Target and position article

Start-ups, entrepreneurial networks and equity crowdfunding: A processual perspective

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A B S T R A C T

This paper outlines findings from a large-scale interview based study of start-ups who obtained equity crowdfunding in the UK. It takes a novel integrative approach towards the analysis of entrepreneurial networks by examining both personal and business networks involved in the equity crowdfunding process. Adopting a processual perspective, the empirical findings show that networks and social capital play a critical role in the crowdfunding process. Start-ups leverage, build and draw upon a complex array of network actors and “ties” as they move through the different stages of their crowdfunding journey. The paper shows that this form of funding confers important relational benefits to recipients which amount to “more than money”. It concludes that equity crowdfunding is a highly “relational” form of entrepreneurial finance, requiring holistic forms of empirical investigation. Implications for theoretical development, managerial practice and further research are outlined.

1. Introduction

Stinchcombe (1965) famously noted that “new” firms have a higher propensity to fail – the so-called “liability of newness” – due to their lack of legitimacy, track record or effective networks. Overcoming this liability may depend heavily on an entrepreneur's ability to create effective “exchange relationships with resource providers” (Smith & Lohrke, 2008, p. 315), which explains why networks become crucial for emerging organisations such as start-ups (Aldrich, Rosen, & Woodward, 1997; Katz & Gartner, 1988; Johannisson, Ramírez-Pasillas, & Karlsson, 2002; Hite, 2005).

A key resource for start-ups is finance. Due to a lack of lending track record coupled with limited collateral, start-ups often incur serious difficulties when accessing funding (Berger & Udell, 1998; Berger & Black, 2011). Since the global financial crisis, funding difficulties facing innovative start-ups have magnified (Cowling, Liu, & Ledger, 2012; Lee & Brown, 2016), prompting them to seek out “alternative” funding sources (Block, Colombo, Cumming, & Vismara, 2017). While banks have traditionally dominated the funding landscape for small and medium-sized enterprises (SMEs) (Colombo & Grilli, 2007), in recent years alternative sources of finance, including crowdfunding, have proliferated (Ahlers, Cumming, Günther, & Schweizer, 2015; Bruton, Khavul, Siegel, & Wright, 2015; Cordova, Dolci, & Gianfrate, 2015). Equity crowdfunding in particular has grown rapidly, especially in the UK, which is now Europe’s largest and fastest growing market for this form of entrepreneurial finance (Nesta, 2016) largely due to early deregulation and attractive fiscal incentives put in place by the UK government (British Business Bank, 2014; Brown, Mawson, Rowe, & Mason, 2017).

Crowdfunding is rooted in the broader concept of crowdsourcing (Simula & Abola, 2014), where the ‘crowd’ is collectively tapped to provide “ideas, feedback, and solutions to develop corporate activities” (Belleflamme, Lambert, & Schwienbacher, 2014, p. 586). Equity crowdfunding occurs when a large number of individuals provide small amounts of finance to businesses via online platforms and is defined as “a form of financing in which entrepreneurs make an open call to sell a specified amount of equity or bond-like shares in a company on the Internet, hoping to attract a large group of investors” (Ahlers et al., 2015, p. 955). This form of disintermediated finance seems particularly suitable for funding early stage entrepreneurial firms (Cumming & Vismara, 2017), which tend to be insufficiently developed to attract intermediated finance such as venture capital or bank lending (Brown et al., 2017). Indeed, some claim that the use of crowdfunding may be a new form of entrepreneurial bootstrapping used by innovative resource-constrained start-ups (Bellavitis, Filatotchev, Kamuriwo, & Vanacker, 2017).

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This paper examines the role of entrepreneurial networks within the crowdfunding process. In theory, equity crowdfunding should render the role of networks superfluous, as firms and investors are brought together seamlessly via third-party internet platforms. Rather than utilise personal networks of friends and family, start-ups should be able to access funding directly from anonymous investors through these online mechanisms, where personal communication is replaced with “pseudo-personal” forms of communication such as videos and social messaging (Moritz, Block, & Lutz, 2015). Indeed, some observers have described crowdfunding as the “disintermediation of the finance market” (Harrison, 2013, p. 286), with studies highlighting the great physical distance between crowdfunded ventures and the “people who fund them” (Agrawal, Catalini, & Goldfarb, 2015, p. 254).

Despite this emerging view of crowdfunding as a “disintermediated” or “de-networked” process (Agrawal et al., 2015), emerging empirical research suggests that networks do in fact play a pivotal role in the crowdfunding process (Colombo, Franzoni, & Rossi-Lamastra, 2015; Frydrych, Bock, Kinder, & Koeck, 2014; Mollick, 2014; Vismara, 2016) and that crowdfunding platforms act as “network orchestrators” bringing together start-ups and potential investors (Löher, 2017; Ordanini, Miceli, Pizzetti, & Parasuraman, 2011). Indeed, these equity crowdfunding platforms act as mini online “stock markets” connecting nascent start-ups to potential investors typically outside the reach of resource-constrained new ventures with limited networking capabilities. To date, however, there has been a lack of in-depth empirical work specifically on how new ventures use networks to succeed and optimise the opportunities offered by the crowdfunding “process”.

