New methods of entrepreneurial firm financing: Fintech, crowdfunding and corporate governance implications

1 | INTRODUCTION

Starting in May of 2016, small businesses and start-ups were permitted to sell shares to the general public in the United States on crowdfunding portals. The U.S. Securities and Exchange Commission has defined rules that make equity crowdfunding a legal means by which firms are able to raise seed capital online. The crowdfunding phenomenon is now slowly spreading to other countries (Barbi & Bigelli, 2017). These developments have given rise to a veritable explosion of new research on crowdfunding, financial technology (fintech), and other alternative methods of start-up financing (Cumming & Hornuf, 2018; Short, Ketchen, McKenny, Allison, & Ireland, 2017). This work has emerged in a variety of fields that include but are not limited to entrepreneurship, finance, marketing, information systems, law, and strategy (Ahlers, Cumming, Günther, & Schweizer, 2015; Mollick, 2014; Newman, Schwarz, & Ahlstrom, 2017; Steinhart, Gao, & Fan, 2017).

The emergence of fintech and crowdfunding has also given rise to unique and pronounced concerns with information asymmetries between insiders and outsiders, along with related agency and other governance concerns (Vismara, 2016). As with IPOs, for instance, the ownership base of entrepreneurial ventures raising capital in crowdfunding has been opened up for the first time to external shareholders. Moreover, crowdfunding platforms that allow fundraising from a pool of online backers will also need to cope with collective action problems (Olson, 1965) as crowd-investors have neither the ability nor the incentive, because of their relatively small investments, to devote adequate resources to due diligence. While collective action problems limit investors’ monitoring incentives, entrepreneurs can be tempted to shirk and engage in self-dealing and opportunistic behavior.

Against that background, this special issue of Corporate Governance: An International Review (CGIR) sought to attract scholarly submissions from a wide variety of disciplinary and methodological approaches to examine the governance causes and consequences of the emerging fintech and crowdfunding arenas. Altogether, we received over 50 manuscripts that dealt with questions around five key themes introduced in the call for papers. First, what are the governance problems arising from agency issues such as the separation between ownership and control (principal-agent) and between controlling and minority shareholders (principal-principal; Jensen & Meckling, 1976; Young, Peng, Ahlstrom, Bruton, & Jiang, 2008) in crowdfunding markets? Second, while most of recent IPOs are offered exclusively to institutional investors, crowdfunding investors are likely to be more diverse than shareholders of newly listed companies (Barbi & Bigelli, 2017). As such, how does this impact corporate governance mechanisms? Third, while there has been some research in crowdfunding that focuses on the success factors of the campaigns (Frydrych, Bock, Kinder, & Koeck, 2014), there is comparatively less work on the ultimate goal of crowdfunding, namely, to build enduring businesses. That is, what happens after the crowdfunding campaigns? Fourth, globalization and technological innovation interact in their effect on crowdfunding, since the reduction in communications costs owing to technological innovation have made crossborder investments easier, thereby reducing the costs of monitoring investments over long distances. Therefore, it may be asked, given financial and communications innovations and eases in regulation on new venture creation (Ahlstrom, 2010), what are the implications for the governance of entrepreneurial ventures associated with fintech and crowdfunding around the world? And how do national institutions interact with fintech and crowdfunding (Globerman, Peng, & Shapiro, 2011)? Fifth, corporate governance practices in crowdfunding differ across countries (Barbi & Bigelli, 2017). Will recent trends and innovation in financing approaches and sources reduce such differences? Or will these differences persist or even be amplified by local financing and traditional institutional controls (Globerman et al., 2011)? How can we differentiate the role of more formal, legal institutions from less formal ones embodied in culture and social capital (Cumming & Schwenbacher, 2018; Scott, 2013) in addressing and explaining such differences?

After the call for papers and subsequent submissions, a careful external review process ensued. It was managed in conjunction with the main regular editors of CGIR who oversaw the process and participated in decisions on all rounds for all papers. Finally, four papers were selected to appear in this special issue of CGIR. These papers are summarized in the next section.

