PUZZLES OF THE CROWD

INVESTORS' PERCEPTIONS OF INFORMATION ASYMMETRY AND AGENCY PROBLEMS IN EQUITY CROWDFUNDING

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Puzzles of the crowd: Investors' perceptions of information asymmetry and agency problems in equity crowdfunding

Abstract:

Equity crowdfunding is an emerging type of financing, providing small firms with a new source of capital and small private investors with new investment opportunities. Thereby, large crowds of small private investors are introduced to a context suggested to be particularly informationally opaque and where agency challenges exist. This thesis explores how the equity crowdfunding investors perceive issues of information asymmetry and agency, and how they are mitigating these potential problems. A single-case study was performed in which data was collected through semi-structured interviews with seven investors that had invested through the Swedish equity crowdfunding platform FundedByMe. Our study suggests that small private investors investing in highly uncertain and risky small firms consider information asymmetry and agency as being prevalent problems but exert limited efforts into mitigating these. Of the efforts pursued, the findings show that the investors' due diligence focused mainly on the characteristics of the management team and that importance was given to the signalling of already committed capital. We argue that the investors' typically low investment sizes explain the limited extent of their mitigating efforts, but also that the investors expect the intermediating platform to signal firm quality, thus expecting the platform to overcome some of the information asymmetries on their behalf.

Keywords:

Agency theory, Equity crowdfunding, Financial intermediaries, Information asymmetry

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1. Introduction

Equity crowdfunding is an emerging non-conventional type of financing, providing entrepreneurial ventures with a new source of capital and small private investors with new investment opportunities (Belleflamme, Lambert, & Schweinbacher, 2014). While small firms' access to financing is of importance to the economy as a whole (Cassar, 2004), equity crowdfunding also introduces large crowds of small private investors to high-risk investments in a context where the available information is particularly opaque and where agency challenges exist (Belleflamme et al., 2014; Berger & Udell, 1998; Sapienza & Gupta, 1994; van Osnabrugge, 2000). One party that has raised concerns about this is the Swedish financial supervisory authority, Finansinspektionen, claiming that a significant informational gap exists between the entrepreneur and the investors in equity crowdfunding, making it difficult for the investors to make well-informed decisions (Svenska Dagbladet, 2018). However, the crowdinvestors' actual perceptions and experiences of this remains, to our knowledge, undocumented.

Early-stage financing is typically characterized by considerable information asymmetry, where one party, in this setting the entrepreneur, has better access to information than the investor (Ahlers, Cumming, Günther, & Schweizer, 2015; Akerlof, 1970). The information asymmetry in the context of small firms is generally considered to be more severe, due to the informational opaqueness of small firms being substantial (Berger & Udell, 1998), partly due to the lack of historical data (Huyghebaert & Van de Gucht, 2007). Moreover, the ventures pursuing equity crowdfunding are private and therefore not subject to the regulation of public firms that concerns the materiality of disclosed information to investors (Berger & Udell, 1998). Thus, the literature suggests that the information asymmetry should be significant within the equity crowdfunding context (Agrawal, Catalini, & Goldfarb, 2014; Ahlers et al., 2015). Investors can mitigate problems of information asymmetry through activities such as deal screening and due diligence, activities that have been suggested to be carried out extensively by other investors such as venture capital firms (van Osnabrugge, 2000). There are, however, few studies examining the actual actions undertaken by investors to address any possible informational problems in equity crowdfunding. Specific to the context of equity crowdfunding is also the prominent role of a financial intermediary, the crowdfunding internet platform, that exerts, or is expected to exert, certain mitigation strategies on behalf of the investors. However, these activities differ among the platforms and it is unclear how the crowdinvestors perceive their role.

Moreover, the relationship between investors and management has been given significant attention, with research suggesting that the relationship could be viewed as one between a principal and an agent (Fama & Jensen, 1983; Jensen & Meckling, 1976, Sapienza & Gupta, 1994; Schleifer & Vishny, 1997). In this domain, it is suggested that the investor will encounter an agency problem, due to that the entrepreneur not always will act in the best interests of the investor. This is a problem that is well-considered by professional financial actors, such as venture capital firms, which exert significant efforts to limit such potential problems through activities such as contracting, monitoring and control (Gompers, 2000; Kaplan & Strömberg, 2003; van Osnabrugge, 2000). The suggested agency problem is also evident in the equity crowdfunding context, in that a campaign involves a separation of ownership and control that enables the entrepreneur to pursue self-interested behaviours. However, while Jensen and Meckling (1976) primarily considered the agency problem as an incentives problem, it should be recognized that the entrepreneur typically remains as a significant owner in the firm, making the incentives problem only minor (Huyghebaert & Van de Gucht, 2007). However, it could be argued that agency problems are not just related to incentives, but also due to disagreements about the most appropriate course of action. Disagreements of this sort are especially evident in the contexts of new ventures, where uncertainty is high and where entrepreneurs often lack experience (Sapienza & Gupta, 1994). Moreover, significant information asymmetry, as expected to be present within equity crowdfunding, advances the risks of interest divergences (van Osnabrugge, 2000). Thus, it could be argued that the agency risks in equity crowdfunding are considerable.

Some research has been conducted regarding the driving factors behind the crowdfunding investors' willingness to invest in ventures on the crowdfunding platforms and the factors that ensure successful crowdfunding campaigns (Mollick, 2014; Vismara, 2016; Vulkan, Åsterbo, & Sierra, 2016). However, there have to our knowledge been few studies examining whether information asymmetry and agency concerns affect the investment decisions of the crowdinvestors, and if so, whether the activities undertaken by them to mitigate these problems differ from the ones of professional investors. We believe that a deeper understanding of the crowdinvestors' considerations in relation to this, and of the practices that are, or could be, available to reduce problems would contribute with important insights on how to optimally structure equity crowdfunding platforms and campaigns.

Considering the above, there is a need to further study the investors' perceptions of information asymmetry and agency in equity crowdfunding. The research questions we aim to study are, therefore: *How do equity crowdfunding investors perceive issues of information asymmetry and agency, and how are they mitigating these potential problems?*

To address the research question, a qualitative study was conducted consisting of interviews with investors that had invested in companies through the Swedish equity crowdfunding platform FundedByMe. Equity crowdfunding provides a new empirical context to the theories of information asymmetry and agency, thereby our thesis aims to contribute to the literature by shedding light on small private investors investment concerns in highly uncertain and risky small firms, as opposed to the more common setting of small investors investing in large and less uncertain and less risky firms. The presence of an intermediating platform in equity crowdfunding also provides new insights on which mitigating activities a small private investor is willing to exert themselves, and which activities they expect a financial intermediary to exert on their behalf.

2. Background

2.1. Defining Crowdfunding and Equity Crowdfunding

Crowdfunding is a unique form of fundraising that draws inspiration from the concept of micro-financing and crowdsourcing (Mollick, 2014). Crowdsourcing is the practice of outsourcing specific corporate tasks to an undefined large group of people, with the purpose of inducing the crowd to contribute to the firm's development, for free or in exchange of a reward (Belleflamme et al., 2014). Besides having the potential benefit of being a resource efficient practice, it might also yield benefits in the outcomes of the specific task. As an example, it has been found that outsourcing of idea generation to potential customers enhances the customer benefits of the firm's products or services to a greater extent than if the idea generation had been kept in-house (Poetz & Schreier, 2012). The crowdsourcing concept is a broad umbrella term and one of its subcategories is crowdfunding, which is the focus of this thesis. The main difference between crowdsourcing and crowdfunding is that the latter is only concerned with financial contributions. The definition that will be used throughout the text is provided by Belleflamme et al. (2014) and states that *"crowdfunding involves an open call, mostly through the internet, for the provision of financial resources, either in the form of donation or in exchange for the future product or some form of reward, to support initiatives for specific purposes"*.

As implied by the crowdfunding definition, there are several ways in which capital providers can be compensated in exchange for their financial contributions, something that is governed by the context of the fundraising. Mollick (2014) suggests that this context characterizes the different types of crowdfunding as either based on donations, rewards, lending or equity. In the donation type, fundraisers often ask for contributions to carry out art or humanitarian projects. The capital provider can then be seen as a philanthropist and are thereby not granted any compensation (Mollick, 2014). Reward-based crowdfunding gives the capital provider a non-monetary reward. This could be some sort of recognition for their support or treatment of the crowd as customers, and thus practically pre-selling not yet produced products (Mollick, 2014). Hence, the types of crowdfunding that involves donations or rewards are both characterized by capital providers that support firms without any clear financial demand in exchange for their contribution. Lending-based crowdfunding, however, typically offers a return on capital to the capital provider in the form of interest and could, therefore, be seen as more of an investment. The fourth type, equity crowdfunding, entails the capital provider with an equity stake in the firm in exchange for their contribution, thereby compensating the capital provider with the possibility of earning a financial profit. This could be viewed as a similar form of fundraising as when funds are sought from conventional investors, with the difference being that equity crowdfunding involves an open call at an internet platform for contributions from a large crowd.

