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CROWDFUNDING AS A SOURCE FOR START-UP FINANCING IN POLAND

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Purpose: Introduce the concept of crowdfunding, its essence and assumptions, as well as determine its role and significance in financing start-up activities in Poland.
Design/methodology/approach: For the purpose of attaining the objective and demonstrating hypotheses, data and information contained in papers and reports by Polish and European institutions and organisations like *European Start-up Monitor 2015, 2016*, *2018, Polskie startupy 2015, 2016, 2017, 2018, 2019* (Start-up Poland Foundation) are analysed and specialist literature is reviewed.
Findings: Sources of financing of start-up activities in Europe and Poland are identified. Alternative sources of financing for innovative business activities are indicated, together with the significance of crowdfunding as a source of capital for start-ups.
Originality/value: The paper addresses the important issue of social financing, a present-day source of financing for innovative projects. Knowledge about the role and significance of this form of financing for development of start-ups in Poland is scant. Alternative sources of start-up financing are explored and the role of crowdfunding in this respect is indicated.

Keywords: crowdfunding, financing, start-ups, innovative projects.

Category of the paper: Research paper.

1. Introduction

Innovation is a pre-requisite for competitive advantage in conditions of market economy. The financial aspect, particularly in the case of start-ups, means it is necessary to resort to alternative instruments of financing, including crowdfunding. It is seen as a form of financing undertakings, projects and activities of various nature and objectives, that undergo dynamic development.

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This paper will address social financing and its role in development of innovative business undertakings at initial stages of their development, in order to determine the role and significance of crowdfunding in financing Polish start-ups. To this end, the following research hypotheses are adopted:

H1. An existing capital gap in financing innovative business undertakings requires unconventional sources of financing.

H2. Crowdfunding is a present-day form of alternative financing for enterprises at early stages of development – start-ups.

H3. Role of social financing in development of Polish start-ups is limited and substantially lower than the European levels.

For the purposes of attaining the above objective and demonstrating the research hypotheses, data contained in studies and reports by Polish and European institutions and organisations is reviewed, including *European Startup Monitor 2015, 2016*, *2018, Polskie startupy 2015, 2016, 2017, 2018, 2019* (Start-up Poland Foundation) and a critical analysis of specialist literature is undertaken.

2. Assumptions for a definition and concept of crowdfunding

Specialist literature offers no standard interpretation or definition of crowdfunding. Indisputably, it means financing various undertakings by the "crowd", as indicated by a straightforward interpretation of the word. The notion was most probably introduced to everyday language by M. Sullivan in 2006 (Dziuba, 2012, p. 84). In the same year, it was propagated by J. Howe, who described crowdsourcing, with crowdfunding as its part, in *Wired Magazine* (Kozioł-Nadolna, 2015, p. 672). Crowdsourcing encompasses diverse forms of cooperation among entities, including enterprises and internet users, for them to take advantage of their intelligence, potential and passion, skills, knowledge and financial resources. "Crowdsourcing may be treated as an open work organisation based on collaboration and involvement of virtual communities" (Caputa, Paździor, 2018, p. 127). Crowdfunding has become an independent phenomenon that denotes social financing of innovative projects in different areas, including business, culture, science, sports and health. There is a number of attempts to define this concept (Table 1).

