

Crowdfunding for Hospitality Ventures

by Elena Belavina

EXECUTIVE SUMMARY

Crowdfunding can raise funds in the absence of traditional financing sources. This research brief provides guidance on the effective use of crowdfunding by hospitality entrepreneurs. Our research (Belavina et al. 2020) shows that crowdfunding advantages go well beyond cash infusion. Significant benefits of using crowdfunding stem from the ability to acquire early information on a venture’s viability. This early information helps avoid investment in ventures with low market potential. Thus, hospitality entrepreneurs should use crowdfunding for venture selection, not just funding. Further, counterintuitively, our research shows that entrepreneurs are better off if they use platforms that impose fund release restrictions. These restrictions help build backer confidence, thus, bringing in more funds and better information from the crowdfunding campaign. Finally, we identify fund release restrictions best suited for hospitality ventures. This finding highlights the opportunities for building hospitality-centric crowdfunding platforms.

Keywords

Crowdfunding, restaurants, breweries, lodging, food & beverage, recreation, entrepreneurship, hospitality industry

Disciplines

Hospitality Administration and Management

Belavina E., S. Marinesi, and G. Tsoukalas (2020) “Rethinking Crowdfunding Platform Design: Mechanisms to Deter Misconduct and Improve Efficiency,” Management Science.

ABOUT THE AUTHOR



Elena Belavina is an Associate Professor of Operations Management at the School of Hotel Administration and the Cornell SC Johnson College of Business. She collaborates with start-ups, established companies, and public agencies to study issues of sustainable urban transportation, food waste, food operations, grocery and food delivery, and supply chains. Her recent research has examined how the grocery industry's structure and pricing policies influence food waste, the environmental impact of online grocery shopping, and the design of bike-share systems. She has also studied sustainable sourcing, relational contracts, and supply network design, including the role of supply chain intermediaries. Methodologically, her research involves a holistic analysis of logistic and economic systems, and econometric analysis of large datasets to advise on system improvements and policies. Before joining Cornell, Elena was on the faculty of the Booth School at Chicago, earned a Ph.D. from INSEAD and bachelor's and master's degrees in applied mathematics and physics from the Moscow Institute of Physics and Technology.

Crowdfunding for Hospitality Ventures

by Elena Belavina

COVID-19 has hit the hospitality industry hard with independent restaurants going out of business, record-low occupancy at hotels, and a long period of uncertainty ahead. As the industry recovers, investors reeling from these losses may no longer have the resources or commitment to invest in new ventures. Institutional investors may also pull back, as in the aftermath of the 2007–08 financial crisis (Dunkley 2016). At the same time, the interest in community-oriented venues is ever greater.

In this context, crowdfunding, or funding by a community of potential guests and amateur investors, can be an attractive way to fund new ventures and reboot existing ones. Hospitality entrepreneurs have raised significant funds both on all-purpose crowdfunding platforms (Kickstarter, etc.) and on hospitality-centric platforms such as PieShell (food and beverage), HotelierCo (hotels) and EquityRoots (franchised hotels), as shown in Exhibit 1.

Based on our recent research (Belavina et al. 2020), this brief provides guidance on the effective use of crowdfunding by hospitality entrepreneurs. Our research shows that crowdfunding advantages go well beyond cash infusion: Significant benefits accrue from acquiring early informational signals on a venture’s viability. This information, if used correctly, limits the venture’s downside risks. Further, counterintuitively, our research shows that entrepreneurs are better off using platforms that impose fund release restrictions. Despite the restrictions, campaigns on such platforms raise more funds and lead to better information. Finally, we identify fund release restrictions best suited for hospitality ventures. This finding highlights the opportunities for building hospitality-centric crowdfunding platforms.

Use Crowdfunding for More Than Funding

Crowdfunding can raise financial resources in the absence of traditional funding sources. However, in consumer electronics and other categories, crowdfunding is increasingly used by large companies that have extensive access to capital. Our research shows that crowdfunding’s primary benefits are as much in limiting downside risks of new ventures as in acquiring capital (Belavina et al. 2020).

A hotel revamp, a new microbrewery, a restaurant concept, or any other such hospitality ventures have substantial market risk. Will enough consumers be interested in this offering? With traditional funding, entrepreneurs invest first and then, only on launch, get a firmer primary data-driven sense of the interest in the venture. Crowdfunding reverses this sequence, drastically limiting the venture’s downside risk.

