Small beer? Borrowers' perspectives of alternative finance in the craft beer sector.

Ciáran Mac an Bhaird (Dublin City University)
Robyn Owen (Middlesex University)
Sarah Drakopoulou Dodd, Juliette Wilson (University of Strathclyde)
Angelo Bisignano (Nottingham Trent University)

Abstract

The recent surge in use of alternative sources of entrepreneurial finance is viewed as transformative, providing entrepreneurs with an increased variety of resourcing options. Through exploring cognitive heuristics of entrepreneurs' financing decisions, this study examines provision of disintermediated debt through online platforms. Heretofore unexamined demand side issues reveal valuable processual advantages for entrepreneurs, along with ancillary non-financial benefits. Our study reveals the multifaceted nature of the financing decision, and how alternative finance is compatible with long standing entrepreneurial preferences for control and managerial independence. Peer to peer lending overcomes a number of issues relating to agency, networks, and spatial aspects of financing. Contrary to previous research, we find that marketing and promotion, rather than raising finance, are of greater importance. Entrepreneurs' preferences for locally provided equity finance have implications for investors and platforms, and disintermediation of finance presents challenges to traditional funders. The surge in use of alternative finance varies by and within sectors, although it is important not to overstate its revolutionizing potential. Rather, it provides entrepreneurs with an expanded variety of financing options, and complements rather than replaces traditional sources. It is likely more beneficial in countries lacking diversification in private debt and equity markets.

Keywords: Crowdfunding; peer-to-peer lending; private equity; Startups; Craft brewing.

Introduction.

The significant increase in provision and use of alternative sources of finance, particularly crowdfunding, has been variously hailed as 'transforming' entrepreneurial finance, as 'democratising finance', and as 'unleashing great economic potential' (Vasileiadou et al., 2015). It is potentially revolutionary for young firms and startups at a disadvantage in securing investment in the early stages of business (Harrison, 2013). The concept of crowdfunding is not novel (Everett, 2014). Celebrated examples of early use include the financing of the Statue of Liberty in New York, and the funding of concerts and music publications by Mozart and Beethoven (Hemer, 2011). Use of crowdfunding has recently increased very rapidly (Moenninghoff & Wieandt, 2013), from a reported $880 million in 2010 to an estimated $34 billion in 2015 (Barnett, 2015), raising the question of whether this represents a transformational change in entrepreneurial finance or whether it is a passing fad (Harrison, 2013). The rapid increase in investment activity through crowdfunding has been expedited by the expansion of the internet and the use of online platforms. This presents increased financing options for small firms, which are important in ameliorating the adverse effects of pro-cyclical lending observed in private debt markets.

Academic studies have lagged the large increase in the number of sources, types and volume of alternative finance. Study of the phenomenon has concentrated largely on dynamics of success and failure (Mollick, 2014), geographical analysis (Agrawal, Catalini, & Goldfarb, 2011; Kim & Hann, 2013), contractual mechanisms (Hornuf & Schwienbacher, 2014b), historical aspects (Everett, 2014), default risk (Everett, 2015), the role of platforms (Belleflamme & Lambert, 2014), transformation of the business angel market (Hornuf & Schwienbacher, 2014a), disintermediation (Rubinton, 2011) and theoretical aspects (Belleflamme, Lambert, & Schwienbacher, 2014). The vast majority of studies have concentrated on investors and intermediaries (Moritz & Block, 2014), with surprisingly few studies related to capital seekers or 'creators'. This is a significant deficit in the literature, as the potential for the use of a resource is largely dependent on the response and intentions of potential consumers or users. It is somewhat surprising that these issues are ignored. Whilst motivations of investors are important, from a sustainability, public policy and markets perspective, the experiences and views of those using crowdfunding are paramount. A number of studies have identified this gap in the literature, including Moritz & Block (2014) and Bruton, Khavul, Siegel, & Wright, (2015). Questions identified by the latter encompass a broad range of issues including substitution and complementarity effects, cognitive aspects and social networking.

Our study addresses this research agenda by investigating the experiences, motivations and intentions of entrepreneurs who have sought finance through crowdfunding campaigns. We do not examine crowdfunding in isolation, rather we investigate the use of alternative finance in relation to resourcing and resource requirements, based on long standing theoretical propositions in entrepreneurial finance. We interview the principals in firms in the craft brewing sector that have recently raised finance. This methodology is important as it facilitates investigation of a number of issues not commonly addressed in financing the small firm sector. The craft brewing sector was selected as it has many features that make it attractive to potential crowdfunding investors. It is a young, growing, creative sector, with a high number of independent firms seeking to expand into a market dominated by large corporates, with many characteristics of startup firms at a disadvantage when raising finance. Financial innovation has been a feature of the craft brewing sector, and the 'equity for punks' fundraising model of Scottish brewer Brewdog has garnered a lot of attention, as well as raising large sums of equity capital, including $2.5 million in a recent USA expansion.

We pose a number of specific research questions as follows. Do entrepreneurs employ alternative sources in response to a financing 'gap'? What are the complementary and substitution effects of alternative finance? What are the cognitive heuristics of those who seek alternative finance? How do entrepreneurs manage relationships with multiple lenders and investors? Does alternative finance provide benefits in terms of cost and ease of access? Are there non-financial considerations in raising alternative finance? Are there implications for the organizational forms of those seeking alternative finance? What are entrepreneurs' future financing intentions in meeting their investment requirements?

Our findings provide new insights into widely held beliefs about crowdfunding (Agrawal, 2014). Craft brewers seek finance from crowdfunding sources because of an investment requirement, rather than being discouraged from applying elsewhere or as a result of a 'financing gap'. Crowdfunding is viewed as complementary, and is used in conjunction with debt, equity and grant funding. Brewers use crowdfunding to raise awareness of their product, projecting a ‘positive story’, and aiming to engender a feeling of ‘ownership’ in their enterprise. Interviewees are positively disposed towards raising finance through crowdfunding in future, although as they become more established and accumulate a track record, reputation effects mean that they can access cheaper finance from other sources. Craft brewers see potential in using crowdfunding sources to finance ‘special projects’, but prefer to seek larger investment requirements from traditional sources. Future prospects for the revolutionary potential of crowdfunding are difficult to gauge given our limited sample, although it appears that crowdfunding is viewed as a ‘heterodox’ source of finance and is unlikely to displace traditional sources of debt and equity.

