The Chain Reaction of Investment Experiences in Crowdfunding - A Longitudinal Analysis of "Coolest Cooler"

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Abstract. Crowdfunding has thrived in recent years because of its effective form and rapid dissemination of information to entrepreneurs. Simultaneously, it can also bring a sense of affiliation, creative products, and potential rewards to backers. Multiple backers and campaigners have been attracted by this novel financing method. However, numerous existing studies on crowdfunding have concentrated on success factors and backers' decision-making patterns. There is currently limited research examining backers' internal motivations and the heterogeneity among backers in their different behavioral manifestations. By primarily using behavioral learning theory and mental accounting, this study will analyze the failed crowdfunding case "Coolest Cooler" to elucidate how investment experiences functions as a pivotal factor in differentiating behavioral patterns between novice backers and experienced backers, including: (1) novice investors may be more vulnerable by herd effect; (2) novice investors may be less vigilant about the failure signals; (3) novice investors may tend to gain emotional loss aversion when failure signals emerge. Therefore, this study may offer practical implications for potential backers in mitigating decision bias and adjusting decision-making.

Keywords: Investment experience; Crowdfunding; Mental accounting; Behavioral learning theory; Loss aversion.

1 Introduction

Crowdfunding is an alternative financing for raising money by collecting funds from the general public [1]. It has gradually matured over the past decade, stimulating innovation by lowering the threshold and cost for campaigners and backers and broadening the range of supporter groups, while causing a series of problems arising from failed projects, such as money loss and engagement loss. Failed crowdfunding campaigns may lead to backers' betrayal of trust, thereby triggering the snake-bite effect, a psychological phenomenon in which investors become cautious after experiencing negative financial investments. Moreover, it may also exacerbate bias that potential backers may reduce their investment in innovative projects or even exit the

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crowdfunding market. Additionally, because of the neglect of heterogeneity among backers, there is a dearth of research on investor experiences that may play a considerable role in their decision-making, which is a typical scenario in behavioral finance. As such, this essay will explore and contribute by examining: (1) the different behavioral patterns between novice backers and experienced backers who have different degrees of investment experience; (2) the different underlying motivations shaping their observable decision-making behaviors; (3) how investor experiences function and adjust herding, risk perception, and loss aversion by discussing the exhibition of backers.

A crowdfunding project named "Coolest Cooler" declared bankruptcy in 2019, which had been supported by over 60 thousand people with approximately 13.3 million dollars in 2014. Such a huge number of backers and the large funding total ultimately resulted in bankruptcy, but multiple backers may not exhibit risk aversion in the project. This phenomenon can be noteworthy to analyze investors' experiences and psychology. Using the data from the comment section for this project in Kickstarter, the paper analyzes the proportion between novice backers and experienced investors and their message content to discuss: (1) whether backers' aim to invest the project were rational requirement or the fear of missing out and irrationally following the trend led by herd effect; (2) whether there are different responses to risk signals among different backers; (3) whether backers generated loss aversion after bankruptcy and whether the aversion primarily come from money or engagement.

2 Theoretical Framework

2.1 Behavioral Finance in Crowdfunding

Crowdfunding is a way for entrepreneurs to raise small contributions from multiple potential backers, which is an important socio- economic phenomenon [2]. Investors' decision-making can be affected by certain effects and theories in behavioral finance: (1) Irrational herding refers to individuals' decision-making driven by observation of others rather than private information [3]. According to their research, herding behaviour tends to substitute signaling during the second phase of fundraising; a larger number of late backers may imitate early backers, which indicates that herding may build upon the contribution of some experienced and informed backers. (2) Risk aversion, relevant to prospect theory, reflects individuals' preference for certain outcomes over uncertain alternatives with equivalent expected returns [4]. For instance, in crowdfunding, backers usually consider elevated risk levels as less credible, resulting in diminished investment in innovative and high-tech projects [2]. (3) Loss aversion suggests that individuals typically weigh losses about twice as heavily as equivalent gains [5]. In crowdfunding, this study principally divides loss aversion into money loss aversion and backers' engagement loss aversion. Engagement loss originating from backers' positive participation in communities implies that backers may suffer emotional and mental loss that may make them feel isolated and disappointed. (4) Mental accounting theory proposes that investors mentally categorize their funds in accordance with factors such as purpose, source, and risk level [4]. For example, people

who are more willing to invest in risky projects may allocate the mental account for high-risk investments. After investment projects failed, people may tend to transfer the investment account to the sunk cost account, attempting to invest more capital and energy to rescue the projects. (5) Behavioral learning theory holds the opinion that individuals' behavior is learned by interacting with the external environment, which was first proposed by John B.Watson in 1913 with the S-R behavioral formula [6]. Ivan Pavlov conducted the famous experiment on conditioned reflex in dogs, proposing the concept of a classically conditioned reflex, referring to learning by association. By using the theory throughout the entire analysis of the case "Coolest Cooler", this paper will illuminate that behavioral learning is a process for investors that people adjust their decision-making in investment through updating their investment experience.