2.2. The Structure of Equity Crowdfunding

Equity crowdfunding was during 2016 the most prevalent crowdfunding method in Europe as well as in the Nordics, with a market volume of 219 MEUR and 75 MEUR respectively. This form of fundraising is growing rapidly, experiencing a growth of 37% in Europe 2016 (Ziegler et al., 2018). A firm wishing to pursue fundraising through equity crowdfunding collaborates with an intermediary, a digital crowdfunding platform, which has a pre-registered group of potential investors as users. In exchange for a fee, the firm is allowed to post an offering for the crowd to invest in the firm through the platform (a "campaign" or a "project"), hence making an open call for funding. The crowdfunding platform then creates attention for the campaign through marketing practices such as social media efforts and special events, however, investors pay no fees for participating in the campaigns (FundedByMe Crowdfunding Sweden AB (publ) [FundedByMe], 2019). The completion of the fundraising is dependent on the campaign reaching a predetermined minimum funding target, typically visible for the crowd investors before investing. If the target is not reached, then none of the pledged investments will be released to the fundraiser (FundedByMe, 2019; Tomczak & Brem, 2013). This 'all-or-nothing model' has been suggested to serve as a protection for the investors from fraudulent campaigns, preventing overzealous investment behaviours, and encouraging fundraisers to carefully set realistic goals (Tomczak & Brem, 2013).

The firms seeking funding are responsible for providing adequate and correct information on the campaign page, and the platforms typically waive responsibility (FundedByMe, 2019; Pepins Group AB (publ) [Pepins], 2019). This includes the fundraising target and the equity value of the firm that are determined by the fundraiser. However, the platforms often have certain demands on which information that must be provided by the firms. Furthermore, the platforms themselves purport to be performing screening activities to choose which firms to accept, sometimes involving external due diligence processes (FundedByMe, 2019; Pepins, 2019). Hence, it could be argued that the platforms have a crucial role in setting requirements on campaigns that facilitate the crowd investors' ability to make well-informed investment decisions.

3. Theoretical Development

3.1. Information Asymmetry

When one party has better access to information than another, an information asymmetry situation is present (Akerlof, 1970; Guldiken, Tupper, Nair, & Yu, 2014). In early-stage financing, it is often presumed that this situation is fairly typical between entrepreneurs and their investors (Ahlers et al., 2015), with a contributing factor to this being that small businesses, in general, are considered to be more informationally opaque than larger ones (Berger & Udell, 1998), this partly because of the limited available historical data of firms in earlier stages of their development (Huyghebaert & Van de Gucht, 2007). Moreover, smaller businesses are often private and thus not subject to the regulation that mandates certain disclosures of material information in public markets (Berger & Udell, 1998). In private markets, lead investors such as venture capitalists can reduce information asymmetries by signalling quality to outside investors in small businesses (Hsu, 2004). In the equity crowdfunding context, however, there is often no such third-party certification of the projects (Vismara, 2016). What more is, it has been suggested that the investors on these platforms are particularly poor at differentiating between ‘good’ or ‘bad’ ventures, because of their lack of experience and capabilities. In summary, the above-mentioned literature suggests that the problems of information asymmetry and adverse selection are particularly severe in the setting of equity crowdfunding (Agrawal et al., 2014; Ahlers et al., 2015; Vismara, 2016).

To overcome some of the problems of information asymmetry and adverse selection, it has been suggested that an actor can try to signal quality in different ways (Leland & Pyle, 1977; Spence, 1974). The framework for this line of inquiry has been called signalling theory. In the context of financing of companies, some of the primary signalling devices that have been considered are equity retention on the part of the entrepreneur who seeks funds, as well as affiliation with venture capitalists, prestigious underwriters and universities (Hsu, 2004; Vismara, 2016). For equity crowdfunding investors it is, to the best of our knowledge, not explored whether they see the credibility of the crowdfunding platform as important. Vismara (2016) also looked at how herding behaviour could be exhibited on equity crowdfunding platforms, using LinkedIn-contacts as a proxy for credibility. Vismara’s study builds on the literature on herding behaviour which includes Banerjee (1992) and Simonsohn and Ariely (2008). One of the main implications of the herding literature is that, where investors believe that others have valuable information, they might follow previous investors' example, even though they are not familiar with the rationale behind previous investors' investment decisions. Ultimately, this risk leading to a situation where investors as a group are not acting rationally, but instead creating negative externalities by committing excessive amounts to projects with uncertain outcomes. In addition to these aspects, the aforementioned study by Ahlers et al. (2015) theorized that *uncertainty*, which the authors saw springing from unknown risk factors, could have a negative effect on the investors' willingness to invest in a project. The data in their study suggested that statements of risk factors led to a reduction of uncertainty, something that Ahlers et al. (2015) perceived as verifying that the disclosing of risk factors was an effective signal to the investors.

3.2. Agency Theory

The separation of ownership and control that external equity financing entails, is an essential element in the contractual perspective of the firm. As pioneered by Jensen and Meckling (1976), the investor-manager relationship is considered as a contractual relationship, under which the principal (the investor) appoints an agent (the entrepreneur) to perform some service on their behalf that involves delegating some decision-making authority to the agent. This relationship will encompass an agency problem, given that the parties are utility maximizers and that the agent, therefore, not always will act in the best interest of the principal (Jensen & Meckling, 1976). The agency problem is in the context of financing therefore related to the difficulties that the capital providers have in assuring that their funds are not expropriated or wasted on unattractive projects since this would reduce the value of the firm (Schleifer & Vishny, 1997). The principal is able to limit divergences of interest between the parties by establishing incentives for the agent and by incurring monitoring and controlling costs (Jensen & Meckling, 1976) (see the section for mitigation strategies).

3.2.1. Agency theory in the context of equity crowdfunding

As equity is offered to investors in equity crowdfunding campaigns, ownership and control get separated – something which enables self-interested behaviours. Equity crowdfunding investors thereby face the same problems as the principals mentioned above. However, specific to new ventures is that the entrepreneur often remains as a significant equity owner in the firm. In equity crowdfunding campaigns, specifically, only around 10 percent of the equity is typically given up by the entrepreneur to the large crowd of investors (Vulkan et al., 2016). This implies that even though a slight separation of ownership and control would cause an increased risk of entrepreneurs pursuing self-interested behaviours, the gains experienced by the entrepreneur to focus on maximizing firm-value would still be significant. Thereby the interest of the entrepreneur and the external investors should to a large extent be aligned. Hence, the agency problems faced by investors in new ventures, and consequently also equity crowdfunding investors, should in relation to incentives problems be minor (Huyghebaert & Van de Gucht, 2007). However, Sapienza and Gupta (1994) argue, in a study of the relationship between venture capitalists and CEOs, that agency problems do not just arise due to suboptimal efforts, but also due to the CEO's potential lack of ability as well as potential disagreements between the agent and the principal on the direction of the agent's efforts. These are problems especially evident in the context of a new venture where the high uncertainty makes it difficult to determine the most appropriate course of action, and where the entrepreneur often lacks managerial experience. Thus, even though no severe incentive problem would be present in the context of a small firm, Sapienza and Gupta (1994) make the argument that substantial agency risks are still present, something that causes actors such as venture capitalists to extensively monitor and control the entrepreneur.

Furthermore, specific to the small firm context is research showing that an entrepreneur's private benefits of control often are large compared to the financial returns, making it a primary consideration for small firm entrepreneurs to maintain as much private benefits of control as possible (Bolton & von Thadden, 1998). As an example, the entrepreneur is likely to get some personal satisfaction from working on the project that he or she founded, and the project might yield reputational enhancements. This could be one factor that contributes to some entrepreneurs' resistance towards being replaced, as reported by Schleifer and Vishny (1997). Thus, even though the entrepreneur might be a substantial owner in the firm, hence being incentivised to maximize firm-value, the entrepreneur could value private benefits such as actions that ensure continued control highly.

Moreover, while the investors in an equity crowdfunding campaign collectively might become a substantial owner in a fundraising firm, they are individually investing comparably small amounts making the ownership highly dispersed. Schleifer and Vishny (1997) argue that this type of investors (investors investing small amounts) are typically too small and too poorly informed to exercise even the control rights that they actually have. This could potentially leave the entrepreneur with even more effective control rights than what is allocated. In the case of large firms where the dispersion of ownership normally is prevalent, there usually exists a number of large shareholders monitoring the management upon which the small investors can free-ride (Schleifer & Vishny, 1997). In contrast, in equity crowdfunding, there is often the case that there are no large minority shareholders, except the founders of the company itself. Hence, the management of an equity crowdfunded firm could be under little pressure to perform well, leaving potential agency risks unmitigated. However, this is a hypothesis based on research performed in other financing contexts, and this study will, therefore, contribute to a better understanding of whether the same theoretical arguments apply for the new phenomenon of equity crowdfunding.

3.3. Mitigation Strategies

3.3.1. Deal screening and due diligence

Investors can carry out strategies with the goal of mitigating problems of information asymmetry and adverse selection. Such strategies include choosing the sources through which the investable ideas originate (i.e. securing a good *deal flow*), filtering out the projects that are of interest to the investor (what is often called *screening*), and subsequently evaluating the projects more thoroughly (this is frequently termed *due diligence*) (for a theoretical model of this process, see Tyebyee and Bruno (1984)). In private markets, some research has examined the ways that venture capitalists and angel investors carry out these activities (Muzyka, Birley, & Leleux, 1996; van Osnabrugge, 2000). In particular, venture capitalists have been shown to rank management team characteristics over other criteria such as financial information (Muzyka et al., 1996). In the domain of equity crowdfunding, there is some quantitative research that has identified board characteristics and the equity stake on offer as factors that can impact campaign success (Ahlers et al., 2015) but there is still a need to better understand the way that equity crowdfunding investors perceive and reflect on their investment setting and their investment process. It could be hypothesized that the equity crowdfunding platform acts as a screener of projects (on the behalf of the equity crowdfunding investors), and when the investor subsequently browses the platform, he or she might do screening and due diligence activities of their own. Vismara (2016) suggests that a possible screening criterion could be the share of the project campaign goal reached. As the information available is clearly constrained, he suggests, that the investors might use such factors to screen projects, effectively engaging in *herding* behaviour (as touched upon in section 3.1).

