Study explores crowdfunding and entrepreneurial failure

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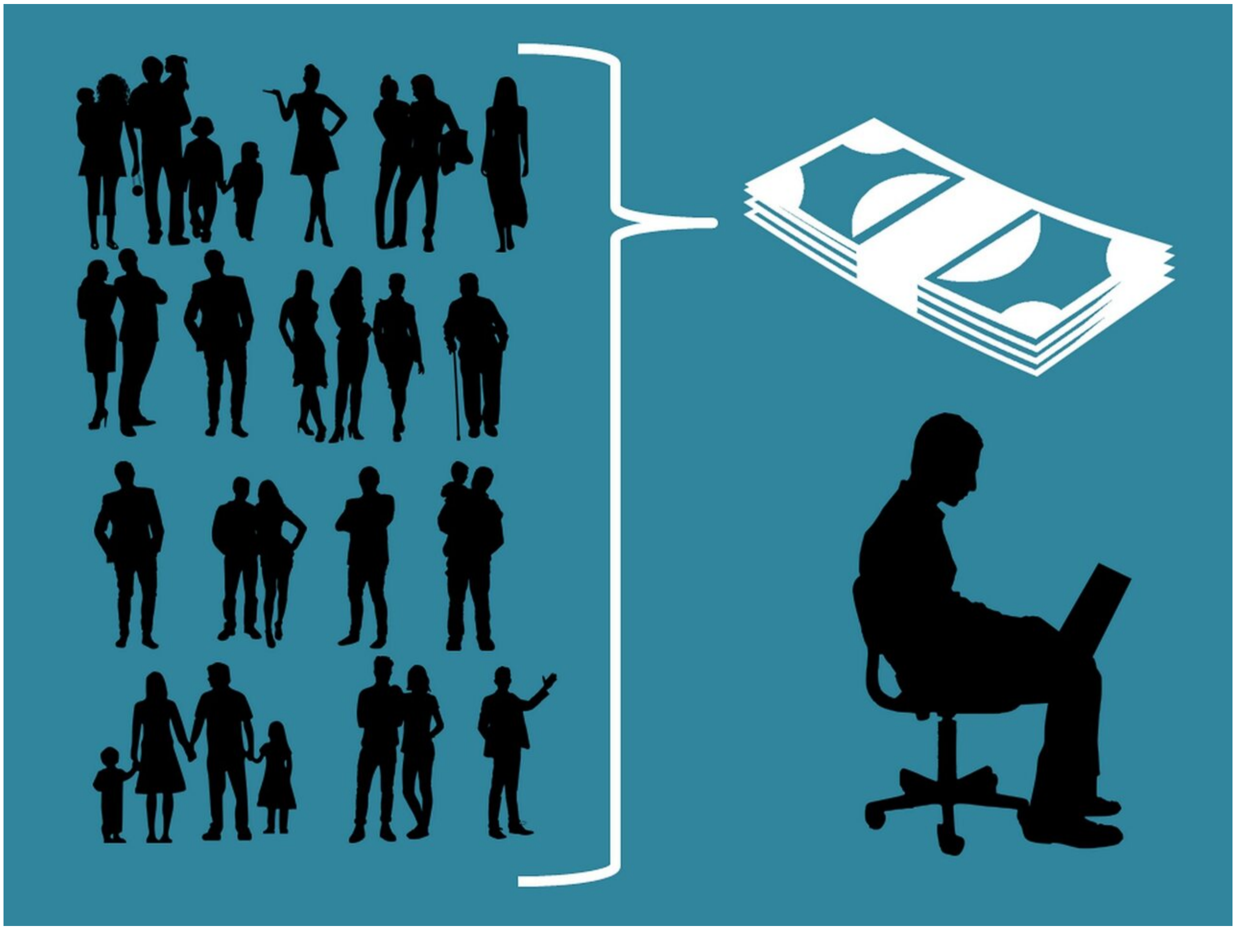

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As means to raise capital for a business venture, crowdfunding has come increasingly to the fore since the advent of social media. A good campaign that goes viral can quickly bring adequate funds for an adventurous start-up. Writing in the *International Journal of Entrepreneurial Venturing*, a team from Germany suggests that this alternative to venture capital and angel investment might actually lead to overfunding of a startup and that this in itself can lead to the failure of the company.

Crowdfunding has been around a lot longer than the internet, of course, many entrepreneurs, activists, authors, and even leaders have sought money from the general public to help them finance their ventures. The advent of the world wide web in the 1990s and the subsequent arrival of Web 2.0 and social media opened up many more avenues along which an innovative entrepreneur might meet putative backers.

Occasionally, those who donate to ventures through crowdfunding campaigns do so out of a sense of altruism, perhaps to finance a worthy venture that might benefit society or an individual in need. More often, the crowdfunding is driven by the potential for reward, a signed copy of that author's book or a discount on the product to be manufactured by a startup, for instance.

There are many potential benefits for the crowd-funder and from the entrepreneur's point of view, their success in such a campaign can often act as a test of the future market. It is now well-known that perhaps half of the ventures seeking crowdfunding fail to reach their funding goal and fall at this first hurdle.

However, of those that are successful around half receive more than their initial funding call. A small percentage end up being massively overfunded based on their initial needs. This phenomenon was largely unknown in the era of venture capitalists and angel investors when the investment was made in a much more steady, slower, and considered manner.

The team offers that one of the explanations in many cases is quite obvious: a good marketing campaign to reap crowdfunding that is not underpinned by a solid offering from the company itself in terms of its product development, production, and sales. Ultimately, it is often the case that "this phenomenon leads to the dominance of startups with great marketing campaigns but with little potential to fulfill their promises," the team writes.

They add that their analysis of failed start-ups reveals that there are other factors at play: entrepreneur, misconduct, poor product features, a failure in the product development process, organizational problems, delays, financial resources, poor market conditions, and failures with partners.

Moritz T. Bruckner and Daniel J. Veit of the Faculty of Business and Economics at the University of Augsburg in Augsburg, Dennis M. Steininger of the Faculty of Business Studies and Economics at the Technical University of Kaiserslautern in Kaiserslautern, and Mark Bertleff, Lead Business Analyst at Capgemini in Munich, explain that the research literature lacks explanations as to why start-ups with adequate funding might be prone to failure and why the seemingly paradoxical notion of too much capital investment might underlie the demise of some companies.

The team's findings challenge the received wisdom regarding the financial backing of a startup and subsequent entrepreneurial success or failure. The framework they have developed regarding backing could be used to guide those who wish to invest through crowdfunding and to help startups avoid the common pitfalls of overfunding.

More information: Daniel Veit et al, Crowdfunding and

Entrepreneurial Failure, *International Journal of Entrepreneurial Venturing* (2022). DOI: 10.1504/IJEV.2022.10051910

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