2.2 Functions of Investor Experiences

Some research showcases that investors' decision-making in the crowdfunding market may not depend solely on money. Predominant backers emphasize their cognitive bias sensitivity and a few irrational choices [2]. Backers may not be concerned only about material and financial risks, but also care about mental and spiritual rewards such as creativity, a sense of community and affiliation, and social networks. Crowdfunding involves both raising money and fulfilling a sense of civic duty [7]. Thus, there is heterogeneity among them. Different investment experiences have different impacts on their decision-making. For instance, investment experiences can shape a cognition of potential investment projects, susceptibility level of herding, risk perception, and asset allocation. In addition, after the manifestation of outcome with their ongoing decision, this investment experience may add to their overall experience, moderating their subsequent investment in the future. Investment experience provides a vital reference for investment strategies.

3 Case Analysis

3.1 Case Description

Certain research found that entrepreneurs can leverage crowdfunding thresholds to mitigate risk level, and crowdfunding' s pre-sale mechanism can transfer production risk [8]. In December 2019, a crowdfunding project, five years after its campaign ended, named "Coolest Cooler" declared bankruptcy, which had attracted 62642 backers and collected roughly 13.3 million dollars during 52 days beginning in July 2014. "Coolest Cooler" was a multi-Function portable refrigerator with 9 features, such as a juicer, Bluetooth speaker, and USB charging station, which has garnered significant support from investors with strong demand and then attracted many novice backers. However, although the project had gained massive funds and a bright prospect, during the fulfillment stage, the funder repeatedly delayed in project updates with various excuses and claimed that the products previously promised to backers can not be fulfilled because of a funding shortage, whereas the funder team sold their products at a unit price of $499 on the online shopping website Amazon. The statement and

behavior aroused public outrage, with multiple supporters commenting, flooding the screen, and intending to file a lawsuit over the past decade. However, before the phenomenon-level popularity, the founder had launched the same project, "The Coolest," and failed in 2013 with only 279 backers and around only $100,000.

3.2 Case Analysis

The Impact of Investor Experiences on Herding: Exhibitions among Different Backers During the Crowdfunding Period. Herding plays a critical role in some crowdfunding campaigns. Given information asymmetry, potential backers may rely on others' contributions as legitimacy signals. In December 2013, the founder, Ryan Grepper, initiated the project "The Coolest" with 279 backers. Among them, there were 177 novice backers and 102 experienced backers, which means the number of novice backers was more than 70% as many as experienced backers, accounting for approximately 63% of the total. In contrast, "Coolest Cooler" in 2014 attracted over 60 thousand people, consisting of 41829 novice backers and 20813 experienced backers. The number of novice backers was more than double the number of experienced backers and accounted for around 67% of the total. Thus, the ratio of novice backers in the two crowdfunding campaigns was higher than that of experienced backers. The absolute number and relative proportion of novice backers have both experienced an order-of-magnitude increase. The data is shown in Figures 1 and 2. In comparison, there is hardly any difference between the products from the two crowdfunding projects, with "Coolest Cooler" having only a long-lasting battery, more than "The Coolest", which means there was no probability for attracting a skyrocketing number of backers who were in need and rational because of significant improvement in the product in 2014 than in 2013. According to these, novice backers were more vulnerable to the irrational herding phenomenon under conditions of information asymmetry.

