowd's" participation and the ownership advantages of reward crowdfunding in particular.

Overcoming funding difficulties

One of the main factors influencing the success of a new business has long been identified as the entrepreneur's capacity to secure funding (Van Auken and Neeley, 1996; Mosey and Wright, 2007). According to their analysis of the literature, Maht and Weatherston (2014) expected that crowdfunding would present special opportunities in this field, including—most importantly—no limitations on the type of firm that may participate. Firm type All of the entrepreneurs operated startups, although four of them were limited liability, for-profit companies, and one was a non-profit community interest company (Alpha). While Beta and Delta aim for modest growth, Gamma and Delta were regarded as lifestyle corporations among the for-profit companies. Additionally, every company works in a distinct industry.While debt financing usually requires asset consideration and equity investors typically pursue high growth technology firms, the results demonstrate that crowdfunding was accessible to these entrepreneurs across a variety of industries and goals, as predicted by Schwienbacher and Larralde (2012) and Lambert and Schwienbacher (2010).

The'fundinggap'

For small, early-stage businesses looking for a comparatively small amount of capital, the funding gap is clearly a significant problem (Bygrave et al., 2003). Since the study's objective was to investigate the advantages and disadvantages of reward-based crowdfunding empirically, only business owners who have raised money in this manner were included in the data sample. A comparatively moderate amount was raised by each participant, far less than what a BA, VC, or debt capital would have raised (Barrow et al., 2005; BVCA, 2009).The highest aim was £10,000 (Beta), while the maximum amount raised was £11,023 (Beta). Perhaps this is why none of the five participants ever thought about VC money as a possibility. The sample in this study demonstrates that smaller financing, which is largely unavailable through other external ways (Ebben and Johnson, 2006; Baeyens and Manigart, 2006), can be obtained in this manner, even though it does not preclude the acquisition of larger sums.

Crowdfunding was the first time that four players (Alpha, Beta, Delta, and Epsilon) raised external funds. Three of the entrepreneurs (Alpha, Beta, and Epsilon) made it clear that they could not access alternative funding vehicles. "[Personal debt] meant that I couldn't get to the bank; they would have laughed me out of the lobby...and I always pay with cash instead of credit." (Epsilon)

"It wasn't necessarily an investable business at that point."(Alpha)
It's interesting to note, nevertheless, that only one participant (Gamma) made an effort to obtain outside funds. While it is improbable that they would have done so (Lam, 2010; GEM, 2006), this shows that the entrepreneurs under study may have inflated the so-called financial gap. Therefore, even though Macht and Weatherston (2014) believe that crowdfunding can help businesses that aren't "investment ready" (pp. 4), the results showed that the company was only four of the entrepreneurs surveyed thought it was not ready.Alternatively, as demonstrated by bootstrapping methods (Winborg, 2009), the entrepreneurs might have actively chosen to pursue crowdfunding because of the special advantages that come with it:
"Although we could have raised that amount from individuals, we were only raising $15,000. We looked more from a donor perspective than from investment." (Delta) According to the entrepreneurs surveyed, crowdfunding offers a variety of special advantages. The speed at which capital can be obtained is one of these.

Speed of capital acquisition
The duration of each participant's online campaign was 30 days or fewer, and the entrepreneur received the funds in a maximum of 5 days. Speed of cash acquisition was important for two participants. One was able to capitalize on an existing service before a competitor (Beta) emerged, and the other was able to start a business within a month of losing their previous job in order to avoid personal financial issues. Epsilon:
We were in a tremendous rush. We had the store open by the end of October, and I was fired [from my former position] at the end of June. (Epsilon)
One of the crowdfunded participants in 2011 was actively seeking a BA investment; the process had been ongoing for two months and was not yet finished (Beta).
In the literature, this advantage of crowdsourcing has been disregarded. This may be the case since reward crowdfunding has always been viewed as part of equity and debt, which are likely to entail drawn-out legal procedures.

Cost of capital acquisition
Many entrepreneurs believe that typical finance transactions' length and repayment expenses are too big a cost for their financial capital (Winton and Yerramilli, 2008). They therefore

frequently look for alternatives. One such option is reward crowdfunding, which has three main expenses: the commission that the internet platform takes, the third-party money transfer fees, and the cost of issuing the funds.The sites utilized here are Crowdfunder and Indiegogo, which take 4% and 5% of the total amount raised, respectively. The commission rate was only known by two participants (Alpha and Beta), indicating that either the rate seems insignificantly low or it is simply taken into consideration when choosing a target amount. Gamma was able to avoid paying about 8% in sales tax by using the incentive program as a prepayment on sales; one member thought it was "free money" (Epsilon).

