Chapter 15

Can Social Dynamics Be Channeled from Offline to Online Communities?

Commitment, Compliance, and Cooperation from Microfinance to Crowdfunding

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ABSTRACT

As alternative source of financing, microfinance and crowdfunding organizations are increasingly relying on commitment, compliance and cooperation among individuals, groups, and communities. In considering the extraordinary growth of the market for microfunding and microlending in recent years, this article aims to investigate a number of important questions. Can the conventional rule of social collateral applied to group lending be replicated in online crowdfunding? What are the institutional, social and organizational requirements in order to transpose the social collateral model of solidarity and responsibility to heterogeneous online crowdfunding and microlending platforms? What would be the implications for borrowers and lenders in terms of group compliance, collaboration and cooperation? By highlighting the differences and similarities between microfinance and crowdfunding structures, the article seeks to provide a broad comparative framework for analyzing different patterns of behavior in communities, organizations and networks that engage in crowdfunding and microlending activities.

DOI: 10.4018/978-1-7998-1760-4.ch015

INTRODUCTION

Three types of reasons have been suggested to explain the state of being unbanked: lack of basic and financial literacy; high level of transaction costs to provide, monitor, and support lending activities; and the poor's inability to provide collateral to reduce risks related to information asymmetries (Armendàriz & Morduch, 2005). Considering the small size of the loans, conventional banks simply do not think it is worth the risk or the high cost of appraising the loan (Akula, 2010). In addition, the inability of the poor to provide financial collateral leads to their exclusion not only from most economic activities, but restrain their integration in social groups. The majority of unbanked populations are located in under-developed countries (Chaia et al., 2009).

Microfinance institutions platforms curate and organize the financial sourcing and inclusion by designing control mechanisms and reinforcing conformity rules. Microfinance provides credit to entrepreneurs and business owners who lack access to traditional banking services due to the absence of financial collateral. By strengthening social ties among individuals, microfinance institutions (MFIs) leverage social (groupal) collateral to replace conventional asset-based collaterals. For doing so, MFIs reinforce group conformity rules within social arena. The Grameen Bank in Bangladesh (Yunus, 2003) demonstrated how engaging social groups could deal with the unbanked problem. The key contribution of Muhammed Yunus was to overcome the asset-based collateral barrier by encouraging members to support each other for the financial risks associated with individual loans. Members' commitment toward peers reduces the cost of carrying out economic transactions and oversight.

With the expansion of information technologies, individuals explored the possibilities of transmitting offline opportunities online. Crowdfunding, like microfinance, relies on the willingness and commitment of groups, rules of compliance among individuals to encourage cooperation within social networks and interest groups for addressing the investment needs of those who have limited access to financial collateral. Crowdfunding carries out via online platforms different forms of financing including credit, donation, equity, and reward. While, crowdfunders may be viewed as lenders and investors who provide financial backup to a wide array of borrowers, yet the question remains whether the rules of traditional group lending and social collateral can be applied to the online crowdfunders? Can the innovative principle of social lending, its managerial practices and organizational dynamics be transposed to the virtual world of Internet?

The transposition from offline to online is not evident because members in offline group know each other while those in online groups have no previous acquaintance (Boxenbaum & Battilana, 2005). It should be noted that conventional social groups and internet-based groups are formed differently. In the case of conventional offline groups, members generally share cultural codes, comply by common rules and behave with a greater degree of homogeneity and predictability. In the case of the internet-constituted groups and online communities, individuals come together from different social and economic horizons, engage in virtual interactions without knowing each other personally, but showing the desire to engage in mutually beneficial economic and social ventures.

In this perspective, we distinguish between "Ex-Ante" communities, who host individuals who are born and grown in the community, and "Ex-Post" communities that coalesce purposefully and operate on the Internet platform. We seek to shed further light on the importance of social ties and the pivotal role of networks in diffusing and translating the economic and social missions of the groups and crowds. Placed