

CROWDFUNDING AND INNOVATION SYSTEM FAILURES.

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SON of NOR

<http://stillalive-studios.com/portfolio-item/son-of-nor/>



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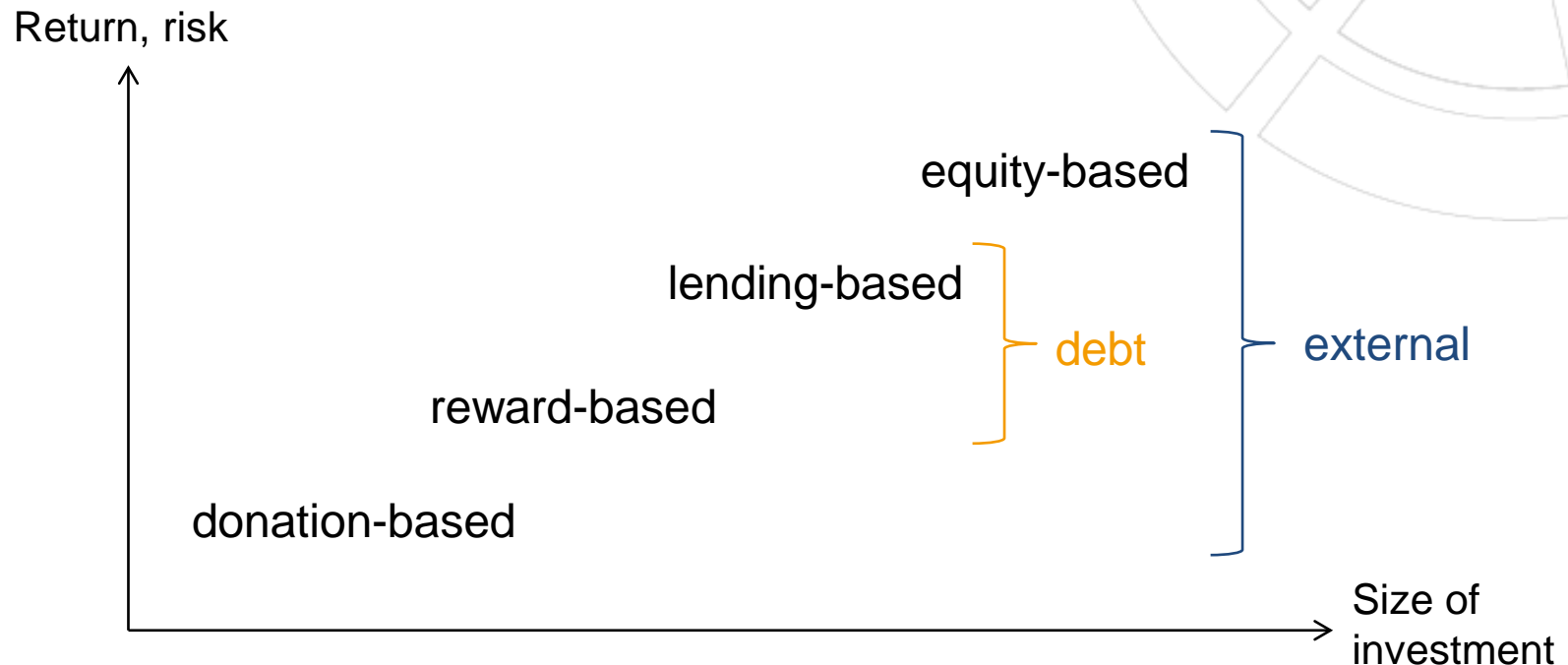
CROWDFUNDING

- Form of micro-financing
- Money from a large number of people (“crowd”)
- Via the internet (now)

(e.g., Ahlers et al., 2012; Belleflamme et al., 2013; De Buysere et al., 2012; Mollick, 2013)

