

## ISLAMIC FUND & WEALTH MANAGEMENT

A way forward

This publication is very timely, as it not only broadly contributes to IIBF's university flagship initiative on Islamic social finance, but it also specifically provides updated information on fund and wealth management with regard to current policies and practices. Empirical findings, case studies discussions, seminal as well as recent related literature are gathered in this book to cater for everyone inside or outside the fund and wealth management industry. With *Shari'ah* as the governing principles, the fund and wealth management industry has remarkably flourished throughout the years. Parallel with the consistent and coherent growth, this book offers insights and in depth investigations covering different aspects that may influence the continuous prosperity of this industry and caters for all players in the field.

Areas such as unit trusts, asset management, *Takaful* as well as pension funds together with several innovative products and wealth distribution mechanisms are put forth and discussed like *Waqf*, an endowment fund that combines investment performance with social distribution opportunities for the benefit of the society or *ummah* as well as technological fund-raising mechanisms such as crowd funding, aim at mitigating problems pertaining to access to financing for those entrepreneurs in need of capital.

All the key components of Islamic fund and wealth management are discussed in this book, thus it is a must read for those involved in this area, especially those responsible for developing policies and practices, in order to carefully engineer more competitive and innovative products and mechanisms based on the findings and outcomes of these studies. Anyone who regards fund and wealth management as crucial knowledge for a more sustainable wealth-managed future should also read this book, including those who also seek productive retirement and pension funds, which follow *Shari'ah* principles.

DR. RAZALI HARON is currently an Associate Professor at the International Islamic University Malaysia's Institute of Islamic Banking and Finance (IIBF). He specializes in corporate finance and investment. He has extensive experience in the corporate sector covering brokerage dealing, fund management, unit trust and capital market.

DR. ADAM ABDULLAH is currently an Associate Professor and Deputy Dean (Research & Publications) at the International Islamic University Malaysia's Institute of Islamic Banking and Finance (IIBF). He specializes in Islamic economics, Islamic finance & investment, including industry experience in Islamic private equity and asset management.



IUM Institute of Islamic Banking and Finance (IIBF)  
International Islamic University Malaysia,  
Jalan Gombak, 53100 Selangor Darul Ehsan,  
Tel : +603 6196 4185  
Fax : +603 6196 4856  
Website: www.iium.edu.my/iibf



ISLAMIC FUND & WEALTH MANAGEMENT | RAZALI HARON  
A WAY FORWARD | ADAM ABDULLAH

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A way forward

RAZALI HARON | ADAM ABDULLAH



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& W E A L T H  
MANAGEMENT**  
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Jalan Gombak

53100 Kuala Lumpur

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# Chapter 12

## The Potential of *Shari'ah*-Compliant Equity Crowdfunding as a Source of Fund for New Entrepreneurs in Malaysia

Muhammad Hafitz Edy, Aznan Hasan and Salina Kassim

Equity crowdfunding has become an increasingly popular fundraising method used particularly to assist new entrepreneurs or start-ups in establishing their projects. It operates using internet facility by leveraging on social networking sites to raise capitals. In the Islamic finance industry, equity crowdfunding is considered to be a relatively new area yet possesses high growth potentials as it is greatly in line with the spirit of the industry. This study seeks to explore the potentials of a *Shari'ah*-compliant equity-based crowdfunding as a tool to raise funds for entrepreneurs to support them in initiating their business projects. By adopting a qualitative research method through content analysis, various types of crowdfunding models that are available in the market are highlighted in which their suitability are assessed in the context of the Islamic finance industry in Malaysia. The study also sets out the latest legal framework and guidelines governing the equity crowdfunding industry in Malaysia. It is also found that more than RM30 million of capital has been raised by different enterprises since the registration of six equity crowdfunding operators by the Securities Commission Malaysia in 2015. Hence, there is a huge potential for *Shari'ah*-compliant equity crowdfunding to tap into the market provided that additional adjustments on its regulations pertaining to the aspects of *Shari'ah* aspects are incorporated.

### 1.0 Introduction

Generally, there is an increasing inclination especially among the young people towards entrepreneurship by means of setting up their own businesses to generate income. However, in getting started, young entrepreneurs are likely to be short of capital, thus requiring them loans from banks for financing. Banks however, would normally adopt the five Cs criteria, namely character, capital, capacity, conditions and collateral,



which is the normal screening process in evaluating applicants before approving any loans. As these young entrepreneurs are new in the market, there is a high possibility that they could not fulfil the five criteria and end up losing the opportunity to receive fund from the banks.