The rest of our paper is structured as follows. The following section provides a brief summary of the primary theoretical debates on small firm financing, along with a synopsis of the crowdfunding literature and how alternative sources of finance might overcome some of the challenges in private debt and equity markets. We provide a description of our methodology, along with an explanation of how our sample was selected. This is followed with a description and analysis of our findings, along with how our results differ from stylized facts about crowdfunding, suggestions for future research and policy considerations.

Previous related literature.

Alternative sources of finance are viewed as ‘evolutionary’ (Bruton et al, 2014) and ‘changing the face of entrepreneurial finance’. It is thus pertinent to briefly revisit some long standing tenets and theories of small firm financing, focusing particularly on information asymmetries, agency, signaling, firm owners’ choice, supply constrictions, and firm life cycle. What are the effect of these issues on the use of new alternative sources of finance, and to what extent do they ameliorate entrepreneurs’ difficulties in accessing finance?

Academic studies consistently identify opacity as the greatest impediment for external investment in small firms. As detailed financing information on small firms is not publicly available or easily accessible, investors are unable to accurately assess the viability or potential of investments. This information is costly to collect, and therefore financiers seek to mitigate potential losses by seeking a significant ownership stake and/or collateral. Provision of collateral ameliorates risk for investors, along with signaling project quality by entrepreneurs. Not all firms have access to collateral, however, and thus cannot access debt finance. Firms may raise external equity from new investors, although this source is typically only available to firms with a particular profile. Hence, a number of firms are resource constrained and cannot invest in positive net present value projects.

Information asymmetries are the basis for the two most prominent theories of small firm financing, pecking order theory (Myers & Majluf, 1984; Myers, 1984) and agency theory (Jensen & Meckling, 1976). The pecking order theory is based on the premise that internal management is better informed than outside investors, and that internal management act in the interests of existing shareholders. This information opacity results in varying costs for additional external finance. Thus, firm owners will finance projects with internal equity in the first instance, followed by external debt, only resorting to external equity from new investors when other sources are exhausted. This view of information asymmetries is most appropriate for established firms (Garmaise, 2001).

Another explanatory factor for adherence to the pecking order theory for small firms is the desire to retain management independence and control of the enterprise. Thus firm owners employ sources of finance with the least amount of external intrusion, sourcing capital from a pecking order of, first their own money (personal capital and retained earnings), secondly short term debt, followed by long term debt, and last of all from new external equity investors. Adherence to a pecking order by small firms is well documented in the literature (e.g. Mac an Bhaird & Lucey, 2010), with some firms adhering to a constrained pecking order, where external equity from new investors is not even considered.

Another approach based on information asymmetries is the signalling model proposed by Ross (1977). Developed in the field of corporate finance, it postulates that managers convey inside information to investors through the proportion of debt in the capital structure. Successful firms with greater revenue streams can support higher leverage than those with lower revenue streams, and the market believes that only the manager knows the true distribution of the firm’s returns. Signaling is also important from a small firm perspective, although it is construed differently (i.e. high levels of debt are viewed negatively in the small firm context). Rather, small firm owners convey positive signals through the amount of personal resources invested in a venture. Having ‘skin in the game’ is positively viewed by investors, notwithstanding the tendency for overconfidence in entrepreneurs.

A further positive signaling mechanism for entrepreneurs is provision of assets as collateral, although this is more a requirement by lenders to ameliorate potential agency problems rather than signaling. Agency problems occur when the agent (entrepreneur) has an incentive to engage in high risk activities at the expense of funders (Barnea et al., 1981). Agency costs are more significant when businesses are small (Hand et al., 1982) because of greater information asymmetries. The vast majority of small firm loans are collateralized, with some financial institutions also seeking personal guarantees from firm owners. Enterprises with intangible assets are at a distinct disadvantage in securing intermediated debt, in which cases firm owners may provide personal assets as collateral.

External resource requirement is commonly determined by the stage of firm development. By their nature, startups have greater resourcing constraints than older firms. Established firms typically finance investment from retained earnings, and are able to access debt finance because of a credit history and relationship effects. Startups, on the other hand, have a greater reliance on the resources of the firm founder and her associated networks, including friends and family. Startups therefore typically have a greater variation in the sources of finance employed. Notwithstanding the problems faced by new and young firms, firm owners are particularly resourceful in gathering resources to finance their fledgling operations. Firm owners respond to these challenges by adopting bootstrapping techniques (Laveren et al., 2010), which are more intensely used in new enterprises (Jones and Jayawarna 2010) and by nascent entrepreneurs (Grichnik et al. 2014).

Other significant factors in firm financing include the variety in sources of finance available, and temporal changes in supply. Private debt and equity markets are particularly concentrated in some countries. For example, in the United Kingdom four large banks supply 85% of total loan finance to SMEs; in Ireland three banks supply 95% of all new loans (Central Bank of Ireland, 2016). As bank lending accounts for over 92% of external finance accessed by SMEs, the concentration of provision in a few institutions means that small firms are vulnerable to pro-cyclical fluctuations in finance provision. As periods of credit constraint commonly coincide with downturns in the real economy, small firms are particularly disadvantaged in accessing finance when most needed. In markets with few financing alternatives, small firms may experience a credit crunch or a financing gap (Mac an Bhaird, 2013). Problems in accessing adequate investment finance are more acutely experienced by firms with a particular profile, and traditionally new firms and firms with a large proportion of intangible assets are more disadvantaged.

