

# **Fund what you trust? Social capital and moral hazard in crowdfunding**

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# Crowdfunding: Kickstarter

## Pebble smartwatch

- Raised \$10.3 million
  - \$115 price
  - April 2012-May 2012
  - 68,929 funders
- YC company originally
  - \$375,000 VC-back but couldn't raise more
- Company closed in 2016



# Kickstarter: Infamous frauds



WHAT IS THE *SIGNAL PROOF* HEADWEAR?



f Share



# Kickstarter: Typical project

After The World Forgets - A documentary

100 Days of Childhood Memories: The Book



I drew and wrote one childhood memory a day for 100 days about my memories of growing up in Singapore. Now here it is as a book!

[Follow along!](#)

Created by

Ailian Gan

**111 backers** pledged \$4,760 to help bring this project to life.

# This paper: Bigly selling points

## Kickstarter data

- Near comprehensive sample of Kickstarter data (86%)
- Analyze 200,000+ campaigns

## Measure of social capital

- County-year
- Most comprehensive and consistent measure improves on Rupasingha et al (2006)

# Social trust measure

## Author's measure

Figure A.1: Social capital index by county in 2014

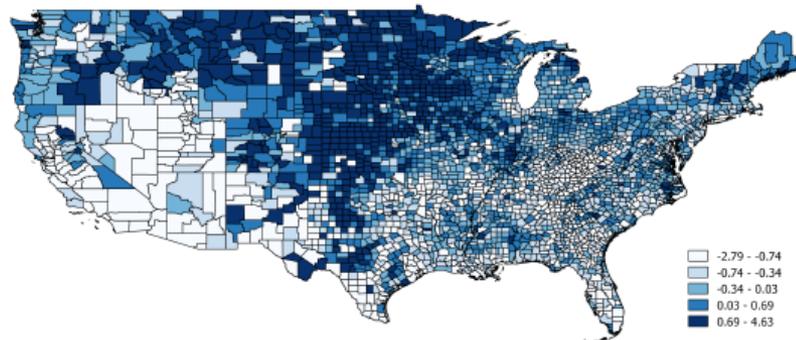
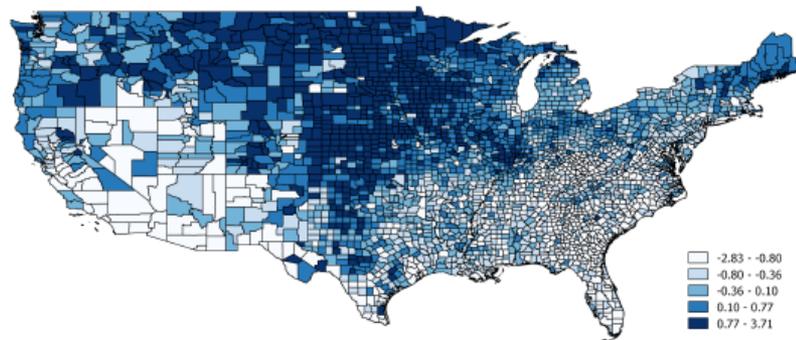
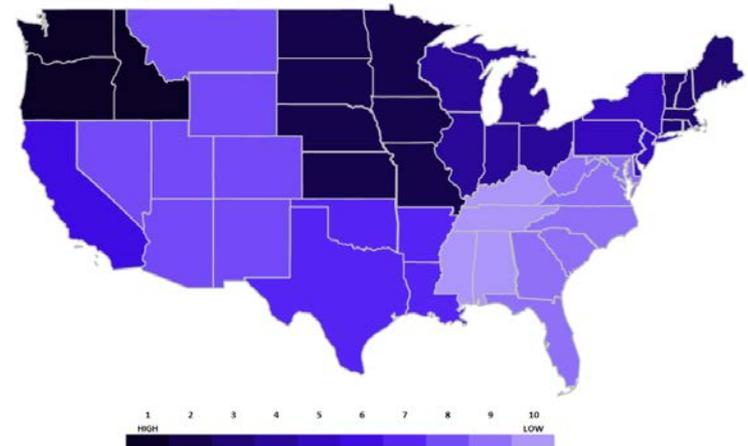


Figure A.2: Social capital index by county in 1995



## World Values Survey

Trust across United States: 2000



# Hypothesis

Social capital mitigates moral hazard by generating trustworthy behavior

*“Social capital enhances trust partly because **social networks** in high-social-capital communities provide better opportunities to **punish those** who do not abide by the norms of the community” (pg 7)*

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Social capital mitigates moral hazard by generating trustworthy behavior

*“Social capital...imposing and strengthening **moral attitudes by education**” (pg 7)*

# Empirical test

## Outcomes:

- Funding successful (yes/no)
- Pledge \$/Goal \$
- Kickstarter suspension

## Social capital (SK):

- Measured at the **campaign founder county**

## Panel with fixed effects:

- Year-month, state, county

# Results

## Social capital is very statistically important

- Highly significant effect & very robust
- Survives controls for local income, campaign characteristics, founder characteristics, **etc.**

## Effects are concentrated among

- High information asymmetry campaigns: Non-staff picks, small campaigns, small cities, etc.
- After stricter policy rules, effects much smaller as expected

# Impressions

## Well written and persuasive

- Very interesting setting
- Very convinced of the results
- Very plausible story

My comments are about exposition, but full disclosure - I likely have confirmation bias

Trust and Certification in Financial Markets: Evidence from Reactions to Earnings News

44 Pages • Posted: 12 Nov 2014 • Last revised: 4 Mar 2018

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# 1. Local economic conditions

Trust might capture time-varying economic conditions (beyond local income).

- County fixed-effects capture stationary local attributes (identification occurs off the time-series)

## Suggestions:

- **Association density (available from 1986):** We use the annual County Business Patterns data collected by the Census Bureau to calculate the number of associations in each county, divided by population, including ten different association types:

- Civic and social organizations
- Bowling centers
- Golf courses and country clubs
- Fitness and recreational sports centers
- Sports teams and clubs
- Religious organizations
- Political organizations

- Labor unions and similar labor organizations
- Business associations
- Professional organizations

Keep these social measures

Drop these economic measures

# 1. Local economic conditions

## Additional suggestions:

- Use trust measure at the beginning of the sample (tradeoffs to this approach)
- Additional local economic measures at state level (noisy, but a proxy)
- Stock returns of local companies

## 2. Sharper test of moral hazard?



Funding is an indirect proxy for moral hazard. Is there a way to do more?

### **Suggestion:**

Any measure of product shortfall (shirking), investor feedback, or fraud?

# 3. Inventor or investor trust?

Conceptually, both should matter

- Wei and Zhang (2017) show that low trust investor are less likely to hold distant stocks (greater local bias).

## Suggestions:

- Add a discussion
- Frame smaller projects/locally-based projects
- Theory should predict (I think) more investors of funded campaigns all else equal.

## 4. Validity

Karoyli (2015) & Zingales (2015) prescribe using multiple measures and samples

### Suggestions:

- International sample with World Values Survey (WVS)
- Repeat U.S. analysis with WVS or General Society Survey (GSS)

# Final thoughts

## Great setting and great data

- Lots of interesting empirical & theoretical ideas

## Trust should really have bite here

- Setting with incomplete contracts
- Trust should fill this gap