One of the innovations to access funding especially for new businesses is through crowdfunding. Crowdfunding emerged in an organized way in the wake of the 2008 financial crisis largely because of the difficulties faced by business start-ups in securing funding from banks, in view of the higher risks in the credit market amid the uncertain economic situation. Essentially, it is a process of funding a project by raising small amount of funds from a group of people or investors via platforms on the internet. The platforms provide investors with direct and quick access to information about the business model and funding needs without requiring financial intermediaries to connect between the surplus unit and deficit unit. Marzban et al. (2014) clarified that crowdfunding is a collective cooperation of a network of people to gather mainly financial resources in the form of donations or investments to support initiatives of others willing to establish, build or develop a specific business or project. It was also stated by Wahjono et al. (2015) that crowdfunding is a way in which people, organisations and businesses, including business start-ups, can raise money through online portals (called crowdfunding platforms) to finance or re-finance their activities. It is useful to support the development of innovative ideas and initiatives that cannot be funded by traditional modes of financing for the start-ups. The reason for this is that internet platforms can potentially reach very large audiences at a relatively low cost, by leveraging among others, on social networking sites. By doing so, crowdfunding will allow for the spreading of risks to a wider group of investors in much smaller incremental amounts as well as enabling the investors to interact with entrepreneurs in order to obtain recent development of such project (Ng et al., 2015).

In the context of Malaysia, a new set of guidelines to regulate the operation of equity crowdfunding has been issued by the Securities Commission of Malaysia in 2015. This effort thus marked Malaysia to become the first ASEAN country to have regulated laws on crowdfunding (Cheah, 2015). With the ambit of these guidelines, this study aims to explore the potentials of *Sharī'ah*-compliant equity crowdfunding to be implemented in Malaysia as the alternative source of funds for the entrepreneurs. Since Islamic finance is not restricted to benefit only the Muslim, the equity crowdfunding developed based on *Sharī'ah* contracts will create more access to fund for individuals both for Muslim and non-



Muslim as well to venture into business. The study adopts a qualitative approach through content analysis to gain various information and ideas regarding crowdfunding. Various literature have been found pertaining to guidelines, articles, journals and reports on crowdfunding. These findings are important to obtain necessary information especially the actual operation of crowdfunding. The present study thus considers the legal framework of equity crowdfunding in Malaysia as a case study to recommend some improvements on the subject for the future undertakings which can provide added value to this area of research.

### **1.1 Crowdfunding: Concept and Mechanisms**

The concept of crowdfunding emanates from the broader concept of crowdsourcing, which involves relying on the crowd to generate ideas, feedback and solutions to develop commercial activities (Belleflame et al., 2013). As a types of crowdsourcing, it takes place for example when a profit-oriented firm outsources specific tasks essential for the making or sale of its product to the general public (the crowd) in the form of an open call over the internet, with the intention of animating individuals to make a voluntary contribution to the firm's production process for free or for significantly less than that contribution is worth to the firm (Schwienbacher and Larralde, 2010). In a nutshell, the crowdfunding and crowdsourcing are interrelated in which the objective is to raise money from a large crowd of people. In this case, the users of crowdfunding platforms use the crowd to raise money for their personal needs, company business or for social causes.

Belleflame, Lambert and Schwienbacher (2013) further asserted that crowdfunding encompasses an open call, mostly through the internet, for the provision of financial resources either in the form of donation or in exchange for the future products or some form of rewards to support initiatives for specific purposes. In terms of commercial perspective, crowdfunding provides an alternative solution to assist entrepreneurs to raise capital from large group of people or investors through special crowdfunding platform on the internet. By using the platform provided by the crowdfunding service providers or operators, entrepreneurs can initiate an online campaign by promoting their ideas, structure of the business project, its advantages and strength, potential profit for the investors and other related information. Accordingly, potential investors who have access to the platform will know about the campaign and if convinced, will channel their money to the project that interests them. Giudici et al. (2012) explained that the crowdfunding operators also have



the duties to assist in this process by means of facilitating in the drafting of contracts and legal documentations, analyse the campaign timeframe and access, updating the progress of the project on the internet as well as managing the escrow accounts and payment methods. In return, they are paid in the form of fees for the services provided.