As regards due diligence processes of equity crowdfunding investors, it has been suggested that they do less due diligence than other (larger) private investors, the reason for this being that equity crowdfunding investors have been characterized as 'small investors', i.e. what the corporate finance literature calls investors that commit small investment sizes and acquire small equity stakes (Ahlers et al., 2015). These investors have been considered to have generally weak incentives for due diligence because of their small investment sizes (Agrawal et al., 2014). In fact, the fixed cost nature of doing due diligence on private companies has been proposed to be an activity that, when properly done, should only be within reach for investors committing capital as large as what is customary for angel investors or venture capitalists (Vismara, 2016). For smaller investors, this argument goes, it would be "prohibitively" expensive to exert the same time and effort to this end (Ahlers et al., 2015). Particularly, face-to-face interactions, something which is common for traditional investors, has been implied to be unfeasible (Agrawal et al., 2014). It has also been suggested that equity crowdfunding investors are less experienced and lack sophistication, compared with other investors, all of which could make it harder for them to address the issues of information asymmetry and adverse selection (Ahlers et al., 2015). Taken together, the literature suggests that equity crowdfunding investors might be less equipped to mitigate problems of information asymmetries and adverse selection than other investors in private markets but, to our best knowledge, not many studies have examined how these investors deal with these issues in practice. It is of particular interest to understand if the investors are aware of these issues, and if so, how they deal with them in a market where the investors are potentially inexperienced and lack the skills to be able to effectively distinguish between 'good' or 'bad' companies. If they are not aware of these issues, they run the risk of investing in overvalued firms. There is also the alternative possibility that the equity crowdfunding investors are aware of the risk of possible overvaluations but invest despite this fact, for other reasons (e.g. altruism or concern for the environment).

3.3.2. Contracting, monitoring and controlling

Investors are able to limit agency problems by establishing incentives for the agent to act in their interest and by incurring monitoring and controlling costs. The cost of these mitigating activities along with the investors' cost of the residual unmitigated divergence of interests (it is generally impossible to achieve complete convergence) are commonly referred to as the agency costs (Jensen & Meckling, 1976).

While the optimal approach on how to deal with agency problems would be to establish optimal contracts, it should be stressed that as the relationship between the investor and the manager evolves over time, eventualities arise that could not have been foreseen and accounted for in the initial contract between the parties (Hart, 2001). Contracts are in this sense incomplete, and a question arises on how future decisions should be taken in response to changed eventualities. Due to these problems, the entrepreneur and the investor have to allocate the residual control rights efficiently (Hart, 2001). In theory, the optimal allocation for the investor would be an allocation in which funds are given to the manager under the precondition that the investor receives the residual control rights. If any eventualities that are unaccounted for would occur, then they would get to decide what to do. However, this is not doable in practice, given that the investor is not informed enough to decide what to do. Hence, the entrepreneur ends up with considerable residual control rights and discretion to allocate funds. This, in turn, gives the entrepreneur the opportunity to pursue potential self-interested behaviours, motivating additional measures to be taken by the investors to limit these problems (Schleifer & Vishny, 1997). While the mitigating activities under the contracting approach take place ex-ante the investment, these additional measures consist of monitoring and controlling activities that are exerted ex-post the investment.

Research demonstrates that venture capitalists and angel investors that invest in similar firms as the ones pursuing equity crowdfunding are exerting extensive efforts in reducing agency risks through mitigating activities (Sapienza & Gupta, 1994; van Osnabrugge, 2000). However, the mitigating activities conducted by the venture capitalists have been found to focus more on the ex-ante activities, while the angel investors have been found to focus more on the ex-post monitoring and control (van Osnabrugge, 2000). The mitigation strategies exerted by equity crowdfunding investors, if any, are currently unknown. However, it is theoretically expected, as discussed earlier, that small private investors will not put in any significant efforts into these mitigating activities. A reason for this is that it would require the devotion of time and resources that would be unjustifiable in relation to the investor's invested amount (Schleifer & Vishny, 1997). Also, the investors will face the so-called free-riding-problem – if the investor does something to improve the quality of management, then all shareholders will experience the derived benefits. Hart (2001) suggests that unless the shareholder is altruistic, she will ignore the positive benefits for the other shareholders and thereby under-invest in the monitoring of the entrepreneur. Moreover, it could be hard to persuade and facilitate the collective action of the crowd of investors, something that could be necessary for efficient control practices. However, the research conducted on dispersed ownership structures has focused on large firms, which is where dispersed ownership structures traditionally have been prevalent. Equity crowdfunded firms, on the other hand, have dispersed ownerships at the same time as being small. This study will, therefore, contribute to an increased understanding of how the arguments on dispersed ownership structures in relation to mitigation strategies apply for small firms.

3.4. Financial Intermediaries

A financial intermediary is an entity that screens companies, allocates capital, and subsequently does monitoring and controlling activities, on behalf of investors (Berger & Udell, 1998). Traditional types of financial intermediaries are banks and venture capitalists, and the emergence of such intermediaries have been linked to the need to reduce information asymmetries in capital markets (Allen & Santomero, 2001). Since smaller businesses are particularly informationally opaque, it has been argued that financial intermediaries are critical for the functioning of markets where smaller ventures are common (Berger & Udell, 1998). Also, one way that financial intermediaries are incentivized is through the acquisition of reputational capital, which is based on prior experience and performance (Hsu, 2004). Moreover, as equity crowdfunding markets are inhabited predominantly by companies that are modest in size, equity crowdfunding platforms should be expected to play an important role as financial intermediaries, intermediating between investors and an entrepreneur, and working for the efficient matching of ideas and capital by, for example, increasing the disclosure that companies do on behalf of the investors (Agrawal et al., 2014). Furthermore, it has been proposed that the platforms should select projects of high quality and limit fraud, and in this way, act to mitigate information asymmetries (Agrawal et al., 2014).

3.5. Theoretical Framework

This study explores how equity crowdfunding investors perceive issues of information asymmetry and agency, and how they seek to mitigate these potential problems. The theoretical framework upon which the study's empirical findings are discussed, primarily adopt research of information asymmetry as pioneered by Akerlof (1970) and literature on agency theory as developed by Jensen and Meckling (1976). The research of Ahler et al. (2015) and Berger and Udell (1998) further extends this literature by suggesting significant information asymmetries in the context of small firms, and Bolton and von Thadden (1998), Sapienza and Gupta (1994) and Schleifer and Vishny (1997), provide suggestions to why agency problems should be present also in the context of equity crowdfunding. The literature explaining mitigation activities in relation to information asymmetry and agency problems (Hart, 2001; Leland &

Pyle, 1977; Spence, 1974; Tyebyee and Bruno, 1984), aims to contribute with an understanding of the available practices to reduce potential problems. Moreover, the research of Ahlers et al. (2015), Agrewal et al. (2014), Hart (2001) and Schleifer and Vishny (1997) provides suggestions for which activities that theoretically would be expected to be performed by the crowdinvestors, where the low investment sizes result in lower exerted mitigation activities and the crowdinvestors' presumed lack of experience can impact the severity of the information asymmetry that these investors face, while at the same time make mitigation efforts less effective relative to more experienced investors. The literature related to financial intermediaries (Allen & Santomero, 2001; Berger & Udell, 1998) serves to shed light on the importance of the intermediating crowdfunding platforms, in relation to the mitigation of primarily information asymmetry, as well as the role that it can play as a signalling entity.

4. Research Methodology

4.1. Research Design and Approach

The purpose of this study has been to explore the considerations of small private investors in relation to information asymmetry and potential agency problems when investing in highly uncertain and risky small firms. The explorative nature of this objective and the problem-oriented research question prompted a qualitative research method following the pragmatic paradigm, thereby placing the research problem as central and applying the best available approach to understand the problem (Mackenzie & Knipe, 2006). As guided by this notion, the thesis was conducted with an abductive approach, in which the theoretical development, empirical inquiry and analysis emerged iteratively (Dubois & Gadde, 2002). Hence, we were making sense of the observations by moving back and forth between theory and empirics. Furthermore, the study was conducted through an in-depth single-case design. A case study was regarded as appropriate due to case studies being a preferred method when research questions are exploratory in its nature and when a studied phenomenon is contemporary and hard to manipulate (Yin, 2009). Moreover, case studies are suitable for developing theory by utilizing insights of an empirical phenomena and its context (Dubois & Gadde, 2002). The adoption of a single-case, investors that have invested through the equity crowdfunding platform FundedByMe, as opposed to a multiple-case, is according to Yin (2009) suitable for revelatory cases. Thus, a single-case study was considered as a well-suited design given the explorative nature of the study and due to equity crowdfunding being a nascent phenomenon of which previous research is scarce.