Provision of alternative sources of finance is thus viewed as a positive development for small firms, both in terms of reducing inherent frailties in the financial ecosystem and increasing diversity in supply. Although alternative sources of finance are not suitable for all firms or sectors, they are particularly valuable to small start-up firms in particular sectors (e.g. entertainment and the arts)(Mollick, 2014). Our focus is crowdfunding, which entails collecting finance for investment, typically by issuing a call across the internet to a large group of potential investors. Seeking assistance from a large group of individuals through the online community is neither novel or confined to finance (Bayus, 2013; Belleflamme et al., 2014), although its prominence has greatly increased with the expansion in crowdfunding. A brief summary of crowdfunding mechanisms is provided in table 1. The vast majority of crowdfunding is intermediated, conducted across platforms such as *Crowdrise, Kickstarter, Rockethub, Indiegogo*, with lesser amounts of funding being raised through individual crowdfunding projects. Most crowdfunding initiatives provide a monetary or non-monetary reward for investors, including equity based (investors receive a share of the profits), reward based (investors receive nonfinancial benefits), pre-ordering (investors receive a product or service at a reduced price), or lending (investors receive interest and principal repayments). Donation based crowdfunding is less common, accounting for less than 10% of individual projects, for example, and is commonly used to fund philanthropic projects or 'good causes' (Belleflamme, Lambert, & Schwienbacher, 2013). These projects are predominantly based in the charitable and non-profit sectors (Harrison, 2013). The model of crowdfunding selected is largely determined by the requirements and outlook of the entrepreneur. The principal motivation of entrepreneurs is to raise finance for their projects (Belleflamme, Lambert, & Schwienbacher, 2013; Gerber, Hui, & Kuo, 2012), although crowdfunding is also used to increase customer awareness (Gerber & Hui, 2013), seek customer validation, gauge the price customers are willing to pay (Belleflamme, Lambert, & Schwienbacher, 2010), disseminate information, and create a community based network of investors, consumers and employees (Hemer, 2011).

Table 1. Sources of alternative finance

Source	Business model	Examples
Equity or investment based crowdfunding	A firm issues equity to a large number of investors through an online platform.	Crowdcube, Seedrs
Rewards based crowdfunding	A firm raises many donations from a number of individuals, typically over the internet, in exchange for goods or services.	Kickstarter
Donation based crowdfunding	A number of individuals contribute donations to meet the funding aim of a particular cause or charitable project.	GlobalGiving
Invoice trading crowdfunding	A firm sells receivables or invoices to a number of investors through an online platform.	Marketinvoice, Platform Black
Loan based corwdfunding	A firm raises finance from a number of people in the form of a loan agreement through an online platform.	Funding Tree, LinkedFinance.
Microfinance	An array of financial services, including loans, provided to firms and individuals, who typically do not have access to other forms of finance because they cannot access collateral.	Credit Unions, Prince's Trust

Firms seeking finance through crowdfunding are concentrated in sectors such as film and video, music, publishing, art, games, food, fashion, comics and photography (Kickstarter, 2016). Campaigns commonly feature products or services in the early stages of development, or novel inventions. The craft beer sector is particularly suited to this medium of financing. Products are non-mainstream, have an experimental, innovative element, are typically rooted in local tradition or culture, and provide an excellent 'story' which can be related through online media and social networks. It is therefore unsurprising that craft beer funding proposals feature on established platforms such as Kickstarter and Indiegogo, and there are even platforms specifically dedicated to craft brewing, such as CrowdBrewed and Craftfund. Success rates of craft brewers in raising funding through crowdfunding platforms are similar to other sectors. For example, of 71 craft brewery campaigns launched on Kickstarter by December 2012, 41% (29) were successful.

Gerber et al. (2012) identify a number of steps undertaken by entrepreneurs in launching a crowdfunding campaign. After preparing and testing publicity material, entrepreneurs publicise their project through an online campaign. Publicity is generated through the platform itself, and through social media. Platforms typically deliver funding with two models, 'all or nothing' or 'all and more'. The former requires funds pledged to be returned to investors if the target is not achieved, and the latter provides the entrepreneur with all funds raised, regardless of whether the target is achieved. All platforms retain fees, including a percentage of the funds raised and processing fee.

Crowdfunding involves the transfer of funds from investors to firms in a similar process to banking functions of deposit taking and loan issuance. The significant difference is that crowdfunding platforms do not perform the same intermediation roles of banks with respect to duration, liquidity, risk management and monitoring (Moenninghoff & Wieandt, 2013). Disintermediation provides platforms with a number of advantages over traditional providers, including lower operating and transaction costs. In addition, platforms do not have regulatory requirements such as minimum capital reserves. Risks are therefore transferred to investors, as the 'democratisation of finance' also leads to greater assumption of risk.

The disintermediation performed by crowdfunding platforms ameliorates some of the problems faced by small firms seeking finance. There is no requirement for collateral, which is typically sought by traditional funders. Nor are entrepreneurs required to provide positive signals to potential investors in the form of personal funds invested or collateral offered. Although project promoters provide publicity material, this is not a signalling mechanism as to the probability of success of the project. A track record or reputation is not required, as entrepreneurs typically seek finance for specific standalone projects. These advantages are most beneficial to young startup firms, and enterprises with intangible assets. These benefits are typically offset by a higher cost of finance, particularly when the platform fees are included.

One of the most high profile innovations in alternative finance is the ‘equity funding for punks’ campaign conducted by the Scottish craft brewer Brewdog (Smith et al, 2010). Their groundbreaking fundraising campaign offered investors the opportunity to purchase shares in the business, in exchange for various ‘rewards’ such as discount in their bars and online shops, an invite to their AGM, along with B shares. Liquidity is a concern for investors, as they have limited opportunity to sell shares, and 75% of the enterprise is in the ownership of the founders, friends and family. Notwithstanding these restrictions, Brewdog raised £13 million from 40,000 investors by the end of 2015, and are seeking $25 million at present to fund their expansion into the USA. This model of equity crowdfunding has many advantages for the brewers, particularly attracting new consumers and investors. In addition, the project proposers did not have to fulfil the rigorous requirements of a private equity placement or Initial Public Offering.

Innovations in the provision of finance for the brewing industry are not a new or novel occurrence. For example, between 1880 and 1913, the number of breweries listed on the stock market went from 12 to 308 (Acheson, Coyle, & Turner, 2015). This significant increase in the amount of capital invested in breweries eventually resulted in large losses for investors, although it had long term effects on the brewing sector and capital markets in the UK (ibid). It remains to be seen whether the successful equity crowdfunding campaigns of Brewdog can be emulated by other craft brewers.

