INVESTMENTS IN THE “WILD WEST”: HOW FAILURE AND FRAUD AFFECT TRUST AND CONTRIBUTIONS IN CROWDFUNDING (SUMMARY)

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INVESTMENTS IN THE “WILD WEST”: HOW FAILURE AND FRAUD AFFECT TRUST AND CONTRIBUTIONS IN CROWDFUNDING

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Principal Topic

As seen in other online contexts (e.g., Benlian & Hess 2011), investors’ trust plays a fundamental role in crowdfunding (Agrawal et al. 2014) due to two risks associated with crowdfunding investments: First, crowdfunded startups can fail to deliver promised rewards and/or go bankrupt (Hornuf & Schwienbacher 2014). Second, crowdfunding is prone to fraud where “entrepreneurs” misuse contributed money (e.g., Mollick 2014; Griffin 2012). Presumably, crowdfunding investors who supported ventures that failed or fraudulent campaigns will lower their trusting beliefs towards the entrepreneur they supported (Gerber & Hui 2013) but also any other entrepreneur pursuing crowdfunding (McKnight et al. 1998). In contrast, having invested in successful venture projects (leading to high returns) likely reinforces trust in crowdfunding entrepreneurs and thus induces higher future investments. However, investor reactions to own crowdfunding experiences remain unresearched. Therefore, this study aims to add insights about the consequences of investors’ experiences on their future trusting beliefs and investment behavior in crowdfunding.

Method

In a laboratory experiment with success-based compensation, 250 university students assigned to a “crowdfunding investor” role each decided on an amount of experimental money to contribute to a risky crowdfunding campaign hosted by experimental “entrepreneurs”. After that decision, each investor received information about the outcome of her/his investment: Investors could experience (1) profitable success, (2) costly failure, or (3) costly fraud induced by “their” entrepreneur. In a second round, this study explores the influence of contributors’ experiences on two variables: First, investors’ trusting beliefs towards (different) entrepreneurs, based on McKnight et al.’s (2002) scales; second, amounts contributed to unrelated projects hosted by different entrepreneurs.

Results & Implications

This study reveals negative effects of experiencing fraud on (1) investors’ trusting beliefs towards unrelated entrepreneurs seeking crowdfunding and (2) future amounts invested to unrelated campaigns. Surprisingly, experiencing failure (not induced by fraud) is not associated with negative effects. This may be explained by conscious risk taking of investors and thus high tolerance for (anticipated) losses. Likewise, experiencing success does not influence trust and investments positively.

This paper contributes to the discussion of trust within crowdfunding and additionally add insights regarding the role of experiences to the discussion on investor decision-making in crowdfunding.

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