Typical crowdfunding campaigns require participants to pledge a certain amount of money in exchange for a reward (usually a discounted advance purchase of the product, a meal in a new establishment, a case of a newly developed spirit, etc.). In effect, the pledges are a direct line of communication to potential customers to obtain a binding commitment to purchase the product or use the service—an early signal of demand. More pledges imply more demand. Irrespective of the cash position, entrepreneurs would only move forward with ventures that obtain sufficiently strong early demand signals. They would abandon ventures with weaker signals before substantial investments are made. In other words, somewhat paradoxically, the value of crowdfunding, over traditional forms of funding, is not as much in its ability to fund but rather in its ability to prevent funding.

It is vital that hospitality entrepreneurs understand this informational advantage of crowdfunding and use crowdfunding for venture selection, not just for funding. Another implication is that crowdfunding is best suited for very uncertain ventures. Traditional funding might be better for less risky ventures. Further, for the pledge signals to be informative, it is important to run campaigns on platforms whose users represent the eventual target market. If this is not the case, entrepreneurs must appropriately adjust the signals and be cautious in interpreting them.

EXHIBIT 1

Use of Funds	Hospitality Venture (Click name to see their crowdfunding campaign)
Developing a new F&B or service product	Stone Brewing Co., Kyl21, Le Bread Xpress, Soylent, Flip Tray
Expanding an existing F&B operation	Roasters Next Door, The Vegetarian Butcher, Stone Brewing Co.
Creating a hospitality-centric marketplace	The Restaurant Zone, Stayful, Roomstorm, Guesty
Historic property revival, renovation, or expansion	Gage and Tollner, The Inn at Duck Creek, Central Historic Hotel
Opening of a new location/concept	Hopsters Brewery, Juliet, Surf Dog, Reem’s Dream
Funding of a new venture	Iron Range, Eureka, The Gibbard Block, Reel Food Truck

Exhibit 1: Examples of hospitality ventures that used crowdfunding

Choose a Crowdfunding Platform that Imposes Fund Release Restrictions

Choosing the right platform to host the campaign is a crucial choice for hospitality entrepreneurs. There are the expected trade-offs between platform popularity and the representativeness of the user base discussed above. Our research shows that there is an additional, significant factor in this choice that is more nuanced and counterintuitive. We show that the restrictions that platforms place on an entrepreneur's access to funds raised make a key difference to the financial and informational benefits of using crowdfunding.

Entrepreneurs typically believe that, all else being equal, platforms or campaign designs that release all funds at one time offer the most financial flexibility to the entrepreneur and therefore are the best choice. In contrast, our research shows that platforms that (partially) defer payments are the better choice for the entrepreneur (Belavina et al. 2020). The reasons lie in understanding the backers' risks and incentives to pledge support for a venture.

An individual that backs a venture faces several risks. First, as with any venture investment, ventures can fail despite the entrepreneur's best efforts because of market or supply-side risks. Further, crowdfunding backers are less-sophisticated investors. While this leads to important demand information and expands the funding pool, it also attracts unscrupulous entrepreneurs who might exploit such investors. Entrepreneurs can misrepresent the venture's potential or lie about their resources and skills to deliver the product—both pieces of information that are not readily available to backers. An entrepreneur also might use some or all funds raised for purposes unrelated to the offering.

In all these cases, it is not easy to distinguish between genuine venture risk and the entrepreneur's unscrupulous behavior. As a result, there is little legal recourse or other traditional investor remedies. Consequently, many backers do not pledge in favor of products, even ones they may genuinely want and like. This limits the funds raised and distorts the information value of the pledges: Entrepreneurs cannot discern if the venture has low interest or if the backers do not trust the entrepreneur.

The key to resolving this dilemma lies in designing funding rules so that, despite the inability to verify all entrepreneur actions, quality entrepreneurs are incentivized to do the right thing, giving backers the trust needed to pledge. Often, successful crowd-

funding campaigns raise much more money than the campaign goal (for example, Stone Brewing Company raised \$2.5M for a new beverage venture, well exceeding its \$1M goal). Our research shows that platforms can use restrictions on the release of this "excess funding" as a lever to create the right incentives. We compared ten different forms of such restriction implementations and identified two that work best (Belavina et al. 2020):

(1) Rather than releasing all funds, the platform can hold the funds in excess of the goal in escrow. Releasing them only after the venture has been built out and its performance and viability are validated. By the entrepreneur's plans, funds above the campaign goal are not needed to build and test the venture. Thus, this does not harm the venture. Yet, this mechanism limits entrepreneurs' unscrupulous actions by providing them incentives and benefits from using the funds in the right way. It also encourages entrepreneurs not to exaggerate either the product performance or their skills because such misrepresentation makes them less likely to deliver on them and more likely to lose the money in escrow; and

(2) another particularly effective variant of the above idea is to convert pledges received above the campaign goal into cancelable pre-bookings for the service offered by the venture. This approach achieves the same incentives as holding money in escrow but without imposing requirements for the platform to hold and release the funds. Instead, it relies on the later pledgees' cancellation or use of the booking to create appropriate incentives.