In practice, crowdfunding can be categorised into four types or models, namely (i) donation crowdfunding; (ii) reward crowdfunding; (iii) lending crowdfunding; and (iv) equity crowdfunding. Donation crowdfunding is typically used to support projects, business or charitable causes in which the funders' intention is to donate instead of gaining any tangible return for their capital commitments (Salman, 2015). In other words, the funders would contribute without any expectation of returns or income. Reward-based crowdfunding, additionally, is when the capital seekers may promise their project funders with special rewards depending on the size of the contribution (Salman, 2015). Some examples of these rewards are public recognition, free gifts, acknowledgement for support, prototype of the products which will be developed, regular news updates, tickets to a special event, limited edition goods and so forth. These are the non-monetary benefits to be given to the funders.

Meanwhile, lending crowdfunding, the funders actually provide loan to start-ups for their business. For that reason, they will receive returns in the forms of interest payments after a specified period of time (Marzban et al., 2014). This type of crowdfunding is also termed as peer-to-peer lending since it allows the loan arrangement between the lender and borrower to be operated differently from the traditional way of lending through banks (Wahjono et al., 2015).

Equity crowdfunding on the other hand, is when the investors acquire shares in the business and make profit or loss depending on the performance of the business. This type of crowdfunding method is similar to the Islamic investment contract of *musharakah* whereby the funders receive shares or stakes in the business or project they invest in (Wahjono et al., 2015). One main condition for this contract is that there shall be no guarantee on the capital and profit, however, if the business is successful, only then the profit will be shared between capital providers and start-ups based on the pre-agreed profit sharing ratio. Ng et al. (2015) agreed that this model has the potential of attracting relatively substantial number of investors, particularly high net worth individuals, professionals or institutional investors, but may also require the backing of a complex securities law and special attention from the financial regulators.



## 2.0 Literature Review

### 2.1 State of the Crowdfunding Industry: Global Scenario

The first online crowdfunding project was launched in 1997 by a UK rock band, Marillion, who was unable to go for a tour in the United States after releasing their seventh album due to lack of fund. Marillion fans in the USA used the fledging internet to raise US\$60,000 to ensure that the band would be able to go on their tour. Although the band was not involved in the early stage of the fundraising, they have since then used the same technique to successfully fund the production of their next three albums (Wahjono et al., 2015). In terms of crowdfunding platform, ArtistShare from the USA became the first modern day crowdfunding platform. Founded in 2000 by Brian Camelio, the platform allows singers and musicians to fund their projects through their fans' contributions (Giudici et al., 2012).

Nowadays, various enhancement and innovations in crowdfunding has been made to further boost the reach of this source of fund to many projects. A significant number of crowdfunding platforms have been established thus far and have grown into a massive industry especially in the USA and Europe. Among the popular platforms in the USA are RocketHub, Crowdrise, Indiegogo, AngelList, ArtistShare, SeedInvest, Quirky, Mosaic, Kickstarter and GoFundMe. Meanwhile, examples of crowdfunding platforms in the UK are Seedrs, BankToTheFuture, Funding Circle, JustGiving, Abundance Investment and Crowdfunder. Crowdfunding platforms that are still currently operating also exist in several European countries, for instance, Symbid in Rotterdam, Netherlands; MyMicroInvest in Brussels, Belgium; Wiseed in Toulouse, France; Innovestment in Berlin, Germany; FundedByMe in Stockholm, Sweden; and Eppela in Italy.

Crowdfunding platforms in South America are also very active. A few examples include: Kickante in Sao Paolo, Brazil; Kueski in Guadalajara, Mexico; La Chevre in Colombia; Broota in Las Condes, Chile; and Ideame in Argentina. These are the crowdfunding platforms that are based in South America continent.

In Asia, crowdfunding has high-growth prospect as reflected by the increasing number of innovative projects are continually being crowdfunded. Among the popular crowdfunding platforms are FringeBacker in Hong Kong, DemoHour in Beijing, China; Kitabisa in



Jakarta, Indonesia; Skolafund in Malaysia, Share and Raise in Thailand, ProTEES Project in Philippines, Sniffrr in Singapore and Campfire in Japan.