This paper makes an important contribution to both the emerging crowdfunding literature as well as to the social and business network literatures by exploring the changing role of various entrepreneurial networks as start-ups go through the equity crowdfunding process. Despite a considerable body of knowledge on network issues, the literature is still considered to lack a rich understanding of when, how and why ties shift from weak to strong, social to economic, or short-term to long-term (or vice-versa)” (Slotte-Kock & Coviello, 2010, p. 48). To address these limitations, this paper adopts an integrative approach when assessing entrepreneurial networks, incorporating the entrepreneur’s own social and business networks and how these evolve during the course of crowdfunding. Given networks “aren’t static: they evolve” (Hite, 2005, p. 115), the issue of process is important because, as we will identify, raising equity crowdfunding involves distinctive temporal stages. We therefore explore the processual changes in networks during the crowdfunding process, drawing on findings from a major interview-based study of equity-crowdfunded firms in the UK.

The paper addresses a number of simple but inter-related research questions stemming from an overarching research question: what role do entrepreneurial networks play in the equity crowdfunding process? We seek to address the following specific questions: 1) What role do different types of networks play in the equity crowdfunding process for start-ups?; 2) How do networks evolve over the crowdfunding process?; and 3) What is the impact from these evolving network interactions during the crowdfunding process for start-ups? The paper is structured as follows. First, we review two relevant strands of literature on networks and crowdfunding, drawing on both social and business network theory for our conceptual framing. The methodology is then outlined before the empirical findings are presented and discussed. Finally, conclusions, managerial implications and areas for future research are addressed.

2. Literature review

2.1. Social and business network theoretical perspectives

Broadly speaking, there are two main theoretical schools of thought in the study of entrepreneurial networks: social network (SN) and business (or industrial network) (BN) perspectives (see Table 1 below). The SN tradition is firmly rooted in the sociological literature and is often linked to the pioneering work of Granovetter (1973). The SN approach attempts to measure, often through quantitative methods such as social network analysis, the impact of an individual’s network ties. According to Granovetter (1973, p. 1361), “the strength of a tie is a (probably linear) combination of the amount of time, the emotional intensity, the intimacy (mutual confiding), and the reciprocal services which characterize the tie”.

Granovetter’s early writings focused on the role of informal ties in individuals’ employment prospects, observing that weak ties with acquaintances such as an “old college friend or a former workmate” played an instrumental role in facilitating information to the “job changer” (Granovetter, 1973, p. 1371). Overall, the SN literature emphasises the identification and measurement of such ties and network characteristics.

The SN perspective has been widely embraced theoretically (Leyden, Link, & Siegel, 2014) and empirically examined (Street & Cameron, 2007) within the wider entrepreneurship literature, where there is a continued focus on – and interest in – the role social capital plays in shaping entrepreneurship (Gedajlovic, Honig, Moore, Payne, & Wright, 2013). For example, Kontinen and Ojala (2011) examined the internationalisation of family-owned SMEs and found that new weak network ties (often formed at international trade fairs) were crucial, whereas family ties were less important. Further empirical work in this vein showed that different types of ties promoted different types of knowledge transfer and learning between bank relationship managers and customers in Chicago (Uzzi & Lancaster, 2003). A core criticism of the SN approach, however, is its static focus and lack of a transitive dimension to network analysis (Slotte-Kock & Coviello, 2010). Granovetter himself noted that focusing only on tie strength ignores important issues concerning “content” and “network structure over time” (Granovetter, 1973, p. 1378). This means that other important aspects such as the types of network ties, the relational nature of ties and the role of network ties can be overlooked. Added to this is a lack of focus on the temporality of network formation and engagement.

The BN perspective, on the other hand, is a much more dynamic approach to studying networks and focuses on how relationships change and why such change occurs (see Table 1 below). BN researchers suggest that network development is cumulative in that relationships are “continually established, maintained and developed” (Slotte-Kock & Coviello, 2010, p. 44). Explored by industrial marketing scholars (Håkansson & Snehota, 1989; Mattsson, 1997; Ritter, Wilkinson, & Johnston, 2004), interaction between parties is considered to be crucial (Fretyag & Ritter, 2005). The connectedness of a business relationship suggests that the boundary of a single such relationship can become “blurred” (Håkansson, Havilla, & Pedersen, 1999, p. 445), thus firms are embedded in networks “of ongoing business and nonbusiness relationships, which both enable and constrain” performance (Ritter et al., 2004 p. 175). In order to make sense of these complex temporally unfolding interconnections, researchers have typically favoured more qualitative methods, often assessing the nature of buyer-supplier relationships/networks (Håkansson et al., 1999). In this vein, scholars have shown business networks to be fundamental in terms of efficiency and development goals of large established companies like IKEA (Baraldi, 2008).

While most researchers have typically examined networks from one or the other of these dominant perspectives, there seems merit in a combinative approach towards network analysis. While the SN approach tends to view networks as having distinctive boundaries which are mediated by the varying strength of ties, the BN viewpoint is more holistic and views the broader context within which inter-organisational networks exist and the external influences shaping them (Slotte-Kock & Coviello, 2010). The BN literature, however, often focuses on established organisations and thereby overlooks the initial nature of ties addressed by the SN literature, which are critical in alleviating resource scarcity as firms commence trading.

Given the limitations identified in both approaches, there seems considerable merit in adopting an integrative use of both perspectives
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