Methodology.

We adopted a qualitative methodology for this study, and whilst not novel, it is not commonly adopted by academic researchers in the field of entrepreneurial finance (e.g. Molly, Laveren, & Jorissen, 2012). This methodology is particularly suited to our research questions, which are not readily examinable using publicly available databases or through questionnaire instruments, a departure from most crowdfunding studies to date, which utilize data from online platforms (e.g. Ahlers et al., 2015; Everett, 2015; Hornuf & Schwienbacher, 2014b). Crowdfunding is an opaque means of financing, and a large number of pertinent issues are not evident from secondary data, such as the level of overall investment required, whether the entrepreneur or her network contributed to the fund, whether the campaign was a response to a rejected loan application, and other related factors. Semi structured interviews facilitate an in-depth analysis of these issues, and provide a nuanced description of entrepreneurs' experiences and intentions, all critical matters in appraising the future potential of disintermediated investment finance.

Eight interviewees, which represents one-eighth of the total population of craft brewers in the Republic of Ireland (Feeney, 2016), were purposively selected for our study. A survey of secondary sources helped identify craft brewers who had either raised finance through crowdfunding, or were considering it as an option. This was facilitated by the high media profile of the craft brewing sector, the novelty of crowdfunding, and the prominence of both across electronic media. Because of the limited size of our sample, we selected a further two interviewees from the UK. These firms have a similar profile to our Irish sample, and provide additional insights, albeit in a different jurisdiction. A detailed profile of interviewees is provided in table 2.

Findings.

How craft brewers are financed at present: The capital structure, financing preferences and choices of craft brewers are comparable with those of firms with similar profiles, as detailed in previous studies (e.g. Mac an Bhaird & Lucey, 2010, 2011). Financing of craft brewing enterprises follows a life cycle pattern, with brewers at startup relying primarily on personal finance, equity from friends and family, and grant funding. All brewers interviewed managed to raise adequate finance to commence operations, although one noted that "…whilst we raised adequate finance to establish the business, we didn't have near enough working capital…". Craft brewers have a preference for internal equity, and/or equity from external investors with minimum intrusion. This is supplemented with small amounts of debt finance, and extensive use of bootstrapping methods. When external funding is required, interviewees note that collateral and signaling effects are important at the outset. One brewer related that an application for a bank loan of €40,000 at startup was successful, partly because the founders had invested €75,000 of their own funds in the enterprise. They emphasised that signaling was important, even though the bank had a lien on the underlying asset, along with personal guarantees from the founders.

Table 2. Summary data of craft brewers.

Brewer	Age (years)	Employees	Preference	Requirement	Attitude to crowdfunding
A	2	3	Equity from local investors Linked Finance (peer-to-peer loans). No intervention from investors.	€20,000 for equipment – seeking equity.	See rewards based crowdfunding as 'gimmicky'. "You have to get your offering right".
B	<3	75	Equity from investors through EIIS Scheme. 'Horses for courses': debt when appropriate.	Approx €4m – seeking equity.	They did not realise they could not use beer as a 'reward', and subsequently didn't put much energy into the campaign. Campaign failed. Reluctant to use crowdfunding again.
C	6	8/9	Internal equity	Investment needs are met by internal equity at present	Complements existing funding; thought the process was 'risk free'. Open to using again, but using bank finance at the moment because 'the interest rate is lower'.
D	1.5 years	3	Equity from external (close) investors, although aiming to keep control of the business.	"We have a continuing requirement, a preference for equity as we don't have much experience in dealing with the banks".	Raised €20,000, 292% of requirement at 6.5%. To share story and attract investors who are 'invested in our growth'; "Crowdfunding helped us to source 'brand ambassadors"; Sought advice from fellow brewers who successfully raised crowdfunding. Sceptical about rewards based crowdfunding
E	3	7 ft, 4 pt			Raised €20,000 for equipment, 234 bids at 6.1% avg. €35,000, 345 bids at avg. 6.19%.
F	4	10	Internal equity and bank funding; don't want external equity because control important; crowdfunding for special projects	€400,000 - €500,000, will seek from bank.	Excellent for special projects: used loan crowdfunding to raise €40,000 to import brewing equipment from Mauritius; raised publicity; gives investors a sense of ownership of business;
G	2.5	3	Keen to have a broad range of financing options, not averse to external equity.	Has a mix of angel finance, crowdfunding, bank (lease) finance,	Raised €15,000 through loan crowdfunding; sceptical about rewards based crowdfunding as "I saw other brewers try it and it bombed".
H	3	3	Equity from close external investors, keen to retain control.		Raised €5,000 through rewards based crowdfunding; positive experience
I	1	1 (+1pt unpaid)	Mix of equity, HNW low cost loans (3%) and reward CF. Discouraged from banks.	Second stage: development of green energy and distillery to come.	Very happy to use reward crowdfunding. Raised £21,000 through Crowdfunder reward CF platform in 63 days with a little push from own investment of £2,500. After fees and non payments received £17,000. Good experience and best way to raise funds given lack of bank finance and lack of knowledge of equity.
J	6	1	Purely self funded, did not want or need to borrow	Start-up costs: refurb old garage site, buy equipment.	Would certainly consider CF if looking at expansion or new company set-up. Would self fund then look to find best loan or reward options. Not likely to select equity.

Bootstrapping is prevalent in the early stages, and most brewers adopt 'classic' techniques such as not taking salaries, taking extended credit from suppliers, debt factoring, buying second hand equipment, borrowing equipment and free rental of premises. A number of interviewees received Leader grant funding, amounting to €90,000. In some cases this represented almost a third of all funds raised. Another was refused grant funding at the outset, as the local development office perceived the project 'too risky', although he received a grant at a later stage when the awarding body deemed him to have 'proven the craft beer concept would work'. As they become established and grow, craft brewers increasingly use internal equity and can access greater amounts of intermediated debt finance at 'reasonable' interest rates, which were typically between 4% and 5%.