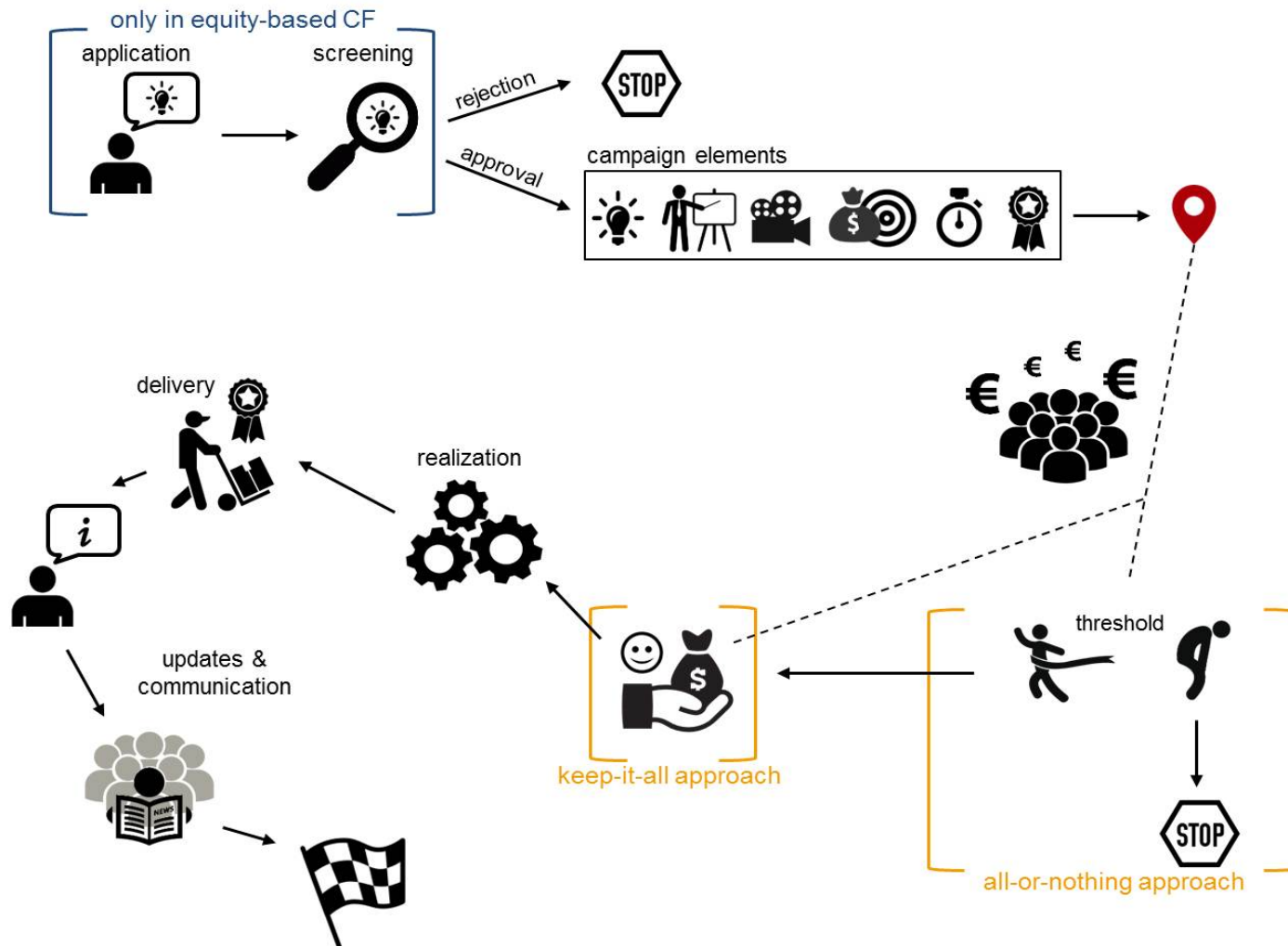
CROWDFUNDING

Forms of crowdfunding



(e.g., Ahlers et al., 2012; Baeck & Collins, 2013; Belleflamme et al., 2013; Gumpelmaier, 2013; Massolution, 2012)