Table 1.
Selected definitions of crowdfunding

Author	Definition
K. Król (2013)	Crowdfunding is a type of capital gathering and allocation for the purposes of development of a specific undertaking in return for specified performances. It engages a broad range of investors and is characterised by utilisation of telecommunication and IT technologies, lower entry barriers, as well as better transactional terms and conditions than those generally available in the market
D. Dziuba (2012)	Crowdfunding is any form of fund gathering by means of computer networks (the broader concept); the process of fund gathering by enterprises, artists or non-profit organisations for the purposes of realising projects, organising undertakings and investments (the narrower concept).
A. Schwienbacher, A. Larralde (2010)	Crowdfunding is financing of a project or undertaking by a group of individuals instead of professionals (e.g. banks, venture funds or business angels) … It works without intermediaries: an entrepreneur "taps the crowd" when gathering money directly from individuals. Typically, communication takes place via the internet.
S. Steinberg (2012)	Crowdfunding is a procedure of obtaining donations from the public in order to gather capital needed to carry out a specific undertaking.
M. Malinowski, M. Giełzak (2015)	Crowdfunding is capitalism in 99%, where initiatives are realised by the Crowd, for the Crowd and according to its rules.
A. Spoz (2016)	Crowdfunding consists in shared project financing by the internet community (called the crowd) by means of the internet platform.
A. Brunello (2015)	Crowdfunding is a process of collaboration of a greater number of people, who decide to contribute low sums towards financing projects or visions of other firms, enterprises, organisations, as well as private individuals.
A. Polanowski (2018)	Social financing is an alternative capital acquisition that consists in a crowdfunding campaign designed to finance a specific project – object of the campaign.

Source: Author's own compilation based on: (Król, 2011), (Schwienbacher, Larralde, 2010), (Malinowski, Giełzak, 2015) (Dziuba, 2012, p. 84), (Spoz, 2016, p. 203), (Brunello, 2015), (Steinberg, 2012), (Polanowski, 2018, p. 4).

The foregoing definitions point to the unique nature of crowdfunding that requires distinct methods and ways of communicating between an originator – entity seeking capital – and the community, referred to as the Crowd. The latter, spelled with a capital "C", denotes the Crowd 2.0, understood as a creative, intelligent, living organism, also known as "Network/Digital Society" (as opposed to the crowd stereotype of a thoughtless mass). Crowdfunding uniquely lacks a traditional financial intermediary, replaced by internet platforms/portals of social financing. The way a project/investment is realised is also different from classic transactions – it comprises of a number of small transactions, involving relatively low sums, from a large number of investors (donors). Thus, the more addressees, the greater the chance of a project's success. "The power of this type of financing rests in the community, whose involvement may translate into realisation of a given project" (Pieniążek, 2014, p. 6). Funds transferred by internet users may be supplied as donations or in return for a performance (normally token) and/or voting rights in support of a specific initiative. The great variety and specificity of crowdfunding definitions stems from the relatively brief history of the market phenomenon. Based on the information available in specialist literature, however, the following characteristics can be distinguished in the definitions of crowdfunding:

- open nature of the invitation, the so-called open call, to the internet community,
- specific objective and amount (to be collected),
- voluntary support of the internet community,
- financial support by the Crowd (as micro-contributions),
- the internet as a tool of communication and unusual financial intermediary,
- (financial and other) gratifications in return for the Crowd's support,
- definite duration of an action.

Due to the diversity of objectives and return arrangements, several crowdfunding models can be distinguished (Dziuba, 2012, pp. 86-87; Kozioł-Nadolna, 2015, pp. 673-674):

1. Donations (charity) model – the most common model, where internet users provide financial support to a specific project with charity objectives. Users are not awarded as part of the classic model, though the sponsor model envisages in-kind prizes (e.g. books, concert tickets):
   a) Non-rewards model;
   b) Reward-based or sponsor model.
2. Lending model – the possibility of directly borrowing from the internet community (bypassing banks and other intermediating institutions/organisations); it comes in two varieties:
   a) Micro-finance – financial aid to the poorest, modest sums are distributed;
   b) Social lending – large sums are gathered and then lent to interested parties on specific terms; loans can be issued for consumption or business purposes.
3. Investment model – users of investment platforms assign their funds to specific projects and undertakings expecting palpable financial profits; this is a common way of financing start-ups; this model features three varieties:
   a) Collective investment – involving various groups, including business angels, who invest relatively low sums in development of a firm or a particular project;
   b) Investment fund – collective allocation of funds and shared investing; an electronic platform may be organised as an investment fund (e.g. venture capital fund); in return for investing in a project, funders expect to participate in profits, e.g. shares or stocks;
   c) Securities model – shares and ownership are sold to internet investors; large funds are normally invested.
4. Mixed model – combination of the above models.