Most importantly, although these mechanisms appear as restrictions on the entrepreneurs, they are, in fact, in the entrepreneur's interest. By creating the incentives to limit the unscrupulous behavior around misrepresentation and actions, they build backer confidence, bringing in more funds and information from the crowdfunding campaign. Thus, these mechanisms make all parties—the entrepreneurs, backers, and the platform—better off.

These mechanisms are most powerful when (a) venture viability risks are high, (b) there is substantial potential for entrepreneurs' unscrupulous actions and misrepresentation, and (c) it is costly to monitor or verify the entrepreneurs—all factors that are extremely salient for hospitality ventures.

Reimagine Platform Designs

Finally, our findings on the best platform designs suggest an opportunity for (new) hospitality-focused

crowdfunding platforms. Platforms that aggressively impose fund-release restrictions are an excellent fit for hospitality ventures. They can bring much-needed funding to reboot the industry and help entrepreneurs select the best ventures. Our research paper (Belavina et al. 2020) provides more details on low cost, effective designs for these platforms. ■

CITATIONS

Belavina E., S. Marinesi, and G. Tsoukalas (2020) "Rethinking Crowdfunding Platform Design: Mechanisms to Deter Misconduct and Improve Efficiency," *Management Science*.

Dunkley, E. (2016). "Crowdfunding rides to the rescue of many SMEs." *Financial Times*. Available at: <https://www.ft.com/content/a1b69b96-475b-11e5-af2f-4d6e0e5eda22>. Accessed 21 May 2020.

CHR Advisory Board

Pablo Alonso
Chief Executive Officer
HotStats

Scott Berman '84
Principal & US Hospitality Industry Leader
PwC

Vivek Bhogaraju MMH '06
GM, Lodging Revenue Performance Solutions
Expedia Group

Patrick Bosworth
Co-Founder, Advisor
Duetto

Ian-Michael Farkas
Vice President, Strategic Accounts
Local Measure

Chuck Floyd, P '15 and '18
Global President of Operations
Hyatt

Eliot Hamlisch
Executive Vice President, Loyalty & Revenue
Optimization
Wyndham Hotels & Resorts

Tim Hentschel '01
Chief Executive Officer
HotelPlanner.com

Steve Hood
Senior Vice President of Research
STR

Taimur Khan MENG '93
Vice President, GM Travel, Transportation, Hos-
pitality Solutions Team
Salesforce

Balaji Krishnamurthy
Chief Executive Officer
Pure Wellness

Joy Butler
Senior Vice President, Global Business Unit
Owner (Lodging)
FreedomPay

Mark Lomanno
CHR Advisory Board Chair
Partner & Senior Advisor
Kalibri Labs

Kelly McGuire MMH '01, PhD '07
Manging Principal, Hospitality
ZS

Dan O'Sullivan
Vice President of Sales, EMEA
Translations.com

Michael Partridge '92
Vice President of Sales & Revenue Analysis
Marriott International

Dilip Petigara
Chief Executive Officer
AccessPoint Financial

Jess Petitt '05
Vice President, Analytics
Hilton

Michele Sarkisian
Partner
Avenger Capital

Stacy Silver
President
Silver Hospitality Group

Dan Skodol, MMH '04
Vice President of Data Science & Analytics
Cendyn

Cecil Staton
President & Chief Executive Officer
AAHOA

Scott Taber '85
Senior Vice President, Rooms
Four Seasons Hotels and Resorts

Adam Weissenberg '85
Vice Chairman and Chief Global Officer AUdit &
Assurance, Asia Pacific Leader - US Global Office
Deloitte & Touche LLP

Rick Werber '82
Senior Vice President, Engineering &
Sustainability
Host Hotels & Resorts

Michelle Woodley '89
President
Preferred Hotels & Resorts

Cornell Hospitality Research Brief

Vol. 20, No. 1 (July 2020)

©2020 Cornell University. This report may not be reproduced or distributed without the express permission of the publisher.

Cornell Hospitality Reports are produced for the benefit of the hospitality and service industries by The Center for Hospitality Research at Cornell University

Linda Canina, Academic Director
Nicole McQuiddy-Davis, Program Manager
Kate Walsh, Dean, E.M. Statler Professor,
School of Hotel Administration

The Center for Hospitality Research
School of Hotel Administration
Cornell SC Johnson College of Business
Cornell University
Statler Hall
Ithaca, NY 14853

607-254-3383
chr.cornell.edu