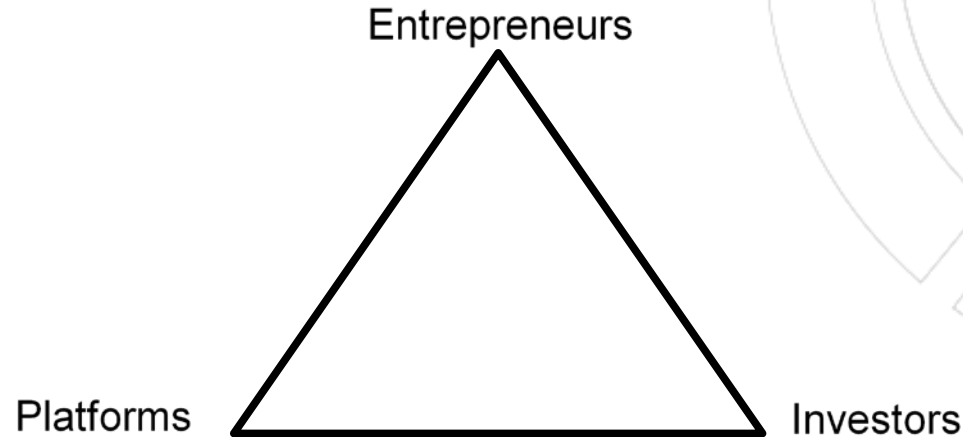
CROWDFUNDING



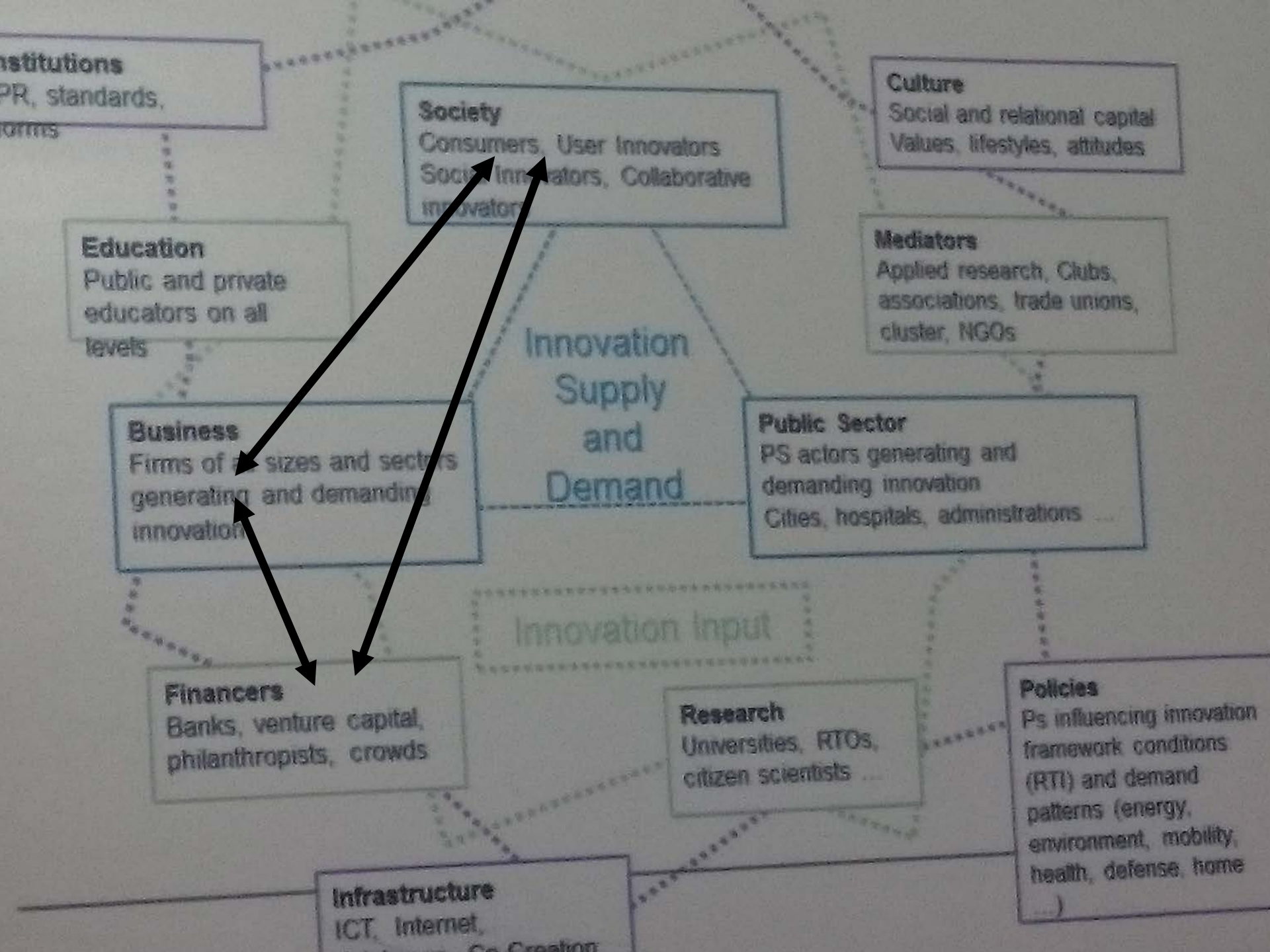
CROWDFUNDING

- Crowdfunding can be interpreted as a special case of crowdsourcing.
 - Just a variant of the open innovation (Chesbrough 2003) tradition.
- Here we assume
 - Crowdfunding is a business model innovation that is more than just a variant of the OI.

CROWDFUNDING



- Part of the
 - (national) innovation system
 - (national) system of entrepreneurship (Ács, Autio, and Szerb 2014)



CROWDFUNDING □ SYSTEM FAILURES.

- **Infrastructural failures** e.g., knowledge and IT infrastructure
- **Institutional failures** imperfections in the institutions, be they formal, written, and consciously created or informal, implicit, and rather more spontaneously formed
- **Interaction failures** weaknesses in the innovation system due to too strong or too weak contact and exchange among the network's actors
- **Capability failures** lack of capabilities, learning potential, resources, and flexibility

THE S-I POLICY FRAMEWORK

System failures Actors	System failures	System failures	System failures	System failures
	Infrastructural	Institutional	Interaction	Capabilities
Demand Consumers, large buyers				
Companies MNEs, SMEs, start-ups				
Knowledge institutes Universities, technology institutes				
Third parties VCs, banks, intermediaries, consultants, sector organizations, employers				

(Klein Woolthuis et al., 2005)

QUESTION

How does crowdfundign adress system failures?