Attitude to intermediated debt finance: Craft brewers have a preference for internal equity, and whilst they do not have an aversion to banks, most were of the opinion that the process of applying for credit was too onerous and time consuming, stating that decisions on loan applications "….simply took too long…". Along with protracted application processes, interviewees remarked on the repetitive nature inherent in intermediated debt processes "….even though we had just made a [loan] application, we were forced to go through the process all over again….". By contrast, their experience in raising finance through crowdfunding was much more straightforward, and did not involve "…large amounts of paperwork…". Interviewees remarked that whilst the owners of platforms performed due diligence, it was rather light and did not place onerous administrative burdens on the firm. A requirement to publish firm accounts on the platform website that were accessible to investors was not deemed too intrusive, as "…this information is available through the Companies Registration Office in any case…".

A number of craft brewers related difficulties in raising debt finance, with one stating that "…banks are totally risk averse. Even when loans are 100% collateralized and backed by personal guarantees, they still refused us credit….". In all but this case, however, the decision to seek crowdfunding was not a result of an inability to raise intermediated debt. Notwithstanding a reluctance to spend time completing paperwork and waiting for a loan decision, interviewees are not negatively disposed to banks[1]. Brewers utilize various types of intermediated credit including

[1] A notable exception was an interviewee who noted that "…the bank just wanted to sell us insurance and other products, they were uninterested in our loan application…".

overdrafts, term loans, stocking loans to purchase raw materials, and mortgages to purchase a premises (one case). In all cases loans are secured on the underlying asset, and in all cases banks also require personal guarantees to protect against moral hazard. This effectively renders limited liability redundant, although brewers accept they must acquiesce in order to secure bank credit "…banks are not supportive of the industry ……..our bank said to us we don't have experience lending to craft breweries, you are too high a risk …. Even though we have highly saleable tangible assets…."

Interviewees related that the cost of bank finance was considerably lower than funds sourced through crowdfunding. Securing term loans at rates less than 5% from the banks was preferable to crowdfunding, which typically yielded 7%-8% for investors. (Overdrafts and other credit facilities such as bridging loans and invoice discounting were considerably more expensive). Typically, interviewees related whilst crowdfunding campaigns were successful, they intended to revert to bank finance for subsequent investment requirements as it cost less….".…we are going back to the bank for the next expansion phase…I mean the crowdfunding was a great thing to do and it was for a specific project, and there was a great story behind that, but I don't know whether we'd rush back to do it again and again and again, it is a higher cost for sure, but at the same time we don't regret doing it…If the bank are happy to put up the funds at pretty low interest rates, then we'll go with that, particularly if you're looking at the realm of €400k - €500k….when you're looking at hundreds of thousands of euro, then the conventional avenues of finance are more applicable….". In a number of cases, when the brewer's commercial bank discovered that they were raising funds through a crowdfunding campaign, they offered to provide intermediated debt. The brewers declined, as the promotional advantages of the crowdfunding campaigns were of first order importance.

<u>Benefits in raising finance through crowdfunding:</u> All interviewees had successfully raised loan based crowdfunding, and most were oversubscribed. One that had failed raised only €2,500 of a €100,000 requirement. Craft brewers do not seek to raise crowdfunding at startup, but at a later stage when the brewery is established. Consistent with evidence from secondary sources (Crowdbrewed, Kickstarter), those seeking lower amounts reach their target, whilst the higher requirement was not met. The amounts required through crowdfunding were much smaller than that already raised from other sources. Funds raised through crowdfunding were viewed as

complementary to other sources, and entrepreneurs were not overly concerned if the crowdfunding campaign failed.

All interviewees related that the principal reason for crowdfunding was for promotional and marketing benefits. This is contrary to most previous studies which cite 'raising investment finance' as the primary motive (e.g. (Belleflamme & Lambert, 2014). They sought to raise awareness of their products among the public, primarily through the platforms and social media outlets featuring their campaigns. Some also featured in mainstream media and in the business press focusing on their crowdfunding campaigns "…we see crowdfunding as a marketing exercise…. It's a form of awareness…. Not just among potential consumers, but also the general public… ". The value of this publicity and advertising cannot be overstated, especially as the startups interviewed had no marketing budget. Interviewees stated that they perceived the sector as having an excellent 'fit' for the advertising medium of crowdfunding, as craft brewing provided interesting and appealing narratives for potential investors. Craft brewers related that they selected specific projects or purposes that they perceived to "…tell a good story to investors…". For example, one craft brewer raised funding to pay for the freight of importing a (second hand) brewery from Mauritius "…it was a good news story, and we wanted to shout about it………..how many people would fly to Mauritius on a whim to buy a brewery?….". Interviewees believed that such narratives, in turn, formed the basis for successful fundraising. Craft brewers perceived the marketing benefits of crowdfunding as being universally positive. Entrepreneurs did not perceive negative effects in the event that they did not attract the amount of investment required, with one viewing crowdfunding as 'riskless', if the campaign failed they were not unduly affected.

Interviewees stated that they wanted to engender a sense of ownership in investors, rather than simply attracting new customers "…I want investors to think that they have a stake in the company……there's 300 or 400 people who now feel that they have a certain of ownership in the company. Because they have invested in the business, they would buy a beer and invite their friends to buy a beer….". Craft brewers were thus keen that investors make a direct link between the success of their investment, and the success of the brewery. They wanted this sense of ownership to transcend specific projects, and perceived relationships built up through crowdfunding as long lasting, being the source of continuing patronage and additional investment. "…one of our first [crowdfunding] investors just bought four barrels [in a subsequent 'rewards' based campaign]…". Craft brewers used rewards based crowdfunding in an attempt to engender a sense of involvement through offering investors 'rewards' such as naming rights on a brew, fermenting vat or barrel. Craft brewers used the logic that it is in the interests of investors to consume the product and encourage others to do so, because they see this, in effect, as striving to ensure their investment is successful.