Furthermore, similar to the conventional crowdfunding platforms is the Islamic crowdfunding platforms that facilitate the funding process between project initiators and crowd funders. Since the demand for Islamic crowdfunding is increasing, few platforms have been established not only to serve the Muslim community in Islamic countries but also in non-Islamic countries. Among the recognised platforms are Beehive in Dubai, United Arab Emirates (UAE); Shekra and Yomken in Cairo, Egypt; Liwwa in Amman, Jordan; EthisCrowd, Kapital Boost, YemenAid and WaqfWorld in Singapore; Global Sadaqah, Skolafund and Nusa Kapital in Malaysia; Sadaqah Indonesia in Indonesia; Seedout in Lahore, Pakistan; as well as LaunchGood in the USA.

According to the Crowdfunding Industry Report (2015), worldwide crowdfunding volumes continued to increase from \$2.7 billion in 2012, to \$6.1 billion in 2013 and reached \$16.2 billion in 2014. In terms of volumes from each continent, North America recorded a total of \$1.6 billion in 2012. This figure continues to increase in 2013, which amounted to \$3.86 billion and finally reached \$9.46 billion in 2014. As for Europe, total funding volume also recorded a substantial increase from \$945 million in 2012 to \$1.35 billion in 2013, and to \$3.26 billion in 2014. Similarly, the total funding volume increased from \$809.8 million in 2013 to \$3.4 billion in 2014 in Asia. In the same year, the African region raised to the total funding of \$12 million, while total funding volumes in South America amounted to \$57 million. Finally, Oceania recorded \$43 million of total funding volumes. The overall total of worldwide funding volume thus amounted to \$16.2 billion in 2014, with North America contributing the largest amount at \$9.46 billion or 58.40% of total funding volume, followed by Asia (\$3.4 billion or 20.99%), Europe (\$3.26 billion or 20.12%), South America (\$57.2 million or 0.35%), Oceania (\$43.2 or 0.27%) and the lowest by African region (\$12 million or 0.07%).

In terms of the categories based on type, lending crowdfunding has been the leading crowdfunding model in the world that generated the highest annual funding volume since 2012. In that year, the model generated \$1.19 billion or 44.07% of total crowdfunding volume. The volume continues to increase in 2013 at \$3.44 billion (56.39%) and reached \$11.09 billion (68.46%) in 2014. This is followed by the donation crowdfunding model whereby it contributed \$999 million or 37% of the



total funding volume in 2012. The funding volume kept increasing for the next two consecutive years; the model generated \$1.34 billion (21.97%) in 2013 and \$1.94 billion (11.98%) in 2014. The reward crowdfunding model, on the other hand started from \$391 million (14.48%) in 2012, increased to \$726 million (11.91%) in 2013, and further improved to \$1.33 billion (8.21%) in 2014. Finally, for equity crowdfunding, the model recorded a total funding volume of \$118 million (4.37%) in 2012, slightly increasing to \$395 million (6.48%) in 2013 and finally reached \$1.11 billion (6.85%) in 2014.

The equity crowdfunding has the lowest annual funding volume compared to other models due to the fact that it is the latest crowdfunding model being promoted in the market. Since the model involves obtaining capital through small equity investment, the operation is more complex and relatively stricter in the supervision by securities authorities in such countries. This is because the authorities have the duty to safeguard the investors' confidence in the securities markets. The entrepreneurs would require more time to fully understand the terms and condition before they host their business on the platform and investors must be fully aware of the risk borne once they channel their money in this crowdfunding activity. However, the increase of funding volume of the equity crowdfunding worldwide from 2012 until 2014 showed that it has a lot of advantages to attract entrepreneurs and investors in using this platform.

In crowdfunding platforms, specifically for donation-based crowdfunding, the leading platform in the market was JustGiving in the UK with a funding volume raised up to \$1 billion; this was followed by GoFundMe platform in the US which has funding volume up to \$500 million. The third one is Indiegogo which is also based in the US. The platform has total funding volume up to \$250 million. This is followed by Youcaring, the US platform which has total funding volume up to \$200 million and the fifth is Fundly platform in the US which has raised \$150 million of total funding volume. As for reward crowdfunding, the top performer is GoFundMe. It is recognised as the platform which operates as the donation and reward model at the same time. Second is the Kickstarter platform, operated in the US that has total funding volume up to \$450 million. Indiegogo, the platform that operated the same as GoFundMe took the third place with total funding volume up to \$250 million. Ulule, from France was in the fourth place with approximately \$25 million and Fundrazr, the Canadian crowdfunding platform that generated less than \$25 million total funding was the fifth leading reward-based crowdfunding in the world.