10 QUALITATIVE INTERVIEWS.

#	Name	Form	Country ¹	Expert ²	Sector	Duration ³
1	James	In person	GER	E	Gastronomy	72
2	Matthew	In person	GER	PO		98
3	Ethan	In person	GER	E	Gastronomy	44
4	Frederick	Skype	GER	E	Finance	42
5	Louis	In person	GER	E	Services	77
6	Paul	In person	GER	E	Education	86
7	Ralph	Skype	AUT	E	IT	32
8	Tom	Skype	GER	PO		94
9	Oliver	In person	AUT	PO		71
10	William	In person	AUT	PO		66
¹ Country: AUT = Austria; GER = Germany ² Expert: E = entrepreneur; PO = platform operator ³ In minutes						Ø 68

CATEGORIES FOR ANALYSIS

Institutional failure

Interaction failure

Capabilities failure

Institutional
failure

Interaction
failure

Capabilities
failure

FINDINGS (I)

System failures Actors	Institutional		
	Hard: laws, regulations	Soft: norms, values	
Demand		negative attitude towards certain sectors (e.g. hospitality) reluctance towards failure	
Companies			
Third parties	collateral requirements of banks insufficient public funding in certain stages		investors are too focused on quantitative information insupportable conditions required by early-stage investors

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- - *Ralph:* No, we were granted **subsidies** and they were principally the **basis for our crowdfunding** campaign. And, apart from that, at that point of time only **early-stage investors are addressable somehow and horrendous conditions** and we have talked to some of them but I mean that is in fact ... [...]