4.2. Data Collection

4.2.1. Primary data

The study's primary collection of data was conducted through semi-structured interviews with investors that had completed investments through the Swedish equity crowdfunding platform FundedByMe. Semi-structured interviews were deemed appropriate, in order to ensure an in-depth understanding of the crowdinvestors' considerations in relation to the studied phenomenon. This as the flexible nature of a semi-structured interview enables the researcher to better understand the ways that the interviewees recognize the studied phenomenon (Qu &

Dumay, 2011). Nine semi-structured interviews were held in the period March to April, with the first three interviews being more explorative, of which the data guided the theoretical development and suggested appropriate primary themes for the following six interviews.

4.2.2. Semi-structured interviews

Semi-structured interviews involve a prepared questioning guided by identified themes in a consistent and systematic manner interposed with probes designed to elicit more elaborate responses (Qu & Dumay, 2011). Two of the interviews were conducted through personal meetings, and seven interviews were conducted over the telephone. Both researchers were present at all interviews. The duration of the interviews was approximately forty-five minutes (one interview was though eighty minutes) and the interviews were, by the consent of the participants, tape-recorded and later transcribed. The participants were also informed about the purpose and anonymous approach of the study at the beginning of each interview, to encourage a more open dialogue. Furthermore, the interviews were held in Swedish since both the interviewers and interviewees had this language as their mother tongue, helping to make the interview situation more relaxed. Quotes that were to be used in the empirics section of this thesis were then translated into English. Some interview questions were prepared in advance (see Appendix A), but the open-ended nature of some of the questions, and the allowance of discussions about additional topics that the interviewee believed to be of interest enabled the interviewee to speak freely beyond the asked questions. Thus, the interviews were conducted in a focused manner (Yin, 2009). The interviews would go on until all of the themes of interest had been discussed, after which the interviewee was asked if there was something of importance that he or she thought had not been touched in the discussions and was worthy of mention. To reduce interviewer or interviewee bias (Saunders, Lewis, & Thornhill, 2012), a list of the interview questions was sent out to the interviewee before the interview. Also to this end, care was taken in asking questions without the use of theoretical concepts (e.g. instead of asking about a theoretical concept such as *"*information asymmetry*",* the interviewers would instead pose questions about the investors' views on the information on the crowdfunding platform in general).

4.2.3. Platform and sample selection

The respondents included in this study have all invested through FundedByMe, which is one of the dominating Swedish equity crowdfunding platforms. The selection of platform to include in the study was made based on two criteria's: the relevance of the platform to the Swedish equity crowdfunding context as a whole, and the availability of contact information to crowdinvestors. The platforms FundedByMe and Pepins were perceived by the researchers to be of significant relevance to the context due to their dominance in the Swedish market. FundedByMe was the only platform from which necessary contact information to investors could be retrieved online. However, it should be noted that Pepins were contacted in the early stages of the study but declined to provide contact information to the investors. Thus, it should be acknowledged that the participants' perceptions of equity crowdfunding as a phenomenon may be biased due to their experiences as influenced by only one of the available platforms. However, the substantial relevance of FundedByMe to the Swedish equity crowdfunding context, in being one of the largest actors, was expected to yield valuable insights into the context as a whole.

To ensure that the participants would be able to form an as authentic account as possible in relation to the research question, the following selection criterion was chosen when selecting respondents: the investor should have invested in a company through the platform FundedByMe, should not be part of the personnel hired by FundedByMe, and they should not have been part of a management team that had sought funding through FundedByMe. The latter criterias were deemed appropriate in order for the study to provide a pure investor perspective of the phenomenon. Respondents were contacted in two ways, either by contacting people being members of the Facebook-group 'FundedByMe Lead Investors' or by reaching out to investors with available profiles on FundedByMe's website. Before contact, a cursory internet search was performed with the aim of ensuring that the investors conformed to the selection criteria. 65 members of the Facebook group were contacted, of which 4 investors accepted to be interviewed and 15 declined. The low response and acceptance rate were, however, speculated to be due to not all members actually having gone through with investments (which was the primary reasons for declining). 28 investors were contacted based on their available profile on FundedByMe, of which 5 investors accepted and 3 declined. The selection of respondents to contact was, besides the earlier described cursory internet search, random. In the initial contact with the investors, they were informed up-front that the study was interested in including them as subjects by virtue of their investing via FundedByMe. Still, during the course of two of the interviews, it was revealed that no investing via FundedByMe had taken place, why these investors were excluded from the empirical findings of this thesis (i.e. seven interviews were included).

4.2.4. Secondary data

The secondary data used in the study primarily consisted of data retrieved from the webpage of the concerned equity crowdfunding platform FundedByMe. The retrieved information was merely used to enhance our understanding of the structure of an equity crowdfunding platform, thereby serving to support the composition and the interpretation of the empirical inquiry. However, the retrieved information was used with caution, so that the empirics could be guided by the perceived available information in the eyes of the investors, as opposed to the actually available information.

4.3. Data Analysis

The research approach followed, as mentioned in section 4.1, an abductive approach, where a theoretical framework was developed in an iterative process with data collection, provoking new theoretical inquiries throughout the course of the study period. In the framework of analyzing case study evidence provided by Yin (2009), this study could be said to rely on a theoretical proposition that was developing throughout the process into a final theoretical framework with which the data was put into relation. The theoretical framework was developed during the course of the study in an interplay between data, which sometimes was categorized in the existing framework, and other times provided the impetus for further literature research and theoretical framework development (Saunders et al., 2002). Hence, in the earlier stages of the study, the analytical process was mainly taking place in verbal discussions between the researchers, and continuous reading of the literature was a prominent part of the process. For example, the researchers immediately followed each interview with a brief discussion on the findings that had just been found, and the interviews were transcribed within a few days of taking place. The process of transcribing the data also helps the researcher to become more familiar with it (King, Horrocks, & Brooks, 2019). As the study entered its later stages, the textual data were categorized in thematical categories that were analogous to the theoretical framework. For example, a response to a question about how the investor views financial information on the equity crowdfunding platform would be categorized under the theme “financial information” and, simultaneously, or later, also fall under the category of “due diligence” or “information asymmetry”. In this way, the data was processed and reprocessed until it formed the final form that can be seen in the empirics section of this thesis. As all the quotes were originally in Swedish, they were also translated into English in this part of the process.

4.4. Quality of Research

The classic quality criteria of research, based in the quantitative research, states that the quality of the research should be judged on its validity and reliability, where the former describes the accuracy by which a variable describes a "real" phenomenon while the latter is concerned with the reproducibility of the study (King et al., 2019). These criteria have also been adopted by some qualitative researchers (King et al., 2019) and have, together with concerns about generalizability, been suggested to form the basis for the quality assessment of qualitative research (Yin, 2009). However, authors such as Lincoln and Guba (1985) have adopted alternative criteria for quality assessment of qualitative research, in critique of these aforementioned criteria (King et al., 2019). According to these authors, a case study is not generalizable in itself, instead any claims of generalizability are imposed on the reader, and should be based on available evidence from the study in question (Moriceau, 2010). In Lincoln and Guba's framework, *"qualitative research does not pretend to objectivity"* (King et al., 2019, p. 212), instead, a researcher should endeavour to give an account that gives the reader a chance to see how the researcher might have come to their conclusion. In that vein, we have tried to provide enough detail for the reader to see how our conclusions have been made while letting any assertions of our study's generalizability up to the reader to make.

5. Empirical Findings

5.1. Empirical Background

The presented empirical findings in this study represent the perspectives of seven investors that have gone through with investments in different firms seeking capital through the Swedish equity crowdfunding platform FundedByMe. The range of the participants' completed number of investments was between one to eight, and the investment sizes varied from 2 to 100 TSEK, though with a more common range between 10 to 50 TSEK (see Table 1). Moreover, the investors' individual investment sizes could vary significantly from campaign to campaign, with two investors' investment sizes varying between 20 to 100 TSEK.

The professional background of the investors was to a large extent characterized by tech and media professions, and only two investors, Investor A and F, had other backgrounds. However, two of the participants with IT background, Investor C and G, were currently running their own firms within other fields of business. The participants' general experience of equity investments outside the equity crowdfunding context resembles the experience of small and active private investors, who before the equity crowdfunding mainly invested in publicly listed markets. Investor F explains it as "*I'm a health professional, so I have no financial background. Investments are merely an interest of mine*", and Investor D explains it as *"I have to say that I am truly an amateur [in regard to investments], and in terms of traditional categorization I'm to be considered as a small private investor"*.

One investor, Investor C, were pursuing investment opportunities as a larger part of his occupation and could be described as an angel investor with a couple of years of experience. However, their investments in equity crowdfunding campaigns were low compared to his regular investments outside the platform.

Table 1 - Interviewed Investors

Investor	*Type of investor*	*No. of investments*	*Size of investments*
Investor A	Small private investors	3-4	2-15 KSEK
Investor B	Small private investor	1-2	10 KSEK
Investor C	Angel investor with 2 yrs. of exp.	3	15 KSEK
Investor D	Small private investor	“a few”	30 KSEK
Investor E	Small private investor	4	10-40 KSEK
Investor F	Small private investor	7-8	20-100 KSEK
Investor G	Small private investor	6-7	30-100 KSEK

5.1.1. Investment Motives

The interviewees described their motives for investing as mainly financial, where the investors expected a financial return at some point in the future. A couple of the participants also recognized that investments in start-ups were particularly intriguing, providing additional enjoyment or thrill to the investment.