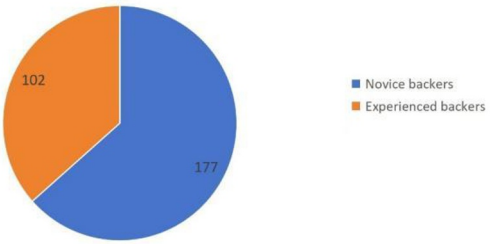


Fig. 1. Number of backers in "The Coolest" (2013) (Picture credit: Original)

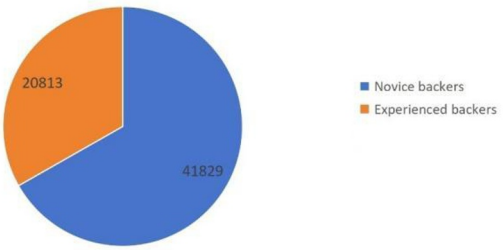


Fig. 2. Number of backers in "Coolest Cooler" (2014) (Picture credit: Original)

Figure 3 indicates changes in the number of backers during the crowdfunding period. The X-axis represents the number of backers, and the Y-axis represents the date. The project started on July 8 with 2199 backers and soared in the period after five days, researching 26271 by July 1. From mid-July to mid-August, the number of backers steadily increased. The last surge was before the end of the crowdfunding by 17610. Additionally, according to early comments and the Frequently Asked Questions (FAQ) section, experienced backers were concentrated within the first two days after the project began. These backers had asked for details of products in comments and supported the project based on individual requirements. In the project completion phase, the $5 support amount (the lowest tier) obviously increased, suggesting that some novice backers may have supported the project to enhance their engagement rather than to obtain the product itself. It is speculated that experienced backers accounted for around 30%, and the proportion of novice backers was around 70%, concentrating at the end of the crowdfunding. Therefore, it can be inferred that due to soaring popularity in the early period and a sense of urgency and substantial fundraising at the end of the campaign, there were obvious herding phenomena in novice and irrational groups for their uninformed, inexperienced, and biased cognition.

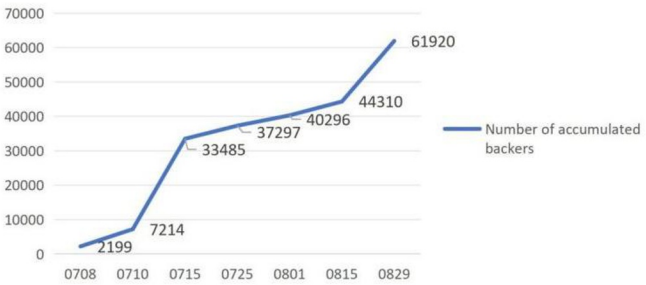


Fig. 3. Number of accumulated backers in "Coolest Cooler" (Picture credit: Original)

Hence, novice backers were more reliant on social learning cues derived from people who are more experienced to make "social learning" due to a lack of

experience, so they exhibited irrational herding, whereas experienced backers can learn that it is unreliable to purely observe what others contribute, thus strengthening their own critical mind and reducing irrational herding behavior.

The Impact of Investor Experiences on Risk Sensitivity and Sunk-Cost Effect: Different Performances among Backers After the Failure Signal. Prior crowdfunding experience can explain differences in how different investors react to risk or failure signals [9]. After a period of time had elapsed since the crowdfunding period, the campaigner started to postpone the update of products due to a capital shortage. A public condemnation took place in the comments section. This study collected approximately 400 comments associated with risk-related and loss-averse cognition discourse from the decade after crowdfunding to analyze whether such risk signals make backers warrant a response and what the differences were between novice backers and experienced backers. The results were exhibited in Figures 4 and 5.

This study classified backers' reactions into four categories: risk alert, sensitive to failure signals, future behavior modification and legal action, corresponding to features in comments respectively like: "That was a scam", "Requirement to return the money and regard the project failed", "I will never support crowdfunding projects again" and "Request to initiate legal proceedings". The data show that sensitivity to failure signals accounted for the highest proportion at around 200 comments, and legal action accounted for the smallest proportion. Both the novice group and the experienced group showed high sensitivity to failure signals, with around 80% novice backers and 90% experienced backers. Among the four categories, novice backers tended to express more emotionally driven complaints and behavior. In the future behavior modification type, 40% novice backers exhibited a change in their behavior, which is higher than experienced backers. By contrast, the exhibition of the other three reactions from experienced backers was all higher than that of novice backers. Experienced backers were more sensitive to the risk of crowdfunding itself and made more rational solutions, such as litigation. Some behavioral finance theories in path-dependent behavior can explain the phenomenon, such as the snake-bite. Novice backers appeared to lack prior exposure to high-risk projects; they may have invested in crowdfunding by following others. After the failure, they had claimed that they would never support crowdfunding projects, which demonstrated they had been bitten by the "Coolest Cooler" snake and were afraid of "snake bites". However, those experienced backers may have been bitten by previous snakes so that they had formed a sense of "snake-bite," and their sensitivity to failure signals was stronger than that of novice backers.