Institutional
failure

Interaction
failure

Capabilities
failure

FINDINGS (II)

System failures Actors	Interaction Weak and strong network failure		
Demand			
Companies	weak correlation between input you give and result that is achieved in bank financing	no smooth information flow	lack of information regarding existing funding sources
Third parties	too impersonal interaction in bank financing high search and contracting costs from addressing each investor individually		poor matching between demand and supply

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- *James:* [...] another benefit is that you can **involve them** in the company's story, later win them as customers if not as sales persons to a certain extent, [...] that they somewhat do marketing for you. I mean, partially, they promote their small piece of the company very proudly in front of their friends and acquaintances, that is, you have a huge propagation the more investors you have. [...]
 - *Tom:* I think the big opportunity that crowdfunding has is that it makes transparent **who is in need of what** and that **people can find each other**; because it is also a sort of matching platform. Some have the demand; others can satisfy this demand and receive something in return. [...] Accordingly, it is not only a funding gap [...] but it also can support the investment gap in Germany, simply as an economic instrument, as **engine of innovation**. [...]
 - *James:* Yes... I would say so. It is a solid first financing alternative and does not necessarily exclude follow-up financing. [...] but it definitely closes this funding gap. In our case it was exactly that way.

FINDINGS (III)

System failures Actors	Capabilities	
Demand	consumers are not integrated in investing	
Companies	insufficient own funds of start-ups/ SMEs number of ideas vs. implementation rate: narrowed pipeline, only a fraction makes it to the market	complex investment process (offline) → CF tries to simplify it via the internet
Third parties	capital requirements up to 100k are barely covered by available investors, VCs only engage from 500k upwards investors: limited risk taking capacity, high absolute risk per investor, investing is restricted to a few large investors only cost-benefit ratio in bank/ angel financing is suboptimal no great multiplier effect/ reach in existing alternatives	

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- *Oliver:* Exactly, that is, for me it was my own experience with founding. [...] and in fact, crowdfunding is not a new topic but it was rather a question of “How can we simplify this process by means of the internet?” And on the other side, how can you optimize and structure mechanisms—that usually are only possible in the VC area starting from EUR 1 million—to the point that they also are useful for financing volumes of EUR 100,000. [...]
 - *Ethan:* [...] If on the other hand I address 1000 people and everyone gives me EUR 100, then every individual has a risk of only EUR 100 and that does not hurt anyone. [...] and the risk is vanishingly low for these people because these are many small amounts from a large number of people. The probability of failure is still the same but the absolute loss potential per person is indeed minimal. [...]



Paul: [...] **If nobody invests in crowdfunding it simply means that it's crap. [...]**

CONCLUSIO

- Business model innovation
 - For profit
 - Addresses important failures of the innovation system
- Does the addressing of given failures create new failures?
- Does the addressing of given failures call for government support of the crowdfunding industry?

FUTURE RESEARCH / QUESTIONS / CHALLENGES

- Effect of early stage crowdfunding on later stage financing?
- Development of the legal restrictions / requirements?
- Development of the crowdfunding sector
 - Diversification & specialization
 - www.1000x1000.at – Innovation projects & startups
 - www.conda.aat – Startups
 - www.greenrocket – Startups in the area of sustainability
 - www.neurovation – Creative industries
 - ...
 - New services (consulting etc.)

THANK YOU!

THANK YOU FOR YOUR ATTENTION.

Supported by



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