Particularly the investment model – mainly the securities model (3.c) and the one based on collective investment (3.a) (e.g. as part of investment funds) – has recently gained importance as an alternative financial instrument, serving to gather capital from current and aspiring investors (Pance-Cybulska, Dąbrowska, 2018, p. 13). These are the core characteristics of crowdfunding as an alternative source of capital (Klimontowicz, Harasim, 2015, pp. 228-229):

- transaction platforms as a location for closing transactions,
- simple and transparent procedures of closing financial transactions,
- absence of regulatory restrictions characteristic to the financial sector,
- no protection of parties of a sale and purchase transaction.

The issues with regulatory restrictions are treated as development barriers. This applies, among other things, to legal regulations, particularly those concerning protection of investors, who become parties to transactions that are not subject to regulations prevailing in traditional financial markets, as well as lenders and borrowers, who are not subject to pro-consumer regulations. Absence of comprehensive legal regulations that would be essentially applicable to crowdfunding is raised in a number of specialist publications (Polanowski, 2018, pp. 4-7; Biela, 2018, pp. 97-105)

3. Crowdfunding versus other sources of financing for innovative business activities

Business is inextricably linked to looking for sources of capital. Funds from owners and their families constitute the fundamental source of financing the initial activities, though they are far from sufficient in a long term. Additional sources of capital are necessary for assuring development. Classic sources of capital primarily involve bank loans and credits, subsidies and structural aid. However, it often becomes impossible to secure these, due to a stage of business, type of undertaking and associated risk, financial condition and reliability of an entrepreneur. Procedures of obtaining financial aid are complicated, time-consuming and often costly, without a guarantee of success. Socio-economic development, though, including:

- the internet, with its information and communication technologies,
- electronic finance (electronic banking),
- and electronic commerce

has contributed to changes of business models in place, among other things. New possibilities of business financing have emerged, in particular for activities that found it the hardest to secure capital, that is, those at initial stages of development. Appearance of social networking services and information platforms has helped to extend offers to global customers/sponsors/investors. Start-ups, with their innovative products, high risk and early phases of development, have benefited. Crowdfunding is becoming more common, not only in charity actions, but also as a contemporary source of financing for business activities that have failed to secure funding from traditional sources. The contemporary sources of financing for innovative business at early stages of development primarily consist of business angels and high-risk funds, chiefly venture capital funds.

A business angel is a private equity investor, usually an individual entrepreneur, who invests capital in innovative business undertakings of high development potential at early stages, mainly start-ups. They offer not only financial, but also intellectual and business capital. On the other hand, venture capital is contributed for a specified time by third-party investors (venture capital funds) to small- and medium-sized enterprises, who have innovative products or services that have not been verified by the market yet, which entails a high risk of investment failure, yet a high expected rate of return of invested capital over time. Promotion of a project, its introduction to a more mature stage and profitable sale to another investor are the key objectives of venture capital investments.

Each of these sources of financing applies to economic undertakings at early stages of development (mainly start-ups) that have innovative products or services, which imply great risks. However, "investment crowdfunding seems to be a more easily available way of securing capital, particularly by micro-, small-, and medium-sized enterprises" (Pancer-Cybulska, Dąbrowska, 2018, p. 15). By investing their capital, venture capital funds set certain formal requirements, including an investment agreement that clearly sets out rights and duties of each party, as well as ways of exiting an investment. Commitment of investor's funds means transfer of some rights to an enterprise and loss of independent decision-making. An investment is expected to generate profits as it is exited. The same is true about such informal investors as business angels. Reaching investors and gaining their approval is another problem. In the case of investment crowdfunding, each member of the extensive internet community may be an investor, while sums involved are usually minor. "The prime difference is practical – this is an investor, who finds a project, not an originator who looks for investors" (Pieniążek, 2014, p. 10). A number of similarities is emphasised between crowdfunding and the so-called bootstrapping, where an entrepreneur primarily takes advantage of their own financial capabilities and creativity to develop their own business (Pancer-Cybulska, Dąbrowska, 2018, p. 16).