For lending crowdfunding, LendingClub platform in the US recorded the highest total funding volume worldwide with more than \$4 billion. This is followed by Prosper platform, also in the US with more than \$2 billion total funding volume. Ratesetter and Zopa in the UK contributed up to \$350 million each, while Lendinvest which is also in the UK recorded total funding volume amounted to \$350 million. Besides that, EquityNet in the US which recorded up to \$300 million total funding volume was the leading equity crowdfunding platform. The second was Fundable platform, based in the US with total funding volume approximately \$150 million. In the meantime, Angelist and Crowdfunder platforms which are also based in the US generated \$100 million each. Finally, the CrowdCube platform, which is headquartered in the UK recorded total funding volume amounted to \$100 million as well.

## **2.2 Crowdfunding Industry in Malaysia**

Malaysia became the first country in Southeast Asia to introduce a regulatory framework for equity crowdfunding in the year 2015. However, the development of the framework has started much earlier since 2014. It was mentioned before that equity crowdfunding is an offering of securities by a privately held business to the general public, usually through the medium of an online platform (Collins and Pierrakis, 2012). According to SC (2014), equity crowdfunding could also be regarded as a type of fundraising that allows start-ups or smaller enterprises to obtain capital through small equity investments from relatively large numbers of investors. It is operated by using online portals to publicise and facilitate such offers to the crowd investors. As a matter of fact, six equity crowdfunding operators had successfully registered with the SC and fully operationalised in 2016. The six registered platform operators are FundedByMe, Ata Plus, Crowdo, Eureeca, Equity.pitchIN and Crowdplus.Asia.

On 21<sup>st</sup> August 2014, the SC published a public consultation paper on its website with the purpose of receiving feedbacks and generating discussion from the public regarding their proposed regulatory framework for equity crowdfunding operations. Among the requirements included in the framework are the permissible and non-permissible activities of equity crowdfunding operators, their obligations, complaints and dispute resolution mechanism, managing conflict of interest, types of securities permitted for offering, limit of funds raised through the equity crowdfunding platforms, advertising method, cooling-off period and



others. The SC allocated 16 days for the public to give their comments. Pursuant to this, on the 19<sup>th</sup> until 20<sup>th</sup> September 2014, the SC decided to organise the Synergy and Crowdfunding Forum with Malaysian Business Angel Network. The equity crowdfunding forum participated by hundreds of entrepreneurs and investors, is the first of its kind in Malaysia. The forum aimed to generate public awareness regarding the potential for equity crowdfunding to become the new source of capital for business activities.

