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Competitive Research Article

Moriah Meyskens* and Lacy Bird

Crowdfunding and Value Creation

Abstract: Social ventures like other entrepreneurial endeavors often have difficulty in seeking financing. This study assesses the role of crowdfunding in social venture funding. We provide insight into crowdfunding types and platforms and social value creation. Then we offer a theoretical framework to help social ventures and social investors best choose which type of crowdfunding (reward, donation, equity, debt) might make most sense to them given their economic and social value creation goals.

Keywords: crowdfunding, social entrepreneurship, social venture, funding

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1 Introduction

Social ventures, like most entrepreneurial endeavors, have difficulties securing funding due to liabilities of newness and smallness (Aldrich 1999, Stinchcombe 1965). At the same time, since social ventures focus on creating social value and less initially on long-term financial returns, sometimes attracting financial investors is more difficult (Bauer-Leeb and Lundqvist 2012; Ridley-Duff 2009). Although social ventures vary in organizational form, both legally and operationally, social ventures seek financing from a variety of sources that include friends, donations, grants, social investors, earned income and bootstrapping (Lyons 2010; Meyskens 2013; Scarlata and Alemany 2012). Crowdfunding has emerged as an alternative means to finance social ventures in both the start-up and expansion phases of growth (Lehner 2013). Crowdfunding facilitates the financing process by providing a platform that enables individuals passionate about an idea or cause to easily invest small amounts of capital and to

***Corresponding author: Moriah Meyskens,** University of San Diego, CA, USA, E-mail: mmeyskens@sandiego.edu
Lacy Bird, University of San Diego, CA, USA, E-mail: lacybird@sandiego.edu

share the idea with others. Increasingly more academic research focuses on crowdfunding themes (e.g. Belleflamme, Lambert, and Schweinbacher 2010; Mollick 2014; Moss, Neubaum, and Meyskens 2014). We seek to contribute to this research stream by providing insight into the linkage between the types of crowdfunding and the value creation goals of the social venture.

Through crowdfunding social ventures motivate individuals to provide financing to support their initiative (Belleflamme, Lambert and Schweinbacher 2010; Gore and DiGiammarino 2014). Although each individual in the crowd generally contributes a small sum to a campaign, the combined financing can be sufficient to help a social venture fund a program or initiative. Crowdfunding stems from crowdsourcing, which is the use of a crowd to obtain ideas, feedback, solutions, and other resources (Belleflamme, Lambert, and Schwienbacher 2014). Social ventures increasingly utilize crowdfunding as a mechanism to finance their programs and operations and gain legitimacy as it provides an alternative means to attract individual investors interested more in their social vision and less in their cash-flow than a traditional investor (Belleflamme, Lambert and Schweinbacher 2010; Lehner 2013). Crowdfunding can be classified as rewards, donation, debt or equity-based financing. We propose that the type of crowdfunding that is best for a social venture can vary depending on the economic and social value creation goals of the venture.

Social ventures create varying degrees and types of both economic and social value depending on their mission, vision and operations (Mair and Marti 2006; Meyskens, Allen, and Brush 2011). This social value includes initiatives that improve health, education, freedom and social order (Whitman 2009) as well as help the environment (Neck, Brush, and Allen 2009) and create employment and personal development (Southern 2001). Ultimately this social value can improve the development of communities and regions (Meyskens, Carsrud, and Cardozo 2010; Paredo and Chrisman 2006). Thus, social value leads to economic value as social ventures help their beneficiaries create wealth and accumulate capital (Whitman 2009). At the same time the reverse may be true. When social ventures help their beneficiaries create wealth and accumulate capital, they enable these individuals to improve their quality of life and in essence create social value. Additionally, some social ventures create economic value for their own organizations by generating earned income or revenue through the sale of products or services as a means to sustain their operations and achieve their mission. If a social venture generates earned income, then they rely less on outside financing.

This paper provides insight into the relationship between different types of crowdfunding and the ultimate value creation goals of the social venture. Better understanding this relationship can help both social investors and social ventures. Social ventures can gain insight into the types of crowdfunding that make sense to focus their efforts on according to their internal value creation goals. At the same time social investors can better understand if they should focus on debt, equity, reward or donation based crowdfunding depending on the value creation focus of the venture. The study proceeds by providing insight into crowdfunding types and platforms, social value creation and then offers a theoretical framework to guide both social ventures and their investors interested in this alternative form of financing.