4. Crowdfunding as an alternative source of financing for start-up activities in Poland

Globalisation of the contemporary economy and a very intensive development of information and communication technologies enhance the potential of even the smallest enterprises for expansion to the international market. As a result, businesses offering tangible and intangible innovative products in virtual environment of the global market gain importance. These are – to a great extent – start-ups, characterised by above-average rates of development and growing market interest. "Start-ups are temporary organisations that seek profitable, reproducible and scalable business models" (Blank, Dorf, 2013, p. 50). "These are undertakings at initial stages of development, liable to above-average market risk, offering innovative products or services, often intangible and without a crystallised business model" (Kaliszczak, Sieradzka, 2018, p. 93). Market success of these enterprises depends on their ability to secure external investors, alternatives to classic sources of financing. Business undertakings at the early stages of development may obtain necessary capital from alternative sources, including business angels, high-risk, mainly venture capital funds and the increasingly popular community financing.

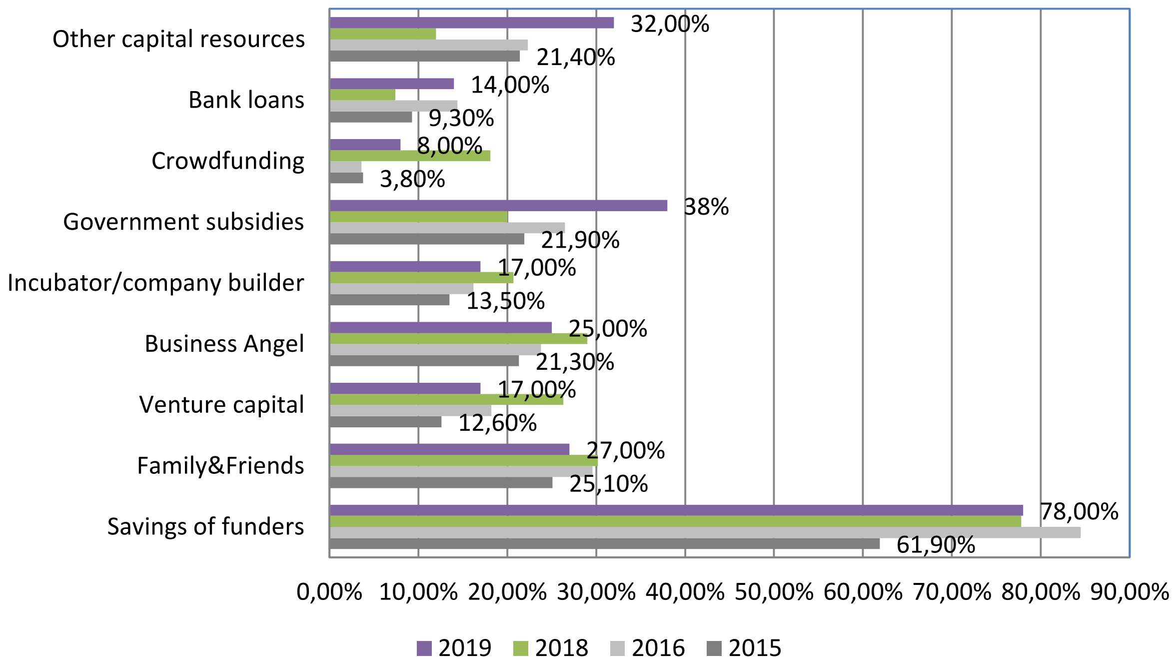
Crowdfunding is an innovative form of alternative financing that offers a range of benefits, chiefly to small, non-standard and creative entities, including (Piekunko-Mantiuk, 2016, pp. 46-47):

- independence from traditional sources of financing,
- potential for combining with other sources of financing,
- many small owners/shareholders,
- lower sums of financing,
- non-refundable financing can be obtained,
- feedback – ideas can be verified by the market,
- communication with the market.