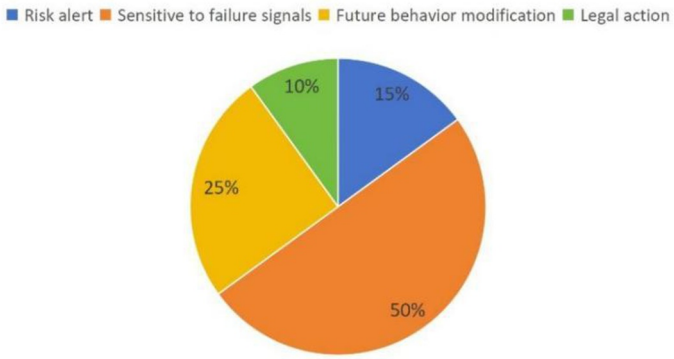
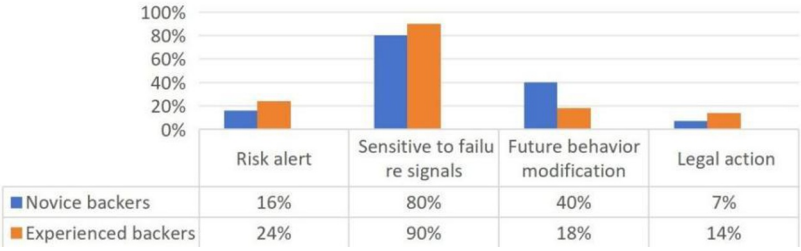


Fig. 4. Proportion of different risk perception manifestation types (Picture credit: Original)



	Risk alert	Sensitive to failu re signals	Future behavior modification	Legal action
Novice backers	16%	80%	40%	7%
Experienced backers	24%	90%	18%	14%

Fig. 5. Proportion of different backer within their respective groups in different risk perception types (Picture credit: Original)

Additionally, as some of the comments from ten years after the failure signal appeared showcases, there were around 71 comments indicating that certain backers transferred their investment account into a sunk-cost account, consisting of 49 novice backers (69%) and 22 experienced backers (31%). Such comments were like "I had already given up the money", "I don't expect to get it back." The result suggested that novice backers tend to transfer their contribution from the investment account to the sunk-cost account, while experienced backers tend to transfer their loss money to the risk cognition account. Novice backers exhibited more emotionally driven responses in their comments, such as "angry", "frustrated, and "disappointed". Experienced backers identified risk signals earlier and performed systematic cognition of crowdfunding.

In conclusion, compared with experienced backers, novice backers showed lower risk sensitivity and were more likely to respond emotionally when facing problems. Furthermore, because novice backers' mental accounting was simpler, emotion may decide their choice. Cognitive deficit from novice backer led them to imitate and agree with expressions from people who were informed and seasoned. Thus, novice backers were earlier to transfer their mental accounting from investment account to sunk-cost account and were more likely to plunge into sunk-cost effect.

The Impact of Investor Experiences on Loss Aversion: Different Psychological Reactions among Different Backers After the Failure Signal. The interpretation of loss aversion depends on the salience of losses to investors [10]. Loss aversion was obvious, particularly after the failure signal appeared based on the 400 comments. There were around 180 backers behaved emotional loss aversion (ELA), nearly half and accounting for the largest proportion, which was featured as expression about emotional hurt and betrayal of trust, and primarily performed as "Angry", "I'll never believe Kickstarter again," and "I feel like I've been tricked." The second was financial loss aversion (FLA) with 120 backers and 30% share, behaving as "I want a refund," and "Where's my money?" such explicit referencing to money, refunds, and other financial demands. Roughly 18% of backers had both of them (BLA), and only a few backers did not exhibit loss aversion (NLA).

Based on the estimated number of novice backers and experienced backers, there were approximately 140 novice backers and 180 experienced backers. As Figure 7 has shown, around half of novice backers experienced emotional loss aversion, which was 22.2 percent higher than experienced. In contrast to that, the proportion of financial loss aversion from experienced backers was higher than that of novice backers by nearly the same percentage points. In addition, the proportion of experienced investors exhibiting mixed loss aversion is also relatively high. Moreover, backers who did not experience significant loss aversion were a high proportion of novice backers. Presumably, these backers may not yet be fully aware of the loss or still hold onto hope. Novice backers in comments were more likely to express anger and frustration and imitate others to claim an extreme change toward crowdfunding. Most experienced backers were more rational and objective; for instance, they stated their demands and measures if the campaigner had no compensation. As such, novice backers tend to gain an emotional loss aversion, while experienced backers tend to obtain financial loss aversion.

