

Proximity as Enabler to Crowd Investors Exploitation:

A Theoretical framework

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Abstract

The ability to leverage external networks for knowledge acquisition and exploitation it is extremely important for new ventures. Crowdfunding offers the possibility to leverage crowd investors' to acquire competences, skills and network.

In this paper we introduce a conceptual framework which considers the potential enablers of crowd funders involvement in funded company's activities. We consider proximity – in its three main facets, i.e. geographical, social and cognitive – as relevant factors that may increase crowd funders activism.

Keywords: Crowdfunding, Knowledge acquisition, geographical proximity, social proximity, cognitive proximity

1. Introduction

The literature agrees that collaboration with stakeholders is beneficial and necessary for the start-up, and compensates for lack of internal resources and competences (Aldrich and Auster, 1986; Stinchcombe, 1965; Lichtenstein and Brush, 2001). However, exploiting external resources, such as crowd investors, can be difficult for new ventures for several reasons (Salter et al., 2014), related to both their firm-level capabilities (Alexy et al., 2012) and their employees and managers' attitudes (Schierjott et al., 2018).

A recent strand of work highlights the role of organizational design for integrating external knowledge in the firm, facilitating interactions with external knowledge sources, and exploiting opportunities (Jansen et al., 2005). For instance, Foss et al. (2011) suggest that use of new

organizational practices, namely, vertical and lateral communication, rewarding employees for sharing and acquiring knowledge, and delegation of decision rights, makes it easier for firms to access customer knowledge. Also, establishing direct channels of communication with external sources via dedicated departments, or interdependencies with internal technology investments, facilitates use of external knowledge (Heimeriks et al., 2007; Noseleit and de Faria 2013; Wuyts and Dutta 2014). In addition to firm-level capabilities, the firm's engagement with external sources is influenced by employees' and managers' attitudes (Schierjott et al., 2018; Agrawal et al., 2010; Chesbrough, 2003). Also, external relationships can depend on the entrepreneur's personal links and willingness to engage with external parties (Ahn et al., 2017).

Despite the constraints on external knowledge exploitation highlighted in the literature, the crowdfunding context is characterized by peculiarities, linked to linked to: (i) crowd investors' characteristics; and (ii) Internet-based transactions, that lead to the emergence of other potential challenges related to exploiting crowd investors to obtain external knowledge. Crowdfunding allows the entrepreneur to gather online financing from the crowd (Lambert and Schwienbacher, 2010; Belleflamme et al., 2013). Crowdfunding and its underlying concept, Web 2.0, allows participation, collaboration, and communication between investors and new ventures and, thus, knowledge exchange. Crowd participation affects new venture development and growth and contributes, in particular, to knowledge and network development (Di Pietro et al., 2018).

We propose a theoretical framework to explain equity investors' exploitation and linkages, using a proximity lens. Proximity, Boschma (2005) suggests, is a multidimensional concept, which includes geographical proximity (same spatial area), cognitive proximity (same knowledge base), and social proximity (common relationships).

Geographical proximity influences the exchange of information, by increasing the probability

of collaboration, by producing spontaneous social and professional interactions, and by increasing the probability of face-to-face interactions (Dyer & Nobeoka, 2000). Additionally, cognitive proximity, is necessary for acquiring information and knowledge from other people (Cohen & Levinthal, 1990). Similarities in current knowledge stocks enhance the transfer of knowledge, whereas differences tend to delay or prevent the absorption of new knowledge from a partner (Lane & Lubatkin, 1998). Social proximity, promoting trust inside business relationships, makes reciprocal knowledge acquisition more efficient, by reducing the risk of opportunistic behaviour and by encouraging informal relations considered more effective for acquiring external knowledge (Nahapiet & Ghoshal, 1998).

It is suggested, also, that proximity, in some (but not necessarily all) of its dimensions, is required to promote connections among actors and to enable learning and knowledge exchange. In what follows, we explain our conceptual model and the different forms of proximity that can hamper or facilitate knowledge transfer between entrepreneurs and the crowd.

2. Theoretical model

Geographical, social, and cognitive proximity

Geographical proximity between the new venture and its partners is considered an important parameter that the new venture can use to exploit external knowledge (Alcacer and Chung, 2007; Audretsch and Lehmann, 2006). Geographical proximity influences information exchange by increasing the probability of collaboration, by producing spontaneous, social, and professional interactions, and by increasing the probability of face-to-face interactions (Dyer and Nobeoka, 2000). In the context of electronic commerce, the literature shows that, although the cost of the distance between buyers and sellers is reduced, information-related costs exist and remain an important impediment to remote transactions (Blum and Goldfarb, 2006; Hortaçsu et al., 2009). The importance of geographical proximity is also addressed in work on

crowdfunding. Prior work shows that distance matters for crowdfunding investment decisions, and that online transactions are more likely between buyers and sellers in the same geographical area (see, e.g., Agrawal et al., 2011; 2015, Ordanini et al., 2011; Lin and Viswanathan, 2015; Hortaçsu et al., 2009). Non-local investors are disadvantaged, relative to local investors, in their access to local information, networks, capital, and resources and, typically, incur higher information asymmetries and transaction costs (Guenther et al. 2018; Ordanini et al., 2011; Hornuf and Schmitt, 2016; Boschma, 2005; Agrawal et al., 2011).