Research into start-up activities in Europe has been conducted since 2015 by the *European Startup Monitor* (ESM), established by the EU Digital Economy and Society Commission. Its 2015 study covered 2300 start-ups from all the European Union member states (as well as countries of major importance to the development of the start-up ecosystem, e.g. Israel and Switzerland), while 2525 entities were examined in 2016. Its definition of start-ups is based on three characteristics:

- duration of activities in the market – up to 10 years,
- application of innovative business technologies/models,
- drive towards dynamic growth of staffing and sales.

Both European and Polish start-ups finance their development mainly out of their own funds (the so-called bootstrapping). These resources constitute the basic "financial starting package" for a majority of European entities, supplemented with financial support from their immediate environment (Figure 1). In search for additional sources of capital, European start-ups most commonly took advantage of support by business angels (29%) and venture capital funds (26.3%), ranking third and fourth (after own funds and financial support by family and friends) in 2018. Banking loans and credits are among the minor sources of financing for enterprise development at the early stages, due to the absence of crediting history or collateral and high risk of undertakings, among other factors. Research points to a growing role of community financing, whose utilisation had increased by 14 percentage points in three years, to reach 18.1% in 2018. This demonstrates a rising role and significance of this form of start-up financing today and in the future.



*2017 – no source data.

Figure 1. Sources of start-up financing in Europe in 2015-2018 (multiple choice). Source: The author's own compilation on the basis of: *European Startup Monitor 2015, 2016, 2018, 2019*. Retrieved from: http://europeanstartupmonitor.com, 02.04.2020.

In connection with the growing role and significance of start-ups to the development of the European economy, their positive effects on employment, innovation and economic growth, the situation on the Polish market needed to be examined (Kaliszczak, Sieradzka, 2018, p. 109). Polish start-ups have been studied by Start-up Poland Foundation since 2015 (covering 1235 in 2019, i.e. 290% more than in 2015), producing annual reports in order to determine the significance to the economy of the part of the digital sector consisting in start-ups (Skala, Kruczkowska, Olczak, 2015). Two characteristics are identified to define start-up enterprises; a minimum of one must be fulfilled to classify an entity as a start-up:

- it must be a part of the digital economy,
- it creates new IT/ICT solutions.

There were 4300-4700 start-ups in Poland in 2019, including 60% active solely in IT/ICT (Krzysztofik-Szopa, Wisłowska, 2019, p. 6).

As far as sources of financing of Polish start-up enterprises are concerned, in most cases, they coincide with European tendencies. As already mentioned, owners' funds are the key source of capital for Polish start-ups (Figure 2).