2 Crowdfunding

Crowdfunding has grown exponentially as a source of financing for entrepreneurial endeavors. In 2012 $2.7 billion was raised online via crowdfunding to finance over 1.1 million campaigns. An estimated $5.1 billion was expected to be raised in 2013 and the growth trend is forecasted to continue (Massolution 2013). According to Crowdsourcing.org and the World Bank, crowdfunding will surpass $300 billion in funding transactions by 2025. Crowdfunding serves as an alternative means for social ventures to fund their programs and operations that is becoming increasingly popular.

The process of crowdfunding is in many aspects similar to the financing of any entrepreneurial endeavor, but everything is done online. Figure 1 summarizes this process. The first step in the crowdfunding process is developing a campaign that focuses on an initiative or need that requires financing. The social venture chooses an online platform to raise these funds, and if applicable chooses the level and types of rewards for funders or backers. The rewards can vary from a simple thank you from the social venture founder to a T-Shirt or product or service produced by the venture. Once a campaign is launched the social venture must remain active on this platform as well as on social media to encourage funders or backers to participate. Once the monetary goal at the end

Figure 1: Crowdfunding process.

of the fundraising period is reached, the social venture can use the capital raised. However, some platforms like Kickstarter have an "all-or-nothing" policy on fundraising goals. This means that if a fundraising goal is not met, the creator of the project will not be allowed to receive the funds raised and contributions are given back to backers (https://www.kickstarter.com/help/faq/kickstarter+basics?ref=footer). If a venture chooses a crowdfunding platform that offers rewards, once the campaign is finished the venture must distribute these rewards which can be a cumbersome process.

2.1 Crowdfunding Models

The different online crowdfunding platforms generally operate around a rewards, donation, debt or equity model. Thus as part of the crowdfunding process explained above, social ventures must choose the type of crowdfunding which aligns with their goals. In the rewards model, funders are promised some product or benefit in return for their monetary contributions to the project. For example the social venture Krochet Kids sought funding to help develop sustainable incomes for women knitting hats in an impoverished area of Peru. Depending on the level of financing, backers were offered rewards such as their name on an inscribed plaque that would be located in the ventures offices in Peru, a hat, a meeting with the ventures Community Involvement Director, or a trip to Peru to meet the beneficiaries behind the program (https://www.kickstarter.com/projects/krochetkids/krochet-kids-peru-limited-edition-hat-collection). The rewards model provides an incentive for participants to donate at certain levels in return for a product or benefit of interest.

The donation model classifies supporters of projects as philanthropists who do not expect a direct return for their donations (Mollick 2014). Many social ventures receive a large percentage of their financing from donations and crowdfunding provides a mechanism to interact more with supporters interested in providing suggestions regarding their operations or products (Schwienbacher and Larralde 2012). Major charities and individuals requesting donations to their cause use this model. One example of this model is the Scripps Research Institute campaign on Crowdrise that aims to find a cure for Ebola (https://www.crowdrise.com/CureEbola). At the time of this writing, $100,000 had been donated through this fundraising process to help this initiative (https://www.crowdrise.com/cureebola). Donation and reward-based crowdfunding grew 85% to $1.4bn in 2012 and made up over half of the crowdfunding raised in 2012 (Massolution 2013).

Another type of crowdfunding that exists but does not offer such a tangible reward is the debt model. This crowdfunding model tends to be used as a way to fill institutional voids where traditional financial institutions do not operate and offers alternative financial aid rather than as a direct way to raise capital (Allison et al. 2013; Moss, Neubaum, and Meyskens 2014). Lending-based crowdfunding grew 111% to $1.2 billion in 2012 (Massolution 2013). In the debt model, individuals lend their money to another individual or group with the expectation they will receive repayment. Sometimes the money is repaid with interest, but that depends on the online platform (Outlaw 2013). The debt model of crowdfunding is similar to the principles of microfinance and the rotating savings and credit association (ROSCA). In the ROSCA, all the members in a group contribute to a pot of money and can contribute and borrow from this combined financing (Armendáriz and Morduch 2010). This debt model attracts users who may not have access to traditional financial institutions.