2 | SYNOPSES OF THE ARTICLES IN THE SPECIAL ISSUE

This special issue contains four papers in addition to this introductory editorial. The papers accepted for this special issue were selected to provide new evidence on the corporate governance implications of
the new methods of entrepreneurial firm formation. The articles engage in a fruitful conversation with frontier debates at the intersection of governance and entrepreneurial finance research. They draw from different theoretical lenses (e.g., agency theory and human capital theory) and are set in different institutional contexts (e.g., the United Kingdom and Germany). Table 1 summarizes the sample, data sources, and contributions of these studies.

First, the Collawert, Vanacker, and Walthoff-Born (2018) paper is one of the first studies on the outcome of equity crowdfunding. With the exception of Signori and Vismara (2018), extant research has mainly focused on identifying success factors in raising capital through crowdfunding and on funding dynamics on crowdfunding platforms (e.g., Frydrych et al., 2014). The authors build on and extend this stream of research by providing a dynamic picture of firm financial and innovative performance and by comparing the performance of equity crowdfunded firms to similar firms that have raised capital from other sources. Second, since equity crowdfunding platforms adopt different shareholder structures, they investigate whether such structural differences are associated with different performance. The two main research questions addressed in this study are, therefore, how do equity crowdfunded firms perform relative to matched nonequity crowdfunded firms that raised other forms of capital? And how do firms financed through a direct shareholder structure perform relative to firms financed through a nominee structure?

To answer those questions, the research site is the equity crowdfunding market in the United Kingdom, which is the largest and most developed equity crowdfunding market in Europe. The United Kingdom accounted for nearly 40% of the global equity crowdfunding market in 2016. Both the two largest equity crowdfunding platforms, namely, Crowdcube and Seedrs, are used in this study. A crucial difference between the two is indeed their deal structuring, whereby Crowdcube uses a direct ownership structure, whereas Seedrs uses a nominee structure. Results show that equity crowdfunded firms exhibit significantly higher failure rates than matched firms. Further, nominee shareholder structures in equity crowdfunding are positively associated with firm financial performance, which may be a consequence of the increased power and incentives of nominees to monitor management and the lower coordination costs.

In a similar vein, Hornuf, Schmitt, and Stenzhorn (2018) investigate the determinants of follow-up funding and firm failure after an equity crowdfunding campaign has taken place. They use data from 13 different equity crowdfunding portals and 413 firms that ran at least one successful equity crowdfunding campaign in Germany or the United Kingdom between 2011 and 2016. The findings show that German firms that received equity crowdfunding not only stood a higher chance of obtaining follow-up funding through business angels or venture capitalists (VCs) but also had a higher likelihood of failure. The number of senior managers and the number of venture capital investors both were positively related to the obtaining of postcampaign financing, while the average age of the senior manager team had a negative impact. The number of venture capital investors and the valuation of the firm were significant predictors that increased the hazard of firm failure, while the number of senior managers and the amount raised during previous campaigns had a negative impact on the hazard of firm failure.

Gutierrez-Urtiaga and Saez-Lacave’s (2018) theoretical paper models reward-based crowdfunding as a two-stage game. In the first stage (campaign), a creator is discovered to be talented when early adopters support his crowdfunding campaign. If the creator was successful in the first stage, he can capitalize on this in the second stage (production). This idea is somewhat counterintuitive, however. In a one-shot game, the creator would be expected to behave in an opportunistic manner and not deliver the goods. Anticipating the potential for this type of behavior, backers may be deterred from giving funds in this setting, leading to market failure. This poses a puzzle for understanding and regulating the reward crowdfunding market. The model proposed in this paper (counterintuitively) shows that the no-penalty