I can't recall what the percentage was. The money is free. I'll be happy to pay a percentage for that. (Epsilon). This relatively cheap cost of capital has gone unnoticed in earlier research, most likely because debt and equity crowdfunding, which have been previously examined alongside reward crowdsourcing, have comparable financial costs to traditional debt, BA, and VC financing (Golf). However, Beta, who had experience with crowdsourcing and BA finance, pointed out that although crowdfunding was significantly less expensive, time was a considerable additional cost.

Time considerations

Four participants (Alpha, Beta, Delta, and Gamma) expressed astonishment at the amount of time their crowdfunding campaigns demanded. They considered crowdfunding to be a fairly straightforward financial tool before the campaign, but two important timing variables became apparent. First of all, because crowdfunding sites had a "allornothing" approach, entrepreneurs had to make sure the goal was met.This required a great deal of work from the entrepreneur, to an extent that was surprising: "It takes much longer and much more attention than you initially expected." For six weeks, I gave up everything else. (Alpha) Beta, who is presently looking for a bank loan, described the variations in the procedure and how, in his experience, crowdfunding needed a lot more time to produce considerably lower quantities.

People likely underestimate the amount of effort involved because entrepreneurs often have a disproportionate amount of interest in their industry and think that people should support them, while the general public frequently lacks the time or inclination to do so.(Beta) The participants stated that the four entrepreneurs will give careful thought to the time commitments needed when deciding whether to participate once more. Crowdfunding appears to have inherent advantages in this field, nevertheless.

A new benefits framework

The kind of framework established here is based on Macht and Weatherston's (2014) framework of crowdfunding advantages, with notably altered material, in order to summarize the findings of his pilot project.

Four participants chose to use crowdfunding after determining that their business was essentially "uninvestable," following the methodology developed by Macht and Weatherston. Although the availability of traditional finance is unknown, it is noteworthy that reward crowdfunding was effectively used to go over the entrepreneurs' perception of financial limitations.

Three main experiences of audience involvement arose for early-stage entrepreneurs, transcending conventional ideas of democratic funding. The goals of the entrepreneur and the kind of company involved may have a big impact on how much and what kind of community

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development and engagement the crowd can be involved in. This could include anything from sharing contacts to volunteering to actively growing the business in unexpected ways.

It's also crucial to remember that the novelty of crowdsourcing and the publicity that follows can have an effect that is comparable to the "certification" effect of VC and BA investment, where investment comes before investment. This effect is known as "compound crowdfunding." Additionally, the goals of the entrepreneurs in this study were strongly tied to their desire to obtain additional capital, whether through conventional channels or a business that was successful thanks to the crowdfunding campaign.

Lastly, the entrepreneur's need to retain ownership and control was key to rewarding crowdfunding, and it was within this framework that notable advantages were found. While reward crowdfunding can circumvent debt and equity and allow the entrepreneur to test a concept without committing to any of the financial and monitoring obligations expected from other funding sources, it has also been demonstrated to be used as a way to augment external funding, thereby reducing ownership given or debt acquired.

Conclusions

It's also crucial to remember that the novelty of crowdsourcing and the publicity that follows can have an effect that is comparable to the "certification" effect of VC and BA investment, where investment comes before investment. This effect is known as "compound crowdfunding." Additionally, the goals of the entrepreneurs in this study were strongly tied to their desire to obtain additional capital, whether through conventional channels or a business that was successful thanks to the crowdfunding campaign.

Lastly, the entrepreneur's need to retain ownership and control was key to rewarding crowdfunding, and it was within this framework that notable advantages were found. While reward crowdfunding can circumvent debt and equity and allow the entrepreneur to test a concept without committing to any of the financial and monitoring obligations expected from other funding sources, it has also been demonstrated to be used as a way to augment external funding, thereby reducing ownership given or debt acquired. impacted benefit results.Many of these supported the work of Macht and Weatherston (2014), but they also went against their theory and showed that reward crowdfunding did not function as well for these early-stage entrepreneurs as earlier research had predicted. Although the focus of this paper was on benefits, several negatives were also noted, particularly with regard to the time commitments required to carry out a successful campaign. These drawbacks not only go against the literature but also the entrepreneurs' own prior opinions.

However, it should be acknowledged that this is an exploratory study intended to stimulate additional investigation and verification. Cross-case studies contrasting early-stage social vs for-profit businesses and comparing experiences across nations could be part of future research. The limitations of crowdfunding, democratic community interaction, and entrepreneur motives and learning are some of the new areas that this work has tentatively indicated for additional research. These kinds of studies will help us better understand the effects of crowdfunding as a source of capital for entrepreneurs.

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