> You, of course, want the money to grow. There is no reason to invest otherwise unless you are doing some kind of impact-investing. But I also think that start-up companies are fun. I have myself been running a start-up and think it’s fun to see companies grow. (Investor G)

> It [the equity crowdfunding campaign] has to be a bit exciting, I want a thrill-ingredient in the investments. (Investor B)

Some of the investors also mentioned that they primarily invest in campaigns that address sustainability issues. However, when asked to elaborate they pointed out that the main investment motive still was to enjoy financial benefits. That said, the motives of two participants differed substantially from the other interviewees, in that they described their main motives behind the investments as being of altruistic rather than of financial nature.

> It’s small sums we’re speaking of, so it’s enough to me that the entrepreneur becomes an entrepreneur rather than me earning money. (Investor D)

> The reason [why I invest in projects through FundedByMe] is to 70 % that I want to contribute to businesses with good causes, 20 % as favourable investments and 10 % because of fear of missing out. (Investor C)

Thus, as outlined above, the interviewees mainly referred to their investment decisions as guided by financial motives. Some investors though pointed out that equity crowdfunding provides an extra thrill of investing, and some outlined that they screened the investments based on environmental and social sustainability. Moreover, two investors recognized that their main motive of the investment was more of an altruistic nature than financial.

5.2. Information Asymmetry Related Considerations

5.2.1. Investors' views of the available information and campaigns

Prior to investing, six of the seven investors (all except Investor D) purported to be using information on the equity crowdfunding platform but also complementing it with external information either by (as in the case of Investor A, F, and G) resorting to internet searches and direct contact with management via telephone or email to acquire information, or (as in the case of Investor B and C) by consulting investor networks. As regards the availability of information on the platform, Investor B said that the *"flashy"* promotional films that are used to advertise the companies were interesting to her, but added that *"This can hide things that one wants to know, though."*. Investor D expanded this notion, as he was describing the information environment on FundedByMe as heterogeneous and challenging.

> The information asymmetry is of course considerable. There are a lot of hopes and there is a great difference in size among the projects and the markets differ so much for the different projects that it is very hard to make a good assessment of [a particular] market and the [merits of a particular] project. […] Some projects have almost nothing. (Investor D)

Most of the investors made it clear that they thought that ventures on FundedByMe were of high risk, but the reason behind this was not explicitly stated in all instances. Still, Investor C provided one such justification, saying that the companies she considers are *"very high risk, since they are very early stage".* Also, Investor F compared the risk of investing in equity crowdfunding to other investment categories. He posited that "*the risk level in investments in these companies in comparison with investing in publicly traded companies, it is much higher*".

Three of the investors (Investors A, C, and D) discussed the problem of companies possibly seeking capital on FundedByMe when they are not able to achieve funding through other, more conventional, means. Investor A also believed that the ventures seeking capital were setting the valuations too high, asking rhetorically *"If their product is so good, why don't they go directly to a private market and get five million at a valuation of 100 million SEK?"* and following this up by implying that the valuations on FundedByMe only are possible because of investor inexperience. Investor C shared his sentiment.

> […] Something that I have noticed regarding FundedByMe, and this is something that is talked about, is that is has gotten a reputation of [having] companies seeking capital there when they cannot get it somewhere else. They also set the valuations way too high. […] The investments that I do are very high risk since they are very early-stage, but then they should have low valuations to reflect it. (Investor C)

5.2.2. Investor inexperience

Another topic that was often reiterated across the interviews was the idea that the equity crowdfunding market is special due to the unusually high proportion of inexperienced and unprofessional investors. Investor A, D, and E self-identified as being, or having been, inexperienced investors. They also implied that their inexperience had been a disadvantage to their ability to properly assess the available information on FundedByMe. Investor A said that *"I have been young in all these things [investing activities]",* later adding *"I might have been fooled by a dream or two, but I have learnt from it*". Also, perceiving his inexperience in a similar way was investor E.

> It is quite difficult [to assess a new venture] because I don't know what information the crowdfunding platforms require [of the ventures] because some [of the ventures] are quite good, and some are really bad. But this perhaps also says something [about me], because this was not something I thought about ten years ago, when I started out with this thing." (Investor E)

Furthermore, Investor E made it clear that, with time, he had become less reliant on FundedByMe's supposed due diligence and was instead now examining the companies himself before investing, saying that "*Lately, I have learnt so much that I examine [the companies] myself."*

5.2.3. Information that is of interest to the investors

All the investors purported to be looking at the financial information, current and prospective, that was presented on the equity crowdfunding platform, but it was clear that almost none of the investors put much emphasis on it by consistently only mentioning it briefly, before starting to talk about information that did matter more for them, in particular, non-financial company characteristics such as especially the management team's character. Such an emphasis on the team was recognized in Investor D and G, where the latter stressed the importance to be able to act on the business ideas.

> […] ideas are nothing without execution, so it is very much the team [that is important]. What plan they have, how they envision their work, what they have done earlier etc. that is important for me. (Investor G)

Worth pointing out is that none of the investors used face-to-face interactions as part of their normal due diligence processes. Instead, they relied on the information on the equity crowdfunding platform, combined with searching the internet for information on the company and the founders, and in some cases contacted management directly via telephone or email. Interestingly, even though no in-person meetings were taking place, some of the investors said that they were still feeling able to pick up on the entrepreneur's character, just by looking at the information on the equity crowdfunding platform. For example, using the information on the platform, Investor F said that it was possible to "*sense how much confidence there is [in the entrepreneur]"*.

5.2.4. The investment size's impact on the extent of the due diligence efforts

Some of the investors had relatively clear answers about the relationship between the amount that was up for contention and how much due diligence they do. Investors E, F and G retold that they were more thorough in their due diligence efforts if they invested larger sums of money. Investor E posited *"Yes, it does. If you put in more money, then you do it more seriously.*", while Investor F said that he had contacted management directly via telephone and/or email when considering a large investment sum. Conversely, when investing relatively small sums, Investor G said bluntly that he had been *"a bit careless"*, and when asked what makes it so, he replied "*I think it is mostly because I have so damn much to do. If I think an [investment] case sounds very interesting, then I can lean more towards using my gut feel"*. In contrast to most of the investors in the sample, and an outlier in this regard, Investor A had a unique perspective in that he exerted the same due diligence efforts without respect to the investment amount committed (however, it should be noted that he only invested in the relatively low range of 2 000 to 15 000 SEK). It is also worth pointing out that while Investor G was generally sensitive to investment size, he said if some piece of information would *"stick out"*, he could contact management directly without regard to the investment size considered. Finally, in conversation with Investors B and C, the investment size's effect on due diligence was not touched upon in the discussions.

5.2.5. Investors’ views on the completion of the funding target

Four of the investors said that they paid attention to how far the ventures’ campaigns were to reach their campaign goals. Investor B was using the metric as one factor, among others, in her investment process, saying that *“it almost shows if the idea is viable. Are there more people than me that believes in this idea?”*. More aggressive use of the metrics was seen by Investor F and G who used this metric to screen investments.

> I think that the crowdfunding arena is interesting from the perspective that you can see the interest for the product. It is similar to a market survey that shows you how many people believes in the project. I immediately filter out projects to which I feel that I need to contribute significant sums to make the company reach the minimum level. In those cases, it is not interesting to me since I don’t feel that I have the right knowledge to be sure that it is a great idea. (Investor F)

> Is there a company that receives a lot of attention, then I put in more time into that company, for the reason that it has been paid a lot of attention. […] Even though I might miss other fine opportunities. (Investor G)

5.2.6. Investors’ expectations of the equity crowdfunding platform

A conception among five of the seven investors (A and E being the exceptions) was that the platforms’ due diligence processes had a role to play in their own investment processes, but they differed in how they perceived FundedByMe carrying out these activities. They were all firmly believing that FundedByMe has to do *some* due diligence, otherwise the platform would be, in the words of Investor B, *“The platform for anything, and I do not perceive them to be that.”*. Investor C, D and G expected the platform to at least check for criminal background in the entrepreneurs, but two of the investors, Investor D and G also went further, emphasizing the platform’s role more than the other investors in our interview sample. Investor D, in particular stressed the platform’s role, as a professional actor, to keep *“scammers”* out while also talking about the quality approval-effect of the platform on the ventures.

> Above all, I have a great degree of confidence in the team, the management team […] and that is in itself a sign of approval for the projects on the platform. For me that is the most important [thing]. (Investor D)

> Well, to some extent we have to trust the platform, FundedByMe and these webpages would not exist if they would only build up crappy companies. […] there is at least a first quality check that FundedByMe has done. (Investor G)

Furthermore, it is noteworthy that in discussions with four of the investors, even when not asked a question about the platform itself, they spontaneously raised the issue of what role FundedByMe plays in doing due diligence on the projects before they go live on the platform. Finally, it is worth pointing out that while some of the investors put trust into the platform's supposed due diligence efforts, all of them retold that the ultimate responsibility for their investment decisions and their consequences still lay on themselves.