Crowdfunding platforms such as Puddle target those who may not qualify for a traditional bank loan such as Teresa Goines. She started a restaurant in San Francisco, CA, and because she was denied a traditional bank loan, she turned to crowdfunding and borrowed $5,000 from 41 people, a loan she has since repaid in full (Hoffman 2014). For Puddle, a borrower must sign up using a Facebook account and a United States bank account. They may then join a "puddle" where they are expected to contribute some amount of money. The individual is able to borrow up to five times the amount they have contributed and they must repay this loan (with a predetermined interest rate typically between 5%–8%) within 3–6 months (https://www.puddle.com/). Puddle is marketed toward those who want an easy way to borrow money, as there are no credit checks and no loan applications. Puddle also creates a sense of community, as a person is able to contribute to a "puddle" in which they share an interest with those seeking to borrow money.

Kiva is also a prominent crowdfunding platform that uses the debt model to help individuals finance microentrepreneurs worldwide. As of November 2014, Kiva had made loans totaling over US$639 million to over 1.4 million entrepreneurs through more than 804,000 loans (http://www.kiva.org/about/stats). Kiva finances these entrepreneurs through their relationships with 288 microfinance institutions (MFIs) in over 84 countries. These MFIs select and vet the individual that are granted a loan and featured on Kiva. Kiva borrowers primarily have business loans, but some have student, housing, as well as personal use loans.

The least common version of crowdfunding is the equity model (Mollick 2014). Although equity-based crowdfunding grew 30% in 2012 to $116 million, it is still very small considering the total $2.7 billion raised through crowdfunding in 2012 (Massolution 2013). In equity-based crowdfunding, investors become shareholders in these ventures in the hopes of receiving dividends or a return on their initial investment (Futko 2014). There are a number of examples of energy and utilities start-ups that use the equity model of crowdfunding such as the Green Electric Power Group. This start-up aims to create social, economic and environmental value through renewable methods of energy consumption and production (Browse Energy 2014). The equity area of crowdfunding has been highly regulated up until recently (Futko 2014). The Jumpstart Our Business Startups (JOBS) Act of 2012 lifted the general solicitation ban preventing sales of equity in private companies to accredited investors (Simon 2014). The JOBS Act legalizes some types of equity financing for start-ups and small businesses based on the amount of crowdfunding sought (Parrino and Romeo 2012).

2.2 Crowdfunding Platforms

Although crowdfunding websites existed in the early 2000s, the emergence of online payment platforms really enabled crowdfunding websites to reach their current levels of popularity (Davies 2013). Figure 2 highlights some of the features as well as the benefits and drawbacks of some of the platforms operating under the different crowdfunding models. Two of the most popular crowdfunding websites in the United States are Indiegogo and Kickstarter. These platforms have easy user interface, brand recognition and large audience reach. Users create crowdfunding campaigns, which are then subject to fee structures for funds raised on the platforms. Indiegogo provides campaigns raising funds for a 501C3 a 25% discount on fees (Indiegogo 2014). At the same time, developing a crowdfunding campaign enables an individual or social venture to gain credibility and legitimacy.

While Kickstarter and Indiegogo are two of the most popular crowdfunding websites, their main target market is not social ventures. Other platforms like Start Some Good and Causes only promote campaigns with a social purpose associated with them. For example, one of Start Some Good's core values is to support change makers who support democracy, equality, transparency, collaboration, opportunity for all, care for the planet and for each other. Creators must submit their idea to the website and wait for approval based upon a series of question such as, "Does the campaign create positive social change?" and "How much social impact would this campaign have?" (Start Some Good 2014). One main benefit of the site Causes is that it is an ad-supported platform, which means Causes earns its revenues through sponsorships and ads. Therefore, users are not charged a set-up fee or any fees associated with the funds raised using the Causes platform (https://www.causes.com/help).

