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Investors' Behavior in Reward Based Crowdfunding: Do Followers Actually Follow?

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Abstract

In reward-based crowdfunding, would-be entrepreneurs raise consumer-based finance for their prototypes from a crowd of small individuals or backers. This is a type of financing characterized by high informational asymmetries and sequential financing where backers (investors that provide financing) can observe the decisions of other backers before pledging their money. Such a setting allows testing the dynamics of informational cascades and herding behavior by investors in crowdfunding. This paper addresses this issue by investigating how backers make their funding decisions and to what extent they rely on the decisions made by early backers. We use a panel data from 3,923 projects crawled from Kickstarter to analyze this issue. We find evidence that followers make use of the information provided by early backers' funding decisions, but they also engage in active observational learning over the quality of the project and the entrepreneur to complement the previous information. In terms of managerial implications, our findings indicate that entrepreneurs will be more successful in project financing if they target their products to the demands of early backers, rather than to the tastes of the median consumer/backer. This strategy of focusing on early backers allows creating a positive informational cascade ending in a successful crowdfunding."



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