Craft brewers' reasoning for selecting loan based crowdfunding rather than other forms of alternative finance is interesting. They generally wanted to raise loan finance, although one brewer launched a rewards based crowdfunding campaign after two successful loan crowdfunding campaigns More than one brewer stated that they thought that rewards based crowdfunding was "…gimmicky…","…tacky…" or "…disingenuous…" "…If you are raising €40,000, then we feel you have to offer something other than a t-shirt or a plaque……….we would rather repay a loan [to investors]………when you look at the Brewdog model, you ask yourself what exactly are investors getting for their money…".. Brewers noted that in the case of rewards based crowdfunding, you had to "…get your offering right…". Referencing a failed campaign, the brewer was of the opinion that the rewards offered were inadequate and "…silly…". He opined that rewards based crowdfunding is "…too much hassle….and undependable….". By contrast, he was favourable to loan based crowdfunding.

<u>Cognitive heuristic/ motivations of craft brewers:</u> In seeking finance, entrepreneurs had a number of considerations apart from the principal issues of availability and cost. Craft brewers' primary heuristic was to retain control of their fledgling firms. They have all invested significant 'sweat equity' in their enterprises, and were generally unwilling to relinquish ownership or dilute their shareholding. They also noted the difficult in placing a valuation on the business at such an early stage of development. They were thus unwilling to accept external equity from investors outside friends and family. The majority of interviewees raised finance through loan based crowdfunding. The principal stated benefit of this source is that brewers retain control of their enterprise, along with managerial independence. Interviewees' preferences were dictated by this consideration, and their 'pecking order' follows the typical pattern of small firm owners, using the source of finance representing the least intrusion in their firm.

A small number of craft brewers raised equity from external investors, although they retained a controlling ownership. Interviewees stated that their preference for outside equity was as much for ease of process and certainty of outcome, even though it involved relinquishing some ownership. There are also positive signaling effects in raising angel finance, as in one case the brewer's bank provided matching funding to the angel investment provided. This brewer also related that he received additional benefits such as assistance with business plans and marketing, although this experience was untypical of the sample. By contrast another interviewee was wary of potential intrusion from investors. Keen to retain control of operational issues, the entrepreneur baulked at raising equity-based finance from the crowd, perceiving it as impinging on managerial decisions regarding brewing and branding.

<u>Operational aspects:</u> Time is one of the most important resources for entrepreneurs as they did not have adequate funding to employ staff. They were typically concerned with daily operational issues, which for craft brewers concerns everything from sourcing raw materials to delivering products, leaving little time for matters such as marketing and finance. With constraints on their valuable time, craft brewers wanted to spend as little time as possible on non-operational issues, such as marketing and raising finance. Interviewees related that they were frustrated at the amount of time required to raise finance. A partner in the largest brewer stated that "….I spend almost 70% of my time seeking finance….". Smaller brewers related that they were frustrated with the "…amount of paperwork required, and the time spent on loan applications, especially when the outcome is uncertain and it takes up to 6 weeks to make a decision…". Similarly, in raising alternative finance, a brewer stated that he raised loan crowdfunding as "…the process was relatively straightforward, and the funder took care of everything…". The perception that raising alternative finance requires minimal effort may be misleading, however. In the case of a failed attempt, the craft brewer admitted he did not devote adequate effort or resources to the campaign. Whilst he had prepared a promotional video, he was unaware of an impediment to rewarding investors with beer over the platform. Investors were not attracted with alternative rewards, and the campaign flopped.

Discussion and conclusion.

The vast increase in use of alternative finance is viewed as revolutionising small firm finance, providing a wide diversity in sources and increasing options for small and new firms that typically commence business from an external resource constraint. Craft brewers have enthusiastically embraced new forms of financing, and are at the forefront in raising finance from non-traditional sources. Experience of those who have raised investment finance through crowdfunding was universally positive, particularly for the benefits of promotion and advertising. Craft brewers sought to engender a sense of ownership in their enterprise, with the logic that investors' return on investment is directly linked to the product. The primary benefits from an operational perspective are ease of access, and timely and efficient delivery and administration of funding. These are somewhat offset by the higher cost of crowdfunding. Our evidence indicates that crowdfunding was particularly beneficial at a specific time in the lifecycle of the firm - relatively early in the life of the firm, post startup, when a firm has become somewhat established and can deliver on investors' expectations. As firms become more established and older, they typically access finance from traditional sources at a lower rate than through crowdfunding. This suggests that crowdfunding may become an important source of funding for a specific profile of firm, and in specific industries. Our findings are interesting when viewed in relation to previous research on crowdfunding. Below we list four stylized facts, and how our findings differ:

(1) Crowdfunding overcomes geographical constraints (Agrawal, 2014): From our limited sample, it appears that investors are located in relatively close proximity to brewers. Although crowdfunding overcomes geographical constraints in funding, there appears to be a 'locally funded' effect. In fact, craft brewers state a preference for locally provided equity. Brewers' desire to engender 'ownership' involves a visit to the brewery. The failed crowdfunding campaign of one interviewee was at a large geographical distance from the project proposer. A proviso to this finding is that our sample is located in a relatively small geographical area.

(2) Crowdfunding substitutes for traditional sources of financing. Agrawal (2014) states that crowdfunding substitutes for sources of equity such as home equity loans. Our sample

unanimously declared that finance raised through crowdfunding is complementary to traditional sources of finance, not a substitute. In most cases, amounts raised through crowdfunding were considerably smaller than those raised from traditional sources.

(3) Lower cost of capital. Received wisdom is that crowdfunding may result in lower costs of capital due to better matching between funders and creators, better information, and bundling of equity and rewards. Our evidence is that craft brewers can access finance at a lower cost from traditional sources, particularly intermediated debt. This may be due to the age profile of our sample, as most are established businesses, although young. Lower costs of finance are likely due to reputation effects.

(4) Crowdfunding provides a mechanism through which creators can receive input from users and investors. Our evidence is that craft brewers did not want external intrusion into operational aspects of the business "…we don't want a large crowd of investors telling us what to do with our brand or our beers…if you listened to everybody it would be a nightmare…". Crowdfunding is viewed as a means of raising finance and creating a community of loyal customers. Apart from rewards based crowdfunding, where investors are invited to name a beer or brewing tank, input on operational matters is not typically sought.