There was a speculation that the different loss aversion between novice backers and experienced backers depends on different mental accounting to a certain extent. Mental accounting plays a significant role in consumers' payment decisions [11]. Therefore, the phenomenon can be explained by different categories of mental accounts. Novice backers not only had never learned about the uncertainty and high risk of crowdfunding from failed investments, but also were more vulnerable to external "noise" and over-reliance on experienced individuals or projects with a large number of participants. Hence, they may tend to build a "dream account", defined as a mental account combining investment bundles with their expectations involving the investment, which invests money and a substantial amount of emotion. After the bankruptcy of the project, their engagement and emotion were defeated, so that their pain from finance was magnified to emotional loss. Conversely, experienced backers may tend to open a risk or consumption account to dispose of the investment cost. Since they had recognized how to get information and infer the risk of crowdfunding from previous experiences. Hence, they tied less emotion to their investment projects. Therefore, once the project goes bankrupt, some of them were prepared mentally, even transferred it to a consumption account, so that they merely afford certain financial loss and hardly feel emotional burden.

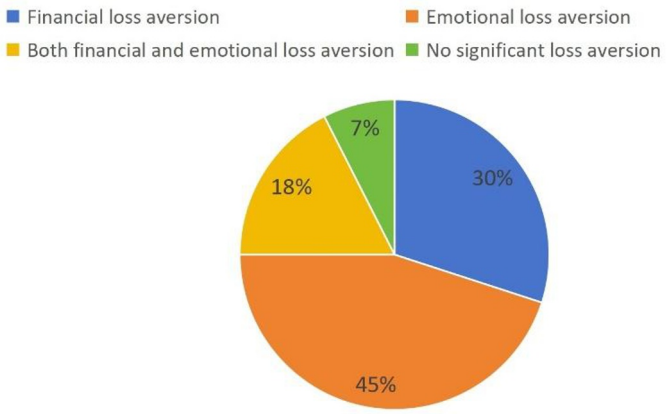


Fig. 6. Proportion of different types of loss aversion (Picture credit: Original)

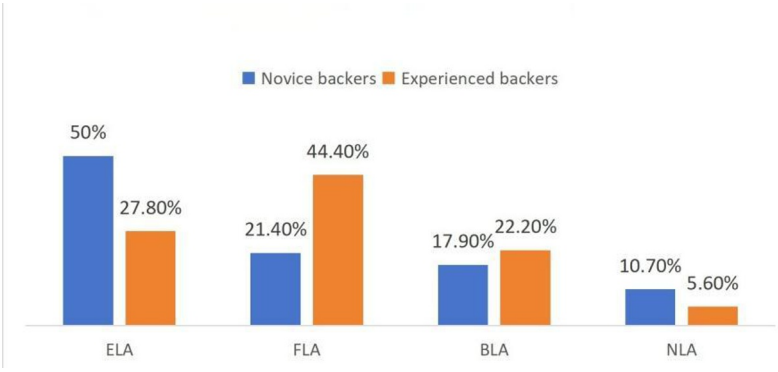


Fig. 7. Proportion of different backer within their respective groups in different loss aversion types (Picture credit: Original)

Generally, due to the different degrees of backers' investment experiences, different backers establish different categories of mental accounts, leading to different loss aversion. Novice backers lacked sufficient investment experience, while experienced backers had already learned from their previous investment experiences. Therefore, novice backers tend to open dream accounts in crowdfunding, causing emotional loss aversion, whereas experienced backers tend to open risk accounts and encounter a loss aversion from finance.

4 Conclusions

Overall, this study has collected the data from novice backers and experienced backers in "Coolest Cooler" and discussed how the investors' experiences influence backers'

decision-making in herding, risk sensitivity, and loss aversion. The results are as follows. Investors who lack investment experience tend to be affected by herding, less sensitive to risk signals, and exhibit emotional loss aversion. Experienced investors tend to invest rationally and independently, sensitive to risk signals, and encounter financial loss aversion. There are also some suggestions to backers in the crowdfunding market: (1)using appropriately structured risk assessment strategies, it is necessary for backers to evaluate the risk level of the projects that they have supported to contribute properly by acquiring multidimensional information directly associated with the projects themselves rather than over-absorbing external information and the behavior of other backers; (2)novice backers should diversify their investment combinations and adjust their decision-making through constantly updating investment experiences.

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