In line with the argument in the extant literature that geographical proximity helps to reduce information asymmetry and facilitates interactions and collaboration, we posit that equity crowd funders located in the same geographical area as the entrepreneur will be more likely to be involved in company activities.

Proposition 1: Geographical proximity between crowd investors and entrepreneurs will encourage exploitation of crowd investors knowledge.

However, recent studies suggest that geographical proximity cannot be assessed in isolation. Geographical proximity per se is neither a necessary nor a sufficient condition for the process of knowledge acquisition (Boschma, 2005; Antonelli, 2000), since other nontangible dimensions of proximity can act as substitutes for geographical proximity (Boschma, 2005; Boschma and Lambooy, 1999). In particular, these authors argue that the importance of geographical proximity will be weakened if the partners share the same cognitive experience (cognitive proximity) and if the relationship between partners is socially embedded and, thus, is characterized by a high level of trust (social proximity) – and especially in the case of tacit knowledge. This justifies our interest in the other two dimensions of proximity.

The notion of cognitive proximity suggests people sharing the same knowledge base and

expertise can learn from each other (Boschma, 2005). The effective transfer of knowledge requires absorptive capacity to identify, interpret, and exploit new knowledge (Cohen and Levinthal, 1990). Thus, actors' or firms' capacity to absorb new knowledge requires cognitive proximity because this facilitates effective communication (Boschma, 2005).

Similarity knowledge stocks enhances the transfer of knowledge while differences tend to delay or prevent the absorption of the partner's knowledge (Lane & Lubatkin, 1998). Empirical studies confirm the positive effect of cognitive proximity on knowledge exploitation (Huber, 2012; Molina-Morales et al., 2014; Dakhli and de Clercq, 2004; Presutti et al., 2011).

This is true, specifically, in the context of crowdfunding, which presents certain other peculiarities. Among these is the fact that entrepreneurs cannot choose their crowd investors. Therefore, lack of knowledge specific to the business is another reason for low or lack of involvement with investor communities. Specifically, start-ups at an embryonic stage of development, need mentoring and support related to how to run the business, and expertise in the focal business sector. Entrepreneurs look to establish relationships with people with such expertise and an understanding of the critical components of the business proposition.

If the similarities in actors' knowledge is low, that is, the cognitive proximity between crowd investors and entrepreneurs is small, this can generate low levels of external engagement activities.

Therefore, we posit:

Proposition 2: Cognitive proximity between crowd investors and entrepreneurs will encourage exploitation of crowd investors' knowledge.

Lastly, the concept of social proximity derives from the literature on embeddedness (Granovetter, 1985), which states that relationships between partners are socially embedded if

they involve a high level of trust. The presence of trust in the business relationship allows more efficient reciprocal knowledge acquisition because it reduces the risks of opportunistic behaviour and encouraged informal relations which are considered more effective for acquiring external knowledge (Nahapiet and Ghoshal, 1998). A tie based on high levels of reciprocal trust reinforces the process of knowledge exploitation (Presutti et al., 2011; Agrawal et al., 2008)

In the crowdfunding context, the importance of social proximity has been investigated in relation to predicting successful crowdfunding fundraising (Agrawal et al., 2015). Friends and family ties represent an important share of the financial support from crowdfunding (Mollick, 2014). This strand of work acknowledges the relevance of social ties and trust among proponents and fundraisers, over the geographical proximity among the parties. This result is important since it shows that social ties are more significant than distance for explaining the decision to invest in a project.

In the case of involvement of crowd investors in the post-funding phase, lack of trust is often a major deterrent to effective external engagement in crowdfunding. Faced with the impossibility of choosing among and controlling who is included in the crowd, the entrepreneurs may find it difficult to identify genuine interest in investing in the company versus potential competitors seeking access to sensitive company information. Revealing company information related to products, growth strategy, partnerships, fundraising, etc., to large numbers of unknown people can be problematic. Because crowdfunding reaches a very broad audience through the web, it lacks the trust involved in traditional fundraising through private transactions with professional investors. Therefore, entrepreneurs are likely to be more willing to engage with crowd investors if they establish a personal relationship with them and can organize face to face meetings to allow the entrepreneur to assess the investors' interest in the company. Therefore, we posit:

Proposition 3: Social proximity between crowd investors and entrepreneurs will encourage exploitation of crowd investors' knowledge.