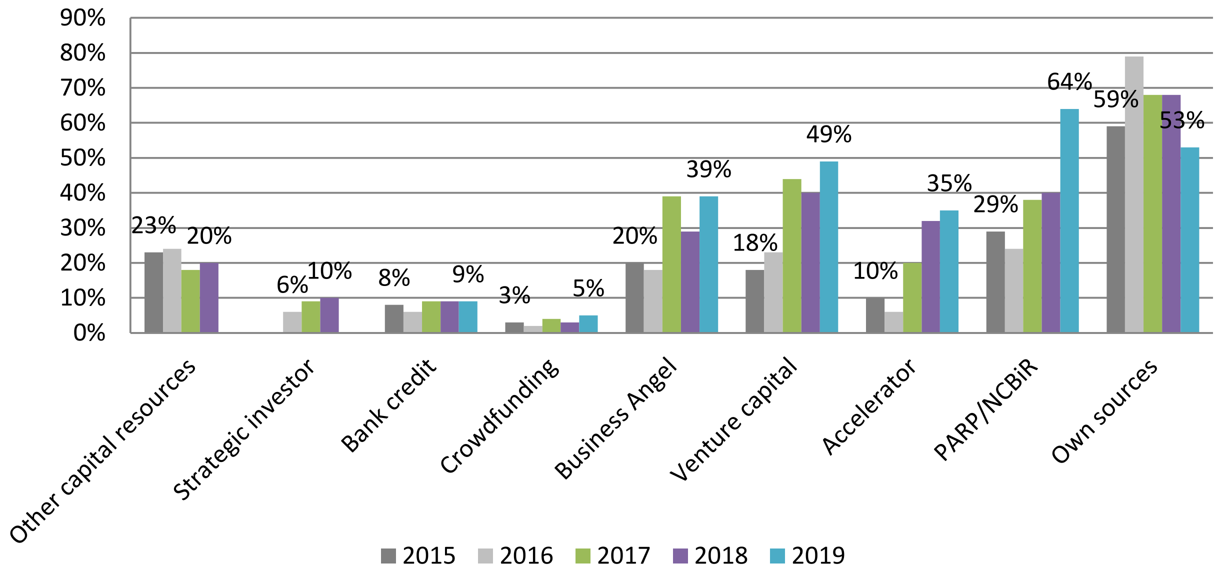


Figure 2. Sources of start-up financing in Poland in 2015-2019 (multiple choice). Source: Author's own compilation on the basis of: Raport, *Polskie startupy 2015, 2016, 2017, 2018, 2019*, Startup Poland and source materials of Startup Poland Foundation, Retrieved from: http://www.startup.poland.pl, 02.04.2020.

Alternative sources of start-up financing have been gaining importance. Venture capital funds – both domestic and international – as well as business angels provide considerable support for increasing number of Polish start-ups. Their utilisation reached 49% and 39% in 2019, respectively. Community financing in Poland is far below European levels. In 2015-2017, the extent of using the Crowd as the source of capital was up to 4%, which matched the situation in the European market. However, the positions of both markets diverged remarkably in 2018. The domestic market experienced merely a moderate rise (by 1 percentage point) to reach 5%, whereas as many as 18% of start-ups in the European market indicated crowdfunding as a source of financing for their investments.

Given the period of research, that is 2015 to 2019, and bearing in mind its short history, a growth tendency can be noted, as well as evidence of the growing role and significance of crowdfunding as an alternative source of financing.

5. Conclusion

Crowdfunding is the latest form of capital acquisition for business undertakings at their initial stages of development, offering innovative products/services, and subject to above-average risk. By funding a project, the internet community becomes an investor and shares responsibility for development and market success. Crowdfunding – mainly of investment type – is not only an unconventional instrument of financing innovative projects/businesses, but also a novel way of investing capital. Despite low threshold of start-up survival, these undertakings display a high rate of return on invested capital in case of market success.

Access to sources of capital is of paramount importance to the development of any business, start-ups in particular. Where classic sources of capital are unavailable, start-ups frequently resort to alternative ones: venture capital funds or business angels, as well as social financing. The following conclusions can be drawn based on the foregoing analysis:

1. Alternative business financing is the main source of start-up funding, beside capital of owners and their immediate environment.
2. Venture capital funds and capital of informal investors – business angels – are among the alternative sources of financing.
3. Significance of community financing to the development of European start-ups has been on the rise. In 2018, 18% of European start-ups took advantage of this capital source (14 percentage points more than in 2016).
4. Use of alternative capital sources in the development of Polish start-ups has been expanding. Venture capital funds and business angels' capitals have experienced a substantial rise in popularity.
5. Community financing as an alternative source of capital for Polish start-ups is at a low level (3% of start-ups in 2018 and barely 5% a year later), considerably behind European levels.

The innovative nature of start-up enterprises enforces a novel approach, not only to business models, but also to ways of their financing. Crowdfunding constitutes a contemporary source of capital support for investments, which has been evolving and is not studied in depth, while the interest in its application has been growing, as demonstrated by practice and research.

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