5.3. Agency Related Considerations

5.3.1. The investors' views of the entrepreneurs' ex-post behaviour

Six of seven participants in the study recognized that they, before their investments, had reflected upon the possibility that the entrepreneurs' ex-post behaviour could interfere with the interests of the investors, thereby creating potential problems to them. Some investors retold that they had not given these concerns much thought, referring to that *"the risk is always present"* (Investor G), or, as Investor E, referring to that the investment size was too small to bother. However, one participant, Investor F, had given the potential concern of misaligned interests considerable thought before his investments but argued that the potential problems should be small.

> I believe that if they [the entrepreneurs] do have an idea, then they also have an interest in making it a reality and earn money on the idea rather than on my investment. […] I'm not worried that they would be dishonest in any way or that they would try to deceive me. (Investor F)

Although Investor F retold that he expected the problems of misaligned interest to be minor, he stressed that a perceived greater risk is the lack of experience among the entrepreneurs seeking funding, something that the investor particularly identified as evident within equity crowdfunding.

To contrast the above, two participants, Investor A and C, said that they perceived potential problems of misaligned interests as typically severe in the case of equity crowdfunding. This mainly due to the dispersed ownership, that they believed to cause less scrutinized managements and less personal reputation at stake for the entrepreneur. These two investors had though experienced considerable self-interested behaviours exerted by entrepreneurs in at least one of their equity crowdfunding investments.

> Of course, it's very comfortable for the entrepreneur to have investors that do not care. Then they to a larger extent will be able to do whatever they want. […] [and when asked about an investment in which the founder took out a high salary the investor answered] then I felt a bit fooled, even though I know that the founder is a good person. That caused me to not invest in the project anymore. (Investor C)

> I have gotten investments in my own company, and then my friend asked me "could you take out all the money in salary?", yes, but I have nothing to gain from it. But of course, if you don't see any good prospect [for the company] and given that you are very disconnected from the investors in crowdfunding… then you would completely disregard all the investors or at least more than if you would have five investors of which you knew all. […] but then I [as an entrepreneur] wouldn't be able to get any investments again and I would ruin my reputation. (Investor A)

Furthermore, one participant in the study, Investor D, did neither perceive any potential problems of misaligned interests nor would the investor bother if that would be the case. This was, however, recognized by him as related to the investors' noticeable altruistic motives and the investors' small investment size.

5.3.2. Investors' ex-post behaviours

When asked about how the investors seek to mitigate the earlier described potential problems of misaligned interests, five of seven investors retold that they did not exert any noteworthy efforts related to these concerns. The main justification for this was the size of the investors' investments.

> I would never invest more than ten to fifteen thousand SEK through FundedByMe so then I don't care that much. If I would invest more, then I really would want all to be fine and I would then involve myself. (Investor C)

> No, I'm not active in that way. I mean, I don't spend time on it [mitigating the potential of entrepreneurs' exerting self-interested behaviours] even though it maybe would be favourable, I'm choosing not to do it. But it's so small equity stakes, if you would take an ownership majority then it would be a completely different thing. (Investor E)

None of the seven participants in the study had reflected upon a potential need of entering into shareholders' agreements or similar contracts. Among the five above mentioned participants not exerting any noteworthy mitigation activities, it was though commonly mentioned that they valued to receive information ex-post the investment, which they in some cases requested directly from the entrepreneur, and that they followed the progress of the company on social media and in other channels. However, the incentives behind these actions were recognized more as a general interest in the performance of their investment, as well as a wish to review if there was anything that the investor could do to the help the company, rather than as monitoring activities. Investor D explained the value-adding perspective by *"the thing is not that much that you want to step in and control if something wouldn't work, it's rather that if you would see an arising opportunity, then it would be positive to contribute"*.

It should be noted that one of the participants that had invested larger sums, Investor G, did say that he perceived his equity stake as low, hence not making it worthwhile to be more active. However, the other participant investing larger sums, Investor F, retold that he did try to address these concerns in the cases where the investment size had been big. *"I'm more active and have a greater interest in the companies that I have invested more money in. So of course, the money matters, it's related."* (Investor F)

Investor F continued by explaining that in the cases of larger investments, then he regularly contacts the companies' management ex-post the investment to get additional information or to raise concerns and observations. However, the investor explained that these were activities mainly exerted as a way of adding value rather than as a way of mitigating potential divergences in interest.

> It's some of the appeal with crowdfunding. You're not just a shareholder, you also become part of some sort of panel for the company. And they are also actively, or at least often, looking for competences among the shareholders. That makes it a bit familiar in a way. (Investor F)

There was only one participant in the study, Investor A, describing extensively exerted mitigation activities with the purpose of preventing entrepreneurs' potential self-interested behaviours. This was described as not related to the investment size, given that the investor recognized himself as a small shareholder. These activities mainly consisted of raising concerns and opinions in closed shareholder Facebook-groups, but also activities such as looking through financial statements of associated companies making sure that no fraudulent behaviour was taking place. In one company, Investor A retold that he had discovered what he perceived as fraudulent behaviour, whereby the investor tried to put pressure on the management through a shareholder Facebook group. Through the group the investor managed to get backing from other investors, effectively forcing the management to respond. Investor A elaborated why he had gone through the Facebook group as a forum by saying *"I had such few shares that I could not have done a damn thing. So, I had to influence others [other investors] […]"*.

5.3.3. The effectiveness of investors' ex-post behaviours

As described in the previous section, a common explanation among the participants of why they were not exerting any mitigation activities was that the low investment sizes did not make it worthwhile to put in the required efforts. However, most of the investors recognized that they probably would be able to influence management despite their low equity stakes.

> You are [in equity crowdfunding] able to influence significantly more than in Investor [the Swedish listed company] so to speak, so I think it is fun that they listen more and that you get more personal communication. [And when asked, "Do you think that you are able to make a real impact?"]. Yes, I think so. (Investor F)

However, a majority of the participants recognized that to make a real impact, it would be necessary to get the support of other shareholders. When asked how to facilitate such joint action, many mentioned Facebook shareholder groups as a suitable forum. This was a forum that had been prevalent for six of seven investors in at least one of their investments, but only Investor A had actively used that forum. However, when asked about the ability to influence as a group rather than as an individual alone, Investor C recognized that it is the companies that govern that ability. *"It depends on the openness of the company because you have to find each other, and you necessarily don't know who the other investors are"* (Investor C)

5.3.4. Expectations on the equity crowdfunding platform

None of the interviewed investors recognized that they had expected FundedByMe to pursue any activities ex-post the investment to look after the interests of the investors. Moreover, neither did none of the participants mention that they had expected any contracting activities to be performed by the platform before the investment. However, three participants (Investor C, E and G) mentioned that a welcomed addition, which according to them would strengthen the investors ability to monitor and control the entrepreneurs, would be if FundedByMe required that entrepreneurs raising capital committed to certain information sharing standards and that the entrepreneurs should facilitate the possibility of shareholders' joint efforts ex-post the investment.

> They should have it in their terms of agreement. If you want to fundraise through crowdfunding, then you need to inform [the shareholders] in this way and this often. (Investor G)

6. Discussion

6.1. Information Asymmetry

Our findings suggest that most of the investors perceived problems of information asymmetry as they have been defined and discussed by Akerlof (1970), Guldiken et al. (2014) and Berger and Udell (1998), for example as supported by the emphasis on the perceived risk, as well as their need to search for information outside the platform, due to an unsatisfactory amount of information on ventures on FundedByMe's web platform. In this section, we will discuss our findings and their theoretical and analytical implications in more detail.

6.1.1. Investor inexperience and its effect on information asymmetry

The idea discussed by Ahlers et al. (2015), that smaller, inexperienced investors might be worse than professional investors such as venture capitalists at differentiating between "good" or "bad" companies, was espoused by some of the investors, as they were talking about how they thought of themselves as being, or having been, less aware of information asymmetry-related issues by virtue of their status as inexperienced investors. This idea was most clearly stated by Investor E who retold that with time and experience, he had become more aware of the fact that some of the ventures were *"quite good"* whereas others were *"really bad"*. Thus, our study supports the notion that investors' inexperience might be aggravating problems of information asymmetry.

Furthermore, while it was evident that ventures on equity crowdfunding platforms were perceived as high-risk by most of the investors, it was only three of them that framed this problem in terms of adverse selection, something which by all of said investors were stated in terms of "ventures seeking capital on FundedByMe as a last resort for capital". Of these investors, only two of them, Investor A and C, also discussed the problem of adverse selection in terms of (over)valuations. What differentiated these two investors from the others, was that they were the only ones that had recently sought or invested capital in conventional private markets, in addition to having invested in several campaigns on FundedByMe. Thus, in our study, they were uniquely positioned to assess ventures on FundedByMe on more similar terms than the other investors. Also, they were purporting to have some education in finance, but this was not unique to them as Investor A, B, and E all had business degrees from university. The absence of discussions relating to valuations among the investors that had not recently been well exposed to both equity crowdfunding and other private capital markets, could be interpreted as these investors being less knowledgeable, which in that case would corroborate with what has been suggested by Ahlers et al. (2015) in that smaller investors, according to that author, are expected to lack the experience and sophistication to mitigate information asymmetry problems as effectively as conventional investors in private markets. The fact that critical discussions about adverse selection problems were only raised by one of the other investors (except investor A and C), seems to support the same idea. Still, an important caveat to that analysis is that there could be other factors behind the relative absence of discussion about adverse selection and valuation. For example, we never asked about valuation issues explicitly, if it was not raised in the first place by the interviewee.