Figure 1 depicts the conceptual model of different forms of proximity and their influence on exploiting crowd investors as external knowledge sources.

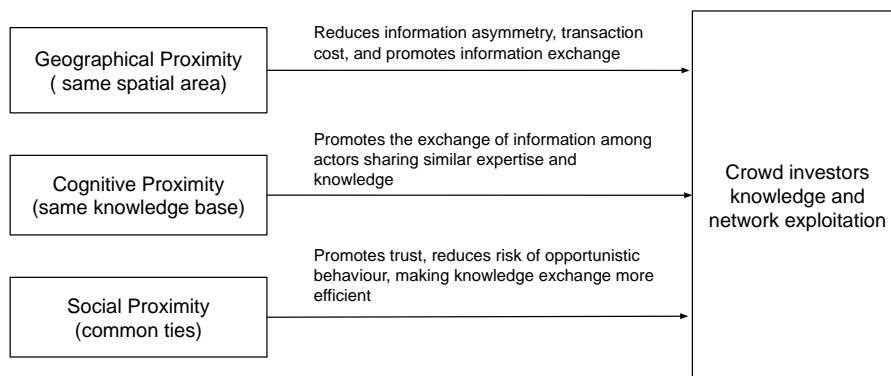


Figure 1: The influence of different forms of proximity on crowd investors' knowledge exploitation

3. Discussion

In a globalizing world where new technologies promote and facilitate mobility of resources (Aizenman and Kendall, 2012; Agrawal et al., 2015; Lin and Viswanathan, 2016), we would argue that distance-related economic frictions remain a strong barrier to resources and knowledge exchanges (Li et al., 2014; Dai et al., 2012; Lin and Viswanathan, 2016; Siegel et al., 2012; Hornuf and Schmitt, 2016; Liu and Maula, 2016), for both economic (e.g. information asymmetries and transactions costs) and, behavioural reasons (including familiarity bias and trust in local opportunities) (Huberman, 2001; Lai and Teo, 2008). However, other form of proximity, such as social and cognitive proximity, may moderate the negative impact of geographical distance and favour exchanges of resources and knowledge.

Social relationships tend to exist not just in physical space but also in social space (Sorenson, 2018). Thus, people tend to have relationships with similar others —similar religion, culture, education level, and with experience in the same types of firms and industries (Miller et al., 2001). Therefore, leveraging social ties facilitates the creation of networks, enhances trust, and increase the chances of cooperation (Lim and Putnam, 2010) between crowd investors and the entrepreneur.

Also, very important for establishing relationships with external stakeholders, such as crowd investors, is a common knowledge base. Crowd investors offer a range of expertise and knowledge which the entrepreneur can tap into. It is important, therefore, for the entrepreneur to investigate investors' profiles to identify what they can bring to the company and how their expertise can be leveraged to support firm development.

4. Conclusion

Understanding how new ventures exploit external knowledge to moderate the liability of newness is an important focus in the study of entrepreneurship (Rosenbush et al., 2013). Our model contributes to this field and to the crowdfunding literature by proposing a theoretical framework that may explain the challenges of exploiting crowd investors, as they represent a critical source of information and knowledge for entrepreneurs (Di Pietro et al., 2018).

Specifically, we consider the role of geographical proximity along with other nontangible dimensions of proximity – social proximity and cognitive proximity – that may act as a substitute for geographical proximity (Boshma, 2005; Boshma & Lambooy, 1999).

We argued that crowdfunders, if involved, could give valuable contributions such as knowledge, skills, and network, to entrepreneurs (Di Pietro et al., 2018). Proximity, in all aspects considered here, can definitely play a crucial role, by positively influencing the involvement of the crowd.

Our model contributes to the entrepreneurial finance and the crowdfunding literature by proposing that the impact of proximity on crowd funders' involvement is crucial in understanding how new ventures might benefit from external knowledge.

Several opportunities for empirical research are related to the model. Many of the constructs have already been operationalized in prior research, in particular geographical, social, and cognitive proximity and new venture performance. Although the concept of "involvement" has been measured by some studies in the crowdfunding literature (Di Pietro et al. 2018), testing out its dimensions in a new empirical context and for new ventures represents a challenge for future research. Future empirical research could look deeper into this direct effect by understanding the post-crowdfunding phase, the role of investors as a source of knowledge and information, and under which conditions their contribution can be crucial for young and innovative start-ups.

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