Qualitative research helped us explore these issues in depth and also enabled emergent findings such as geographical proximity of investors and brewers to come to the fore. Craft brewers have enthusiastically embraced crowdfunding as a valuable source of investment finance, although the majority of our interviewees state that having successfully raised finance through crowdfunding, they intend to source subsequent investment needs from the cheapest source, which they perceive to be intermediated debt from commercial banks. Thus in keeping with lifecycle financing patterns (Mac an Bhaird & Lucey, 2011), the cost of investment finance declines as firms gain reputation from a track record. The challenge for providers of alternative source of finance is to provide finance to firms in the mature stage of development at rates competitive with traditional sources. Crowdfunders should also consider their principal advantages over traditional funders, which are ease of process and relatively straightforward administration and delivery of finance. Crowdfunding is also consistent with the principal motivation of entrepreneurs, which is to retain control of their enterprises. Platform providers should emphasise this, as it is a significant advantage over other sources of finance such as external equity from new investors. Again, this may be more prevalent in some sectors than others, as craft brewers are extremely passionate about their products and business, and this personal attachment reinforces the traditional entrepreneur's desire to retain control and managerial independence.

Future avenues for research might investigate how entrepreneurs' demands change across countries, whether adoption of alternative finance influences organizational forms of the enterprise, lifecycle effects across sectors and firm profiles, the effect of regulatory requirements on entrepreneurs' behavior, whether crowdfunding broadens the network of investors, and how and why entrepreneurs select one form of alternative finance over another. It remains to be seen whether crowdfunding represents an alternative to traditional sources of finance for firms of all sizes in all sectors,. The future for alternative finance is dependent on many factors, including the ability of entrepreneurs to overcome information asymmetries and fulfill their obligations to investors. It is not a perfect mechanism for overcoming agency, and recent high profile cases do not engender confidence. Crowdfunding may be of greater benefit in countries where there is a lack of diversification in private debt and equity markets, and where the cost of debt may be a consequence of higher concentration. The early entrepreneurial finance ecosystem has undoubtedly changed, although it is too early to say whether crowdfunding represents a revolutionary change or is a passing fad.

References

Acheson, G. G., Coyle, C., & Turner, J. D. (2015). Happy hour followed by hangover: financing the UK brewery industry, 1880–1913. *Business History*, *6791*. http://doi.org/10.1080/00076791.2015.1027693

Agrawal, A., Catalini, C., & Goldfarb, A. (2011). The Geography of Crowdfunding. *SSRN Electronic Journal*, 1–57. http://doi.org/10.2139/ssrn.1692661

Agrawal, A. K. (2014). Some Simple Economics of Crowdfunding. *National Bureau of Economic Research*. http://doi.org/10.3386/w19133

Ahlers, G. K. C., Cumming, D., Günther, C., & Schweizer, D. (2015). Signaling in equity crowdfunding. *Entrepreneurship Theory and Practice*, *39*(4), 955–980. http://doi.org/10.1111/etap.12157

Baker, T., Miner, A. S., & Eesley, D. T. (2003). Improvising firms: bricolage, account giving and improvisational competencies in the founding process. *Research Policy*, *32*(2), 255–276. http://doi.org/10.1016/S0048-7333(02)00099-9

Bayus, B. L. (2013). Crowdsourcing New Product Ideas over Time: An Analysis of the Dell IdeaStorm Community. *Management Science*, *59*(1), 226–244. http://doi.org/10.1287/mnsc.1120.1599

Belleflamme, P., & Lambert, T. (2014). Crowdfunding: Some Empirical Findings and Microeconomic Underpinnings. *SSRN Electronic Journal*, Working Paper 2437786. http://doi.org/10.2139/ssrn.2437786

Belleflamme, P., Lambert, T., & Schwienbacher, A. (2010). Crowdfunding : An industrial organization perspective. *Business*, 25–26. http://doi.org/10.1.1.416.4643

Belleflamme, P., Lambert, T., & Schwienbacher, A. (2013). Individual crowdfunding practices. *Venture Capital*, *15*(4), 313–333. http://doi.org/10.1080/13691066.2013.785151

Belleflamme, Paul and Lambert, Thomas, Crowdfunding: Some Empirical Findings and Microeconomic Underpinnings (August 30, 2014). Available at SSRN: http://ssrn.com/abstract=2437786 or http://dx.doi.org/10.2139/ssrn.2437786

Belleflamme, P., Lambert, T., & Schwienbacher, A. (2014). Crowdfunding: Tapping the right crowd. *Journal of Business Venturing*, *29*(5), 585–609. http://doi.org/10.1016/j.jbusvent.2013.07.003

Bhide, A. (1992). Bootstrap Finance: The Art of Start-ups. *Harvard Business Review*, *70*(6), 109–117. Retrieved from http://search.ebscohost.com/login.aspx?direct=true&db=buh&AN=9302143635&site=ehost-live

Bruton, G., Khavul, S., Siegel, D., & Wright, M. (2015). New Financial Alternatives in Seeding Entrepreneurship: Microfinance, Crowdfunding, and Peer-to-Peer Innovations. *Entrepreneurship: Theory and Practice*. http://doi.org/10.1111/etap.12143

Central Bank of Ireland (2016). SME Market Report. Financial Stability Division, Central Bank of Ireland, Dublin. Retrieved from https://www.centralbank.ie/docs/default-source/publications/sme-market-reports/gns-5-10sme-market-report-2016h1.pdf?sfvrsn=8.