Name	Website	Model	Description	How it Works	Pros	Cons
Indiegogo	Indiegogo.com	Reward	Empowers people to activate the global community to make ideas happen.	Start a campaign; activate your community; fund your dream	Offers tutorials and tips on how to create a successful campaign; website easy to use; no obligations or commitments; 25% discount offered for any campaign raising money for a 501c3 org	Some international restrictions on PayPal payments; no liability in disputes between campaign owners and campaign funders; fundings are non refundable
Kickstarter	Kickstarter.com	Reward	Kickstarter is a platform and resource for creators to fund their pojects.	Create a campaign that lasts 1-60 days and set a funding goal. Creators must also set rewards to entice backers	Easy user interface; widely known.	Funding is all-or-nothing -- projects must reach their funding goals to receive any money; cannot fund for charity or financial incentives; no liability in disputes between creators and backers; restricted to certain countries; restricted to using Kickstarter's mold of fundraising.
Start Some Good	StartSomeGood.com	Donation	Helps changemakers raise funds to make a difference in the world.	Build a campaign, promote your campaign and grow your community.	Site offers tips and guidelines on building a successful campaign; global organization; can be used by non-profits, for-profits and individuals; provides support or projects; only social good projects allowed on site	Strict criteria to be featured on site; takes 5% of funds received by campaign
Causes	Causes.com	Donation	They are a for-profit tech company whose platform allows anyone to start a campaign and select a charitable organization as their beneficiary.	Create a campaign to petition or fundraise for a cause. Campaign members are given tools to recruit supporters, share messages, videos and photos.	Utilizes social media to garner support for campaigns.	Only 501(c)(3) organizations may fundraise on this site
Classy	Classy.com	Donation	Crowdfunding, peer-to-peer, event registration & website donations all under one roof.	Create a campaign or event using your existing branding and begin fundraising.	Utilized by national brands; offers extensive support and customer service; offers webinars and guides; World's largest fundraising platform; data and reports easily available to help track progress and donors;	To gain access to premium products (account strategist, data analytics, website integration) the pricing can be expensive ($499 per month). fees to collect funds;
Puddle	Puddle.com	Debt	Puddle connects people and provides them with credit. Whether it's for a small business, starting a new project, buying a laptop for college, traveling the world, or just to cover those unexpected expenses. "Everyone contributes, everyone borrows."	Members sign up by using an active Facebook account and United States bank account. Members join "puddles" where they contribute to the group's funds. Members can bororw up to 5X the amount they have contributed. Members determine the appropriate interest rate and loans are repaid in either 3 or 6 months.	Easy access to capital; no loan applications; creates a sense of community; based on proven microfinance principles; low default rates.	Must have a Facebook account; must have a United States bank account; can only borrow 5X the amount contributed
Kiva	Kiva.org	Debt	Connect people through lending to alleviate poverty. Leveraging a worldwide network of microfinance institutions, Kiva lets individuals lend as little as $25 to help create opportunity around the world.	Kiva uses field partners to vet potential borrowers; these borrowers are then listed on Kiva's website where individuals can lend money to whichever borrower they connect with; loans are repaid at which point the lender may reinvest that money with another Kiva borrower or take the money out of the Kiva system.	Borrowers: provides access to capital at fair interest rates (note: interest rates are not charged by Kiva, but may be charged by field partners disbursing loans); no previous credit history necessary; Lenders provide a means to help society; high payback rates	Loans are not guaranteed; loans cannot be claimed as tax deductions
Lending Club	Lendingclub.com	Debt	Creates a more efficient, transparent and customer-friendly alternative to the traditional financial institutions in order to offer borrowers lower interest raes and investors better returns.	Borrowers complete a loan application on the website which is evaluated by the Lending Club at which point Lending Club determines an interest rate. Investors select loans in which to invest and earn monthly returns.	Credit check has no impact on applicant's credit score; provides borrowers an average of 29% on their interest rates; provides investors with strong returns	Disqualifies individuals with credit scores deemed as unsatisfactory by the Lending Club; loan orgination fees
Zip Lending	Ziplending.com	Debt	Innovative lending for small businesses; provides small business loans from $5,000-$250,000.	Individuals lend directly to a borrower.	Quick access to capital-same day approval, next day funding; bad credit is okay; easy application process.	Loans are not guaranteed; loans cannot be claimed as tax deductions
Equitynet	equitynet.com	Equity	Connects investors and businesses for equity and debt financing opportunities	Both entrepreneurs and investors develop a profile, optimize their business plan or browse businesses respectively and then can communicate with eachother.	Patented technology enables entrepreneurs to analyze and optimize their business plan before they engage investors. Also enables investors to conduct due dilligence on investments. EquityNet was the first crowdfunding platform to enable Title II of the US JOBS Act, which allows businesses to publicly advertise their need for equity funding online	Still highly regulated

Figure 2: Crowdfunding platforms.

