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CROWDFUNDING OR HERDFUNDING? AN EXAMINATION OF SOCIAL INFLUENCE IN VENTURE INVESTMENT DECISIONS (SUMMARY)

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≈ SUMMARY ≈

CROWDFUNDING OR HERDFUNDING? AN EXAMINATION OF SOCIAL INFLUENCE IN VENTURE INVESTMENT DECISIONS

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Principal Topic

Crowdfunding is a means of raising funds directly from individuals and avoiding traditional capital providers such as professional investors (Howe, 2008). The Internet has led to the proliferation of crowdfunding on a worldwide basis. In April 2012, President Obama signed the Jumpstart Our Business Startups (“JOBS”) Act, which elevated crowdfunding to equity markets in the U.S. Many small business advocates see this Act as a boon to entrepreneurial activity by opening previously inaccessible capital channels. While there is reason to be optimistic about the JOBS Act, there is also reason for concern. Herding behavior occurs when individuals converge in a particular behavior (Bikhchandani, Hirshleifer & Welch, 1998). In this study, we invoke social psychological theories to develop a framework to explicate herding behaviors in a crowdfunding context. Drawing on conformity and regulatory focus theories, we propose that individuals will respond differently to favorable and unfavorable social information, depending on their underlying prevention or promotion focus.

Method

We tested our hypotheses using a randomized factorial between-participants design utilizing students enrolled in a large southern university. Participants were directed to what they believed was an actual beta version of an equity crowdfunding web site. They then watched a short video in which an entrepreneur pitched a business idea. The website also included (favorable/neutral/unfavorable) social information. Participants were then asked several questions, including their willingness to invest in the venture.

Results and Implications

Participants in the favorable social information condition were more willing to invest while participants in the unfavorable condition were less willing to invest. Further, we found favorable social information strengthened the relationship between investors’ promotion focus propensity and their willingness to invest. However contrary to expectations, we did not find that prevention focus predisposes individuals to the presence of unfavorable information, but it does positively influence their willingness to invest in an opportunity. Based on our findings, we offer practical recommendations in light of the growing interest in crowdfunding as a viable financing vehicle.

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