6.1.2. Signals, screening and herding

Our study presents several examples of equity crowdfunding investors using already committed capital by other investors to a project, as a signal that helps them to screen for attractive investments. In this way, the empirics of our study builds on the literature of signalling (Leland & Pyle, 1977; Spence, 1974) and herding behaviour (as pioneered by Banerjee (1992) and put in the context of equity crowdfunding by Ahlers et al. (2015) and Vismara (2016)). First, for some of the investors in our sample, the share of the campaign goal attained was used as a signal of quality. Investor B and F, in particular, expressed how they believed that this indicator said something about the wider market interest and viability of the business idea. In addition, our study also found that for some investors, the use of this signal was an integral part of their investments process, going so far as to screen investment projects based on how close they were to reaching their campaign goal. In this way, our thesis provides a clear account of equity crowdfunding investors using this piece of public information on the platforms to screen for the viability of a business idea. As cautioned in Banerjee's (1992) article, however, herding behaviour such as the one described above might lead to inefficient outcomes, something that was also acknowledged by Investor G, who said that he understands that using the strategy to focus only on investments that already have gotten attention in this way, there is the risk that you *"miss other fine opportunities"*. Our study thus shows, in an exploratory fashion, that herding is used consciously by some equity crowdfunding investors as a strategy to overcome some of the, arguably, severe information asymmetry problems facing investors on an equity crowdfunding platform such as FundedByMe.

6.1.3. Due diligence

Most of the investors in our study did not see the financial information that was presented on the platform as a piece of information that weighed heavily in their assessments of the merits of the investment projects. Instead, they were stressing the importance of non-financial information, in particular the management team behind the ventures, as exemplified in the empirics-section of this study by the excerpts from Investor C, D, and G. The view of management characteristics as high-priority criteria is similar to what was reported by venture capitalists in Muzyka et al. (1996) and in this respect, the equity crowdfunding investors were similar to VCs. To get the information that they were interested in, they gathered information on the platform, did internet searches outside of it, and, in the case of Investor A, C, and F had direct contact with the entrepreneurial team over telephone or email. As noted in the empirics-section, no face-to-face due diligence was part of the investors' normal investment processes, thus supporting Agrawal et al. (2014) and Ahlers et al. (2015) in that in person due diligence is too costly for small investors. However, even without resorting to such, relatively expensive, due diligence activities, Investor D and F were both positive in their abilities to assess the personal characteristics of the entrepreneurs using the information given on the platform alone. What type of due diligence process that is behind Investor F's ability to *"sense how much confidence [there is in the entrepreneur]"* could not be determined from our data, but it is noteworthy that some equity crowdfunding investors perceive that they have the ability to assess relatively subjective management characteristics from just the information provided on FundedByMe.

The impact of the investment size on the due diligence activities of the equity crowdfunding investors was mostly in line with what the literature implies, in that investing of smaller sums of money was associated with lower exerted due diligence efforts (Agrawal et al., 2014; Ahlers et al., 2015). This was most clear, as was pointed out in the previous paragraph, in that no investor used face-to-face interactions as part of their due diligence process. Moreover, the relationship between the due diligence effort and investment size held true for the Investor E, F and G in that they purported to do more thorough due diligence when they were investing larger sums. Conversely, for relatively small sums, Investor G's retelling that he occasionally has been *"careless"* and only resorting to *"gut feel"* in his due diligence could imply that below certain investment sizes, some investors become less rational, and are to a larger degree resorting to their emotional response to investment ideas as guide to what to invest in. The relationship between investment size and due diligence was also apparent in that Investor E and

F contacted the prospective investees directly when investing larger sums, hence corroborating the literature. In opposition to what previously was discussed, however, Investor G was initiating direct contact with management when he perceived something to *"stick out"* in the information provided on the ventures, thus suggesting that other factors than investment size alone can influence an equity crowdfunding investor's willingness to exert due diligence effort. This "exception to the rule" was also observed in Investor A who stated that the investment size did not impact his due diligence activities, although the reasons for this behaviour could not be determined.

6.1.4. The equity crowdfunding platform

Five out of the seven investors in our sample held the view that the equity crowdfunding platform had a role to play in their investment activities, mostly in doing due diligence to provide some quality assurance of the ventures for the investor. Combining these empirics with what has been put forth in section 6.1, FundedByMe was perceived as a financial intermediary in a market with problems of information asymmetry in accordance with Berger and Udell's (2001) definition as well as what Allen and Santomero (2001) have laid out.

In support of the previous paragraph's statements, we found responses such as the ones provided by Investor D and G, clearly stating that the equity crowdfunding platform was providing a *"sign of approval"* and a *"quality check"*. In Investor G's mind, if the platform did not make sure that the prevalence of *"crappy companies"* were limited (by doing appropriate due diligence), the platform would stop being used by investors. This in turn suggests that the equity crowdfunding platform plays a role similar to traditional financial intermediaries as described by Berger and Udell (1998) and have a reputational capital in a way that is analogous to what Hsu (2004) describes. The role of reputational capital could also explain why Investor A and C expressed their waning interest for investing in crowdfunding over time, since these investors were marred by bad investing experiences on FundedByMe. However, Investor G contradicted this notion, as he was getting more interested in investing on FundedByMe even after having had a few bad investing experiences, thus showing that other factors could be at play for the decreasing interest of Investor A and C. Also positive to investing in FundedByMe, Investor D saw the reputational capital of FundedByMe, which in his case was embodied in his belief in the management team, as a crucial factor to his view of the platform as the safe-guarder of the quality of ventures on the platform, hence strongly supporting the view of the equity crowdfunding platform as financial intermediary with a reputational capital.

Moreover, while all the investors stated that they were ultimately responsible for their investment decisions, a reiterated idea was that the equity crowdfunding platform has a special role to play in this market, due to it being a professional actor in a market with many inexperienced investors. This idea was most clearly held by Investor D, who said that the implication was that the platform should keep *"scammers"* out. Variations of this theme was retold by Investor C. Investor E said that he, with time, had become less reliant on the platform to do the due diligence for him, instead doing more of it himself, again implying that the equity crowdfunding platform has a special role to play for the inexperienced investor while being of less importance and stature for the more seasoned one (compare with section 6.1.1). In conclusion, we have given some evidence for the case of FundedByMe playing the role of a financial intermediary in the minds of some equity crowdfunding investors, as well as using reputational capital to effectively signal quality of the ventures to the investors. All in all, these perceptions could, from the literature's point of view be a way to cope with a market with unusually severe information asymmetry problems.

6.2. Agency Problems

The empirics of this study corroborate the agency related concerns raised by Jensen and Meckling (1976), in that almost all of the participating investors recognized a problem of entrepreneurs potentially pursuing self-interested behaviours, in breach of the investors' interests. However, a question persists whether these agency related problems are viewed as severe or trivial. Thereby either supporting the literature that argue that the fact that the entrepreneur often remains as a large shareholder only implies a minor incentive problem (Huyghebaert & Van de Gucht, 2007), and/or the literature that proposes that the high uncertainty in new ventures and substantial benefits of control yields substantial agency risks (Bolton & von Thadden, 1998; Sapienza & Gupta, 1994). The interpretation of the participants' responses does in relation to this topic yield mixed results. The fact that many of the participants only had given these concerns negligible amount of thought, to some extent overlooking the potential problems as an always evident risk, suggest a perception of the problems as being minor. This would stand in contrast with the literature of Sapienza and Gupta (1994), thereby also suggesting that the participating equity crowdfunding investors view these problems differently than other types of investors such as venture capital firms.

However, almost as many participants did recognize significant agency problems, thereby providing inconsistent responses. One participant, Investor F, clearly stated that the incentives problem was immaterial, but that a more serious concern was the ability of the entrepreneur. This view corroborates both with the suggested minor incentives problems as proposed by Huyghebaert and Van de Gucht (2007), and the agency risks derived from the entrepreneur's lack of experience as suggested by Sapienza and Gupta (1994). Two other investors, Investor A and C, on the other hand, perceived significant incentives problems, thereby contradicting Huyghebaert and Van de Gucht (2007). Interestingly, one justification for this was that the dispersed ownership, as typical in equity crowdfunding, implied little pressure on management and hence extensive freedom to pursue self-interested behaviours (in the spirit of Bolton and von Thadden (1998) and Schleifer and Vishny (1997)). Another argument was that the dispersed ownership entails that the entrepreneur becomes disconnected from the shareholders, with little reputation at stake if pursuing self-interested behaviours compared to if the shareholders would have had closer relationships with the entrepreneur.