3 Crowdfunding and Value Creation

Crowd investors have different mechanisms to assess the initiatives or ventures that they seek to finance. Most individuals from the crowd are not sophisticated investors and they avoid evaluating business plans, cash-flow liquidity and collateral (Bauer-Leeb and Lundqvist 2012; Ridley-Duff 2009). However as crowdfunding becomes more mainstream, individuals in the crowd are becoming more selective in their investments and many traditional investors are utilizing this mechanism to make their investments. In the case of social ventures, crowdfunding investors are often driven by the purpose and value creation goals of the social venture. Nicholls (2010) assesses the investment logics of different types of social investors and develops a matrix of nine different models to examine the trends of social investment capital in the United Kingdom. We build on this study to better understand the type of crowdfunding that best aligns with the value creation goals of the social venture.

Social ventures create different types of economic and social value (Mair and Marti 2006; Meyskens, Allen, and Brush 2011). They generate social value by helping society or the environment. This can come in the form of facilitating education, health, freedom or helping a disadvantaged group (Whitman 2009). Social ventures also create environmental value by promoting activities that are green and environmentally friendly like recycling or alternative energy (Meyskens and Carsrud 2013). This environmental betterment is a type of social value. At the same time social ventures create economic value both directly and indirectly. Some social ventures sell products or services for which they receive revenue, thus generating income to directly help sustain their organization or to pay back investors. This is direct economic value that is created for the social venture. Social ventures also indirectly create economic value by supporting clients or beneficiaries in their pursuit of wealth creation (Whitman 2009). For example, an organization might support a microentrepreneur who then is able to grow their business and have more income for their family. This microentrepreneur might also hire another worker who now has an income. These are examples of indirect economic value creation facilitated by the social venture.

Social ventures create varying levels of economic and social value according to their missions, visions and internal goals. Depending on the respective importance of economic and social value creation for a social venture, the type of crowdfunding platform might vary. Choosing the appropriate crowdfunding model is important for a social venture so that they best focus their efforts to raise financing for a program or initiative.

		Economic Value	
		Low	**High**
Social Value	**Low**	Reward	Equity
	High	Donation	Debt

Figure 3: Crowdfunding and value creation.

Figure 3 provides an overview of the theoretical framework we propose. First, when a social venture creates high social value, but low economic value, a social venture should choose the donation crowdfunding model. The donation crowdfunding model attracts investors interested in acting as philanthropists who do not expect any type of financial return. These investors are less concerned if a social venture is generating income and are more interested in the social benefit created by the social venture. By using this crowdfunding method, social ventures will more likely attract investors who seek high social value creation and they will not need to reward their social investor in any way. Second, when a social venture creates high social value and high economic value then a social venture should choose the debt crowdfunding model. Through debt crowdfunding social investors can help an entrepreneur or individual create economic value both directly and indirectly. This entrepreneur often goes on to create economic value by creating jobs or income for their own venture. At the same time in some debt crowdfunding models, social investors earn income for themselves through the interest charged. Research into Kiva lending has shown that investors prefer to invest in ventures that have an entrepreneurial orientation (economic value) and that those having a social orientation have slower repayment (Moss, Neubaum, and Meyskens 2014). Third, when a social venture creates low social value and low economic value then they should choose the reward crowdfunding model. The reward model provides a means for ventures to market their venture, gain funding, establish proof of concept and in the process legitimacy. For individuals in a crowd that have interest in the social cause, but need to be incentivized in some way since the social venture has low economic and social value, this type of crowdfunding model is most practical. However, in the reward model, the social venture must provide a reward which can be logistically time-consuming to distribute once the campaign is complete. Social ventures in the start-up phase that are still seeking proof of concept might find this to be a good option. Finally, social ventures with high economic value and low social value should opt for the equity model of crowdfunding. Equity investors seek a return on their investments and generally place more emphasis on economic over social value. Social ventures must be willing to give up ownership of a piece of their venture. They must also be legally structured in a way that allows them to sell equity to social investors. Thus the equity model is operationally and logistically more cumbersome for a social venture.

4 Conclusion

This paper provides an overview of the concepts surrounding crowdfunding, the different crowdfunding models and platforms. We offer a theoretical framework to help social ventures and social investors best choose which type of crowdfunding (reward, donation, equity, debt) might make most sense to them given their economic and social value creation goals. This is just an initial framework and could be potentially tested in the field. A qualitative study of a network of social investors or social ventures could provide different insights on crowdfunding preferences based on the economic and social value created by a social venture. However, our hope is that this study provides some initial insight and guidance to both social investors and social ventures on how to navigate one important aspect of crowdfunding.

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