

How a simple change can protect crowdfunding backers from fraud

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Budding entrepreneurs with a business idea inevitably face the problem of finding financing. With the advent of crowdfunding platforms such as Kickstarter or Indiegogo—where the entrepreneur appeals to the masses

to support the business venture—raising funds to get projects off the ground is getting easier.

But crowdfunding also opens the door to a host of unwanted behaviors. Some entrepreneurs may inflate a product's potential, or decide to keep backers' funds despite being unable to deliver the product. Backers of the projects are left in the lurch, typically with little recourse to a refund. And lawsuits are rare.

New research shows that a few simple changes to a crowdfunding [platform](#)'s design could substantially strengthen protections for the backer, and make everyone better off. Currently, crowdfunding platforms' terms of service make it clear they are not responsible for safeguarding the money of those who choose to back the project.

As such, "campaign backers are exposed to significant entrepreneurial misconduct risk," according to the [research paper](#), "Rethinking Crowdfunding Platform Design: Mechanisms to Deter Misconduct and Improve Efficiency," written by Simone Marinesi and Gerry Tsoukalas, both Wharton professors of operations, information and decisions, along with Elena Belavina, a professor at Cornell.

The paper's authors believe that designing a better crowdfunding platform will help mitigate those risks—and yet, academic research has largely ignored this area of study despite its practical benefits, says Tsoukalas.

"This is the first paper to propose practical [crowdfunding](#) mechanisms that deter entrepreneurs from misappropriating backers' money and making exaggerated performance claims during the [fundraising] campaign," adds Marinesi.

More information: Elena Belavina et al. Designing Crowdfunding

Platform Rules to Deter Misconduct, *SSRN Electronic Journal* (2018).
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