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<th>Summary of articles in this special issue</th>
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<td>Authors</td>
<td>Sample and data</td>
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<tr>
<td>Collawert, Vanacker, and Walthoff-Born</td>
<td>205 U.K. firms that received equity crowdfunding on Crowdcube or Seedrs in the period of 2012–2015, matched with 305 firms from the Orbis dataset</td>
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<tr>
<td>Hornuf, Schmitt, and Stenzhorn</td>
<td>413 firms that ran at least one successful equity crowdfunding campaign in Germany or the United Kingdom in the period 2011–2016</td>
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<tr>
<td>Gutierrez-Urtiaga and Saez-Lacave</td>
<td>Theoretical model (two-stage game, where the first stage is the campaign and the second is the production stage)</td>
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<td>Cumming and Schwienbacher</td>
<td>2,678 investment rounds in 747 distinct fintech ventures in the period 1990–2015, matched with 277,994 in non-fintech investments from VentureXpert database</td>
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contract is the optimal contract between creators of unknown talent and early adopters of their products. If, indeed, creators can benefit from being discovered as talented, they can capitalize by selling to late adopters and benefit from the goodwill generated in the delivery to the early adopters. This study, therefore, contributes to the literature by showing the importance of the innovative contractual arrangements offered by the crowdfunding platforms in the context of a market for talent discovery.

Finally, Cumming and Schwienbacher (2018) represent one of the first papers on fintech venture capital. They build on the institutions and corporate governance literatures by showing the importance of enforcement in driving relative differences in investment patterns and investor participation. The two main research questions addressed in this study are, therefore, where are fintech venture capital investments taking place around the world? And what are the role of institutional factors on the international allocation of fintech venture capital? They document a notable change in the pattern of fintech VC investments around the world relative to other types of investments after the global financial crisis. Specifically, they find that fintech VC investments are more common in countries with weaker regulatory enforcement and lacking a major financial center after the financial crisis. Also, they show the spike in fintech investments is more pronounced for smaller private limited partnership venture capitalists that likely have less experience with prior venture capital booms and busts. These fintech VC deals are substantially more likely to be liquidated, especially when located in countries without a major financial center.

3 | CONCLUDING REMARKS

The four papers in this special issue of CGIR offer new insights into the governance implications of the new and crucial fintech and crowdfunding markets. The popularity of crowdfunding and other forms of fintech has grown drastically, particularly after the 2008–2009 financial crisis, and at different rates around the world. Country-level governance through legal and institutional conditions have played a pronounced role in shaping the international development of crowdfunding and fintech. These developments have offered entrepreneurial firms new opportunities to access fresh capital from different sources, improving their chances of success. The papers in this special issue not only address this promise but also show that there are pronounced governance issues associated with these developments, as evidenced, for example, by the high failure rate of firms after crowdfunding. However, the papers in this special issue further show that corporate governance mechanisms may be able to mitigate the risks associated with these new forms of finance. Moreover, the work herein highlights the tremendous promise and importance of these start-ups in view of their pronounced innovation.

3.1 | Future research

Further research on the corporate governance implications of new methods of entrepreneurial firm formation could examine other long-term firm outcomes associated with these new forms of finance, including new venture survival, financial positions and subsequent capital raising, job growth, patents, innovation, and productivity. The research herein offers insights into important things that can be studied with additional data that will likely become available in subsequent years. Future research can likewise examine how different governance mechanisms function in conjunction with these new financial innovations and the effect they have on firm (and investment) performance.

Finally, further work can also seek to better understand the international and institutional differences in governance mechanisms and how they intersect with new methods of firm formation and finance. There is much to understand about key factors such as national culture, social capital, governance, institutional and legal systems, and their intersection with entrepreneurship and entrepreneurial finance (Globerman et al., 2011; Li & Nair, 2009; Vismara, 2018; Young, Tsai, Wang, Liu, & Ahlstrom, 2014). We look forward to further studies on these topics, particularly on the corporate and contractual governance implications associated with the rapidly changing and evolving international landscape of fintech and crowdfunding, and hope the papers in this special issue inspire further work for many years to come.

REFERENCES


