

# How customer investors can aid crowdfunding success

By **Philipp Cornelius**

**The role of crowdfunding has long been thought of as merely a method of raising capital; opening up access to the capital markets for entrepreneurs who borrow from a large number of individual retail investors. Yet crowdfunding is far more than this: it's a tool for market research and product development.**

Entrepreneurs can use crowdfunding campaigns on websites like Kickstarter and Indiegogo to talk to customers, receive feedback on their product, and even get in touch with potential retailers. All these benefits and more are laid out in a research paper titled *The Role of Customer Investor Involvement in Crowdfunding Success*, which I co-authored with fellow researcher, Bilal Gokpinar.

In the study, we collected data from October 2012 to June 2013 on about 22,000 crowdfunding projects on the popular website Kickstarter.com. The study involved looking at whether changes that entrepreneurs made to a project after they had received a comment from a funder had an impact on the likelihood of the success of the crowdfunding campaign.

Data analytics was an important part of the research. For example, we used instruments and fixed-effects models whereby we were able to rule out whether the assumed positive impact of funders' comments was actually driven by something we did not observe in the data, such as product quality or the ability of the entrepreneur. We rooted out these potential unknown impacts by looking at within-project variations over time and using exogenous instru-

ments, which allowed us to mathematically remove confounding factors from the estimation equation.

## Increasing success

We found that comments from funders improved the likelihood of success and contributed to an increase in funding received by the entrepreneurs from the crowdfunding campaign. One comment increased funding by, on average, US\$65, though the variation between the value of comments was wide; some comments had a large effect, increasing funding by thousands of dollars, while others had a smaller impact.

It's easy to spot an unhelpful comment that offers no criticism, constructive or otherwise. So what makes a specific comment valuable? Usually, it's information about the product – a recommendation for a new design, say, or how it is priced. Based on an additional in-depth study of 25 random crowdfunding projects, their comments, and the interaction between the backers and the creators, we also found that funders often use their social networks to help, such as connecting entrepreneurs to potential suppliers.

Another common piece of advice passed from funder to creator was around the features of a product, with recommendations for additions to the product that would improve its functionality. For example, the NEEO smart home remote added API support after backer feedback on Kickstarter.

This suggests that crowdfunding can be far more effective than market research, because customers have skin in ▶



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the game. In traditional market research, customers can say whatever they want about a product, even if it is not helpful or indeed true. Crowdfunding solves this problem, because all the comments come from people who are genuinely interested in the success of the product. It is a similar commitment that venture capitalists have to their portfolio companies, since they too, depend on the success of the venture in which they have invested.

currently can. Instead, we believe VCs and crowdfunding are complementary, with each offering something the other cannot. For VCs, it is hands-on operational support and for crowdfunding it is through customer feedback.

Crowdfunding is traditionally associated with start-ups, but big companies can use it to improve their internal innovation processes too. Many companies, from AT&T to Xerox, use innovation labs in which they attempt to

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## Disruption potential

There has been quite a bit of debate about the impact crowdfunding could have on the venture capital industry, with some warning that crowdfunding could disrupt traditional start-up investors. My research shows that crowdfunding can substitute some of the value-added aspects of having a VC backer.

VCs do not just provide business founders with money: they provide advice as well – at times even placing managers at the portfolio company to help steer its growth. Crowdfunding cannot mimic that entirely, but it can offer valuable advice on product development, human resources, and even supply chains.

VCs are not doomed, though, as they still provide more profound and long-term support than crowdfunding

create new products or services with a view to integrating them into the wider business should they grow and succeed. Crowdfunding works for big companies in similar ways, as they get access to a big pool of ideas that they could not necessarily come up with themselves. It is like outsourcing innovation. Or spotting what in economics is called the unknown unknowns: you do not know what problem you are looking for because you are not aware of it.

Netflix, for instance, used crowdsourcing to improve its movie rating prediction engine. Over three years it received some 44,000 submissions for ideas to improve the algorithm for movie rating prediction as part of a US\$1m "Netflix Prize" competition that

ultimately improved the algorithm by 10 per cent.

## Diversity of thought

Big companies like Netflix might also be attracted to crowdfunding because of its diverse pool of investors. It is generally accepted in business that diversity of thought is a commercial benefit. This being the case, crowdfunding could be especially helpful for the technology industry, where there have been a host of high profile product failures that commentators argue could have been avoided if a more diverse team worked on the product's development. Consider, for example, the bathroom soap dispenser that automatically ekes out soap by





detecting a hand beneath it. A YouTube video showed a flaw in its design: it did not work on black skin and the developers did not spot this problem because they were white and tested the product on white consumers.

Seeking this diversity of thought, several large multinational companies have used crowdfunding for market research. One example is Coca-Cola, which used Indiegogo to test the waters in America

for Valser, its premium mineral water brand that was first launched successfully in Europe. The drinks company vastly exceeded its targets for its one-month crowdfunding campaign, proving that corporations can successfully utilise the wisdom of the crowd.

However, managers should be warned that there is a risk of reputational damage and consumer backlash if funders feel like they are being used

as guinea pigs. Funders on crowdfunding sites are often emotionally invested in a project and want to be involved in the product as it develops. This is not always the case with big brands, and consumers may not want to back a product if they know the money is simply going into a corporation's already deep pockets.

The atmosphere in online communities can turn sour quickly, as we have seen on Twitter and Facebook. This has happened in crowdfunding, too, although to a lesser extent. For instance, when Warner Bros launched a crowdfunding campaign for the Veronica Mars movie it was criticised because the money went straight to the corporation's coffers. And General Electric drew criticism for failing to keep funders updated after they had committed money to its US\$150,000 campaign to fund an ice maker built by one of its subsidiary companies.

The key to crowdfunding success, then, is respecting and learning from those offering you money. ■

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