Ebben, J., & Johnson, A. (2006). Bootstrapping in small firms: An empirical analysis of change over time. *Journal of Business Venturing*, *21*(6), 851–865. Retrieved from http://www.sciencedirect.com/science/article/B6VDH-4HKMPRY-1/2/190d3c32f0a9b550b08501989723a978

Everett, C. R. (2014). Origins and Development of Credit-Based Crowdfunding. *SSRN Electronic Journal*. http://doi.org/10.2139/ssrn.2442897

Everett, C. R. (2015). Group membership, relationship banking and loan default risk: The case of online social lending. *Banking and Finance Review*, *7*(2), 15–54. http://doi.org/10.2139/ssrn.1114428

Feeney, B. (2016). Craft Beer and Microbreweries in Ireland: A Report for the Independent Craft Brewers of Ireland and Bord Bia. August, 2016. Retrieved from: https://www.bordbia.ie/industry/manufacturers/insight/publications/bbreports/RecentMarketingReports/Craft%20Beer%20and%20Microbreweries%20in%20Ireland%202016.pdf

Freear, J., Sohl, J. E., & Wetzel Jr., W. E. (1995). Who bankrolls software entrepreneurs? In *Frontiers of Entrepreneurship Research* (pp. 394–406). Retrieved from http://fusionmx.babson.edu/entrep/fer/papers95/freear.htm

Gerber, E. M., & Hui, J. (2013). Crowdfunding : Motivations and Deterrents for Participation. *ACM Transactions on Computer-Human Interaction*, *20*, 32. http://doi.org/http://dx.doi.org/10.1145/2530540

Gerber, E. M., Hui, J. S., & Kuo, P.-Y. (2012). Crowdfunding: Why people are motivated to post and fund projects on crowdfunding platforms. *Proc. of the International Workshop on …*, 10. http://doi.org/http://dx.doi.org/10.1145/2530540

Grichnik, D., Brinckmann, J., Singh, L., & Manigart, S. (2014). Beyond environmental scarcity: Human and social capital as driving forces of bootstrapping activities. *Journal of Business Venturing*, *29*(2), 310–326. http://doi.org/10.1016/j.jbusvent.2013.02.006

Harrison, R. (2013). Crowdfunding and the revitalisation of the early stage risk capital market: catalyst or chimera? *Venture Capital*, *15*, 283–287. http://doi.org/10.1080/13691066.2013.852331

Harrison, R., Mason, C. M., & Girling, P. (2004). Financial bootstrapping and venture development in the software industry. *Entrepreneurship & Regional Development*, *16*, 307–333.

Hemer, J. (2011). A snapshot on crowdfunding. *Enconstor*, 39. Retrieved from http://www.isi-lehre.de/isi-wGlobal/wGlobal/scripts/accessDocument.php?wAuthIdHtaccess=800364842&document=/isi-wAssets/docs/p/de/arbpap_unternehmen_region/ap_r2_2011.pdf&display=1&forceDownload=0

Heuven, J., & Groen, A. (2012). The role of social networks in financing technology-based ventures: An empirical exploration. *Venture Capital*, *14*(2-3), 131–149. http://doi.org/10.1080/13691066.2012.659473

Hornuf, L., & Schwienbacher, A. (2014a). Crowdinvesting - Angel Investing for the Masses? *Forthcoming in Handbook of Research on Venture Capital: Volume 3. Business Angels*, 1–20. http://doi.org/10.3386/w19846

Hornuf, L., & Schwienbacher, A. (2014b). The emergence of Crowdinvesting in Europe. *Munich Discussion Paper, No. 2014-43*, 1–24. Retrieved from http://epub.ub.uni-muenchen.de/21388/

Hung, H. (2006). Formation and Survival of New Ventures. *International Small Business Journal*, *24*(4), 359–378. http://doi.org/10.1177/0266242606065508

Jones, O., & Jayawarna, D. (2010). Resourcing new businesses: social networks, bootstrapping and firm performance. *Venture Capital*. http://doi.org/10.1080/13691061003658886

Jonsson, S., & Lindbergh, J. (2013). The Development of Social Capital and Financing of Entrepreneurial Firms: From Financial Bootstrapping to Bank Funding. *Entrepreneurship: Theory and Practice*, *37*, 661–686. http://doi.org/10.1111/j.1540-6520.2011.00485.x

Kim, K., & Hann, I.-H. (2013). Does Crowdfunding Democratize Access to Capital? A Geographical Analysis. *SSRN Electronic Journal*, 1–35. http://doi.org/10.2139/ssrn.2334590

Laveren, E., Helleboogh, D., & Lybaert, N. (2010). The use of financial bootstrapping in small and medium-sized ventures and the impact on ventures growth and performance. RENT 24 : Research in entrepreneurship and small business : the entrepreneurial process in a changing economy, Maastricht, the Netherlands, November 17-19, 2010, 1-24.

Mac an Bhaird, C. (2013). Demand for debt and equity before and after the financial crisis. *Research in International Business and Finance*, *28*, 105–117. http://doi.org/10.1016/j.ribaf.2012.10.001

Mac an Bhaird, C., & Lucey, B. (2010). Determinants of capital structure in Irish SMEs. *Small Business Economics*, *35*(3), 357–375. http://doi.org/10.1007/s11187-008-9162-6

Mac an Bhaird, C., & Lucey, B. (2011). An empirical investigation of the financial growth lifecycle. *Journal of Small Business and Enterprise Development*, *18*(4), 715–731. http://doi.org/10.1108/14626001111179767

Moenninghoff, S. C., & Wieandt, A. (2013). The Future of Peer-to-Peer Finance. *Zeitschrift Für Betriebswirtschaftliche Forschung*, *August/Sep*, 466–487.

Mollick, E. (2014). The dynamics of crowdfunding: An exploratory study. *Journal of Business Venturing*, *29*(1), 1–16. http://doi.org/10.1016/j.jbusvent.2013.06.005

Moritz, A., & Block, J. H. (2014). Crowdfunding: A Literature Review and Research Directions. *SSRN Electronic Journal*, 33. http://doi.org/10.2139/ssrn.2554444

Rubinton, B. J. (2011). Crowdfunding: Disintermediated Investment Banking. *Social Science Research Network*, 1–20. http://doi.org/10.2139/ssrn.1807204

Smith, R., Moult, S., Burge, P., & Turnbull, A. (2010). BrewDog: business growth for Punks!. *The International Journal of Entrepreneurship and Innovation*, *11*(2), 161-168.

Vasileiadou, E., Huijben, J.C.C.M., & Raven, R.P.J.M. (2015). Three is a crowd? Exploring the potential of crowdfunding for renewable energy in the Netherlands, *Journal of Cleaner Production*, http://dx.doi.org/10.1016/j.jclepro.2015.06.028