6.2.1. Exerted mitigation efforts

The majority of the participants did not pursue any activities with the purpose of mitigating agency problems, even though almost all of them had recognized that some agency problem prevails. Moreover, none of the investors had expected the equity crowdfunding platform to pursue any mitigating activities related to agency problems for them. Thereby, the majority of the equity crowdfunding investors in the study differed from the professional investors such as venture capital and angel investors, of as in van Osnabrugge (2000) was reported to pursue more extensive activities with the purpose of dealing with these potential problems. These investors, that did not pursue any mitigating activities, justified this behaviour with the notion that their small investment sizes did not make the required efforts worthwhile to pursue. Hence, corroborating with what theoretically is expected of small investors in dispersed ownership structures (Schleifer & Vishny, 1997). This provides a reasonable explanation of why the equity crowdinvestors differed from more traditional investors, in that their investment sizes are significantly lower than the ones of the venture capitalists and angel investors. However, some investors' willingness to contribute with value-adding activities stands in contrast with the literature suggesting that the investors would not want to perform activities upon which other investors could free-ride (Hart, 2001). This was not found to be related to the shareholders having altruistic motives, as proposed by Hart (2001), given that the main motives of the investors were financial. However, it could be speculated that the sustainability focus of many of the investors' investments entails an urge among the investors to contribute to the greater cause behind the venture, and not just the success of the venture itself.

To contradict the majority of the investors' actions, there were two participants that actually exerted mitigating activities, of which one, Investor F, was one of the larger investors in terms of invested funds. The activities performed by Investor F mainly consisted of monitoring the management, however, the investor recognized that he mainly performed activities in the companies in which he had invested larger sums, hence providing additional support for Schleifer and Vishny's (1997) idea of what should be expected of small investors' behaviour. However, on the contrary, Investor A pursued extensive mitigating efforts even though his investments were small in monetary terms. Besides monitoring the entrepreneur, Investor A also performed controlling activities, where he attempted to join forces with other investors to strengthen his cause. This was the only investor in the study that had tried to unify the crowdinvestors' individual influence. Neither Investor A nor F had exerted any contracting activities as a way of mitigating potential agency problems.

An interesting and unexpected finding from the interviews was that many investors actually believed they had a possibility of influencing the entrepreneur, without pursuing efforts that in another context, where dispersed ownership structures exist such as in public markets, would have been very costly. Many of the investors perceived that the entrepreneurs' dealt with individually raised concerns seriously and that the possibility of pursuing necessary joint controlling efforts as a crowd, often were facilitated by the entrepreneurs through Facebook shareholder groups. Thus, it is possible that the majority of the investors do not exert any mitigating activities even though the activities might not be that costly to pursue. The empirics of this study does not provide any clear answers on what other reasons there could be to this phenomenon. However, it could be speculated that other underlying reasons could be that many investors view the agency problems as insignificant, are unaware of how to perform mitigating activities, or are reluctant towards voicing opinions on open forums. While the study thereby provides some support for the notion that management in companies with dispersed ownership structures are under little pressure from investors to perform well (as long as no larger investors are present upon which the smaller investors can free-ride) (Schleifer & Vishny, 1997), it is not necessarily due to the fact that the small investors' ability to influence is limited or costly.

7. Conclusion

The purpose of this study has been to explore the considerations of small private investors in relation to information asymmetry and potential agency problems when investing in highly uncertain and risky small firms. By discussing the empirical findings in relation to a theoretical framework based on well-recognized financial literature, we have both been able to provide findings supporting the literature as well as new empirical insights.

First, our study provides an enhanced understanding of small private investors' considerations in relation to information asymmetry when investing in small firms. The participating investors' perceived problems of information asymmetry as defined and discussed by Akerlof (1970), Berger and Udell (1998) and Guldiken et al. (2014), and also viewed the information available at the crowdfunding platform as unsatisfactory to solely base an investment decision upon. Moreover, the empirical findings provided some support for the suggestion that small private investors' inexperience potentially could aggravate the information asymmetry (Ahlers et al., 2015). Also, the study offers a more comprehensive understanding of the importance that small private investors puts in the signalling of already committed capital, providing contextual support to the literature of Leland and Pyle (1977) and Spence (1974), in being considered by many participants as an important way of overcoming information asymmetry. Furthermore, the due diligence efforts exerted by the investors to further overcome the information asymmetry mainly focused on non-financial information, where the most important information was suggested to be the characteristics of the management team. Thus, showing that the participating small private investors had similar informational prioritizations as professional venture capital firms (Muzyka et al., 1996). Moreover, the extent of the participants' exerted due diligence efforts was to a large degree dependent on the investment size, thereby being in line with the literature suggesting that extensive due diligence efforts are too costly for small investors to pursue (Agrawal et al., 2014; Ahlers et al., 2015).

Furthermore, many of the participants in the study held the view that the intermediating crowdfunding platform had a role to play in their investment decision, suggesting that the platforms are to be viewed as financial intermediaries in accordance with Berger and Udell's (1998) definition. The findings suggest that the small private investors in equity crowdfunding view the platforms as having important reputational capital, thereby signalling firm quality to the investors, analogues to what has been suggested by Hsu (2004). Thus, it could be interpreted that the investors participating in the study expect the equity crowdfunding platforms to overcome some of the information asymmetries on behalf of the investors.

While the thesis supports the research of Jensen and Meckling (1976) suggesting that an entrepreneur-investor relationship will encounter challenges of agency, the empirics provided mixed results in relation to how severe the participating small private investors perceived these problems. Moreover, most of the participants did not exert any activities to mitigate perceived agency risks. Thus, the participating crowdinvestors differed from professional actors, such as venture capitalists and angel investors, which have been reported to pursue significant mitigation efforts (van Osnabrugge, 2000). This behaviour and the participants' justifications thereof corroborates with the suggestion of Schleifer and Vishny (1997) in that the low invested sums made the mitigating efforts not worthwhile to pursue. However, the willingness of many investors to pursue value-adding activities weakens this argument, and contrast the literature (Hart, 2001) by suggesting that the free-riding problem not necessarily could explain the behaviours of small investors to not pursue mitigating activities. Moreover, the notion of many participants that it actually is possible to influence entrepreneurs in equity crowdfunding, despite the investors individually low equity stakes, contribute to the literature by contrasting the view of Schleifer and Vishny (1997) and Hart (2001) who suggest that small investors in dispersed ownership structures have very limited possibilities to influence management.

Because of the individuality of each case and the specific contextual factors of the participating investors' investments, it should be stressed that the findings of this study might not be true for other empirical contexts. Moreover, the findings are influenced by the investors' experiences of either favourable or disappointing investments, guiding their general attitude towards equity crowdfunding as a phenomenon. It should also be noted that the equity crowdfunding platforms differ in terms of structure, implying that the expectations on, and perceptions of, other crowdfunding platforms could be different from the one presented in this study.

Besides providing contributions to previous literature, the empirical findings of this study also provide important practical implications, mainly by showing that many of the participants viewed the equity crowdfunding platform as an important signalling entity, thereby suggesting that the platforms need to be aware of investors perceiving them as signalling quality. Moreover, the study provides suggestions for actions that could be undertaken by platforms to reduce both information asymmetry and agency risks to investors, for example through focusing more on educating and informing investors about risks, and by providing forums ex-post investment that enhances the investors' ability to jointly monitor and control the management.

This thesis provides an exploration of the beliefs of, and actions undertaken by, small private investors in equity crowdfunding. To further add to the body of knowledge within this context, we recommend further research focusing on how the equity crowdfunding platforms perceive the information asymmetry and their role as an intermediator. Moreover, it would be of interest to explore how crowdinvestors' perceptions and actions affect entrepreneurs pursuing equity crowdfunding. This would specifically be of interest from a broader governance perspective, in that the potential lack of large external investors and the suggested limited governance activities of the small private investors, could imply that equity crowdfunded companies remain unpressured from external investors, potentially providing important implications for the overall economy. This line of research would though be given the generalizability of this thesis' findings, and it would, therefore, be favourable with supporting quantitative research. Finally, the sub-finding that Facebook shareholder groups were common for equity crowdfunded firms, provides an interesting base for research looking into how those kinds of forums could be used as a corporate governance mechanism for small private firms.

8. References

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9. Appendix

APPENDIX A: Interview Guide

Introduction and Background

- Do you approve of the interviews being tape-recorded? Do you have any questions before we begin?
- Could you briefly describe your background and occupation?
- How would you describe your general experience of financial investments?
- What experiences do you have from investing through equity crowdfunding?
- Why did you begin to look at investment opportunities at FundedByMe?
- What would you say that the motives behind your investments are?

Information related questions

- Which information are you looking for when considering an investment? What is of most importance?
- Do you believe that the available information at FundedByMe's platform is sufficient for making an investment decision?
- How do you perceive the funding target, and the current capital fulfillment rate, as displayed for each campaign on FundedByMe?
- Are there any specific types of campaigns that you believe are more suitable for equity crowdfunding?

Agency related questions

- Have you entered into any shareholders' agreements or similar contracts upon investing? Are such contracts something that you have considered to be of importance?
- Have you after the investment gotten information about the current state of your investment, or have you tried to get this information? Why?
- When considering investing, how did you view the possibilities of influencing and controlling the company after the investment? Was this an important consideration, why? Have you tried to influence the management after completing the investment?
- Would you say that you have had the opportunity to influence and control management?
- How did you perceive the possibilities of disposing your shares when making the investment decision?
- How do you believe that the management of equity crowdfunded companies are affected by the fact that there are many shareholders in these types of firms?
- Would you say that it is possible to pursue joint efforts with the crowd of investors to control the management?

Financial intermediaries

- How would you describe the role of FundedByMe for you as an investor?
- Which expectations do you, as an investor, have on FundedByMe?