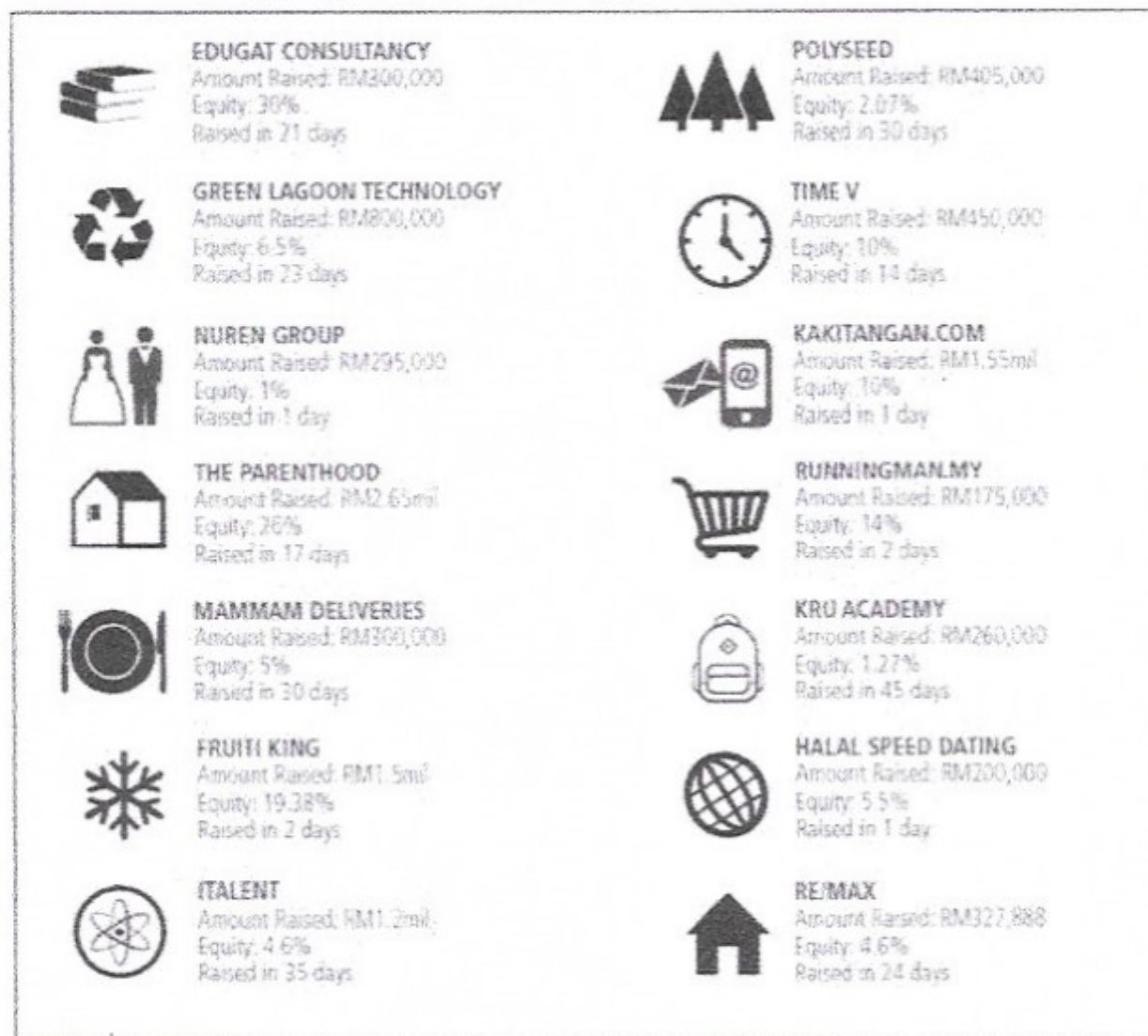
On 22<sup>nd</sup> September 2014, the SC released its public response paper regarding the proposed regulatory framework. It received response from entrepreneurs, financial institutions, potential crowdfunding operators and the general public as well. Majority of these parties provided positive feedbacks on the proposed framework. Following this, the SC then issued a guideline pertaining to equity crowdfunding on 10<sup>th</sup> February 2015. The document, called the Guidelines on Regulation of Markets under Section 34 of the Capital Markets and Services Act 2007 is intended to govern all the equity crowdfunding activities (SC, 2015). By having the guidelines, only then could the equity crowdfunding be legally operated in Malaysia. Operators interested to establish the equity crowdfunding platform are invited to submit their application to the SC. This resulted in the successful establishment of the six platforms mentioned previously who were successful in their application to be the registered operators and able to perform the equity crowdfunding activities legally beginning 2016. However, the guidelines were superseded by the Guidelines on Recognised Markets on 11<sup>th</sup> December 2015 and then further revised on 13<sup>th</sup> April 2016 as the intention was to include the regulatory framework for peer-to-peer financing or lending-based crowdfunding as well. As notified by the SC (2016), the revised Guidelines on Recognised Markets came into effect starting 2<sup>nd</sup> May 2016. Realising that the start-ups are facing challenges in obtaining funding through traditional financial institutions due to lack of assets for collateral, no track record yet and limited cash flow, the SC stated that both equity and lending-based crowdfunding are expected to widen the financing avenues for start-ups, micro, small and medium enterprises (SC, 2017). While equity crowdfunding is aimed to facilitates the enterprises for seed capital and early-stage financing, lending-based crowdfunding is expected to assist more mature and established businesses that seeking fast approval of short term financing for working capital or capital for growth.

The equity crowdfunding is a very fast-growing market. In less than a year of its operation, RM10.41 million was raised by 14 successful



companies. According to the SC Annual Report 2016, Kakitangan.com holds the record as the fastest company to meet its minimum funding target. The company managed to raise RM1.55 million only in one day. Meanwhile, The Parenthood raised RM2.65 million, surpassing its minimum threshold of RM1.05 million by 251%. This was also the largest amount raised through the equity crowdfunding platform in Malaysia. In addition, Halal Speed Dating managed to attract the largest investments by foreign investors in a particular deal, which amounted to 25%. The Malaysian equity crowdfunding market has thus far managed to attract not only local investors but foreign investors, including those from Australia, Finland, Germany, Singapore, Sweden and Turkey.

Diagram 1: Companies that Achieved Targeted Funding Volume through Equity Crowdfunding Platforms in 2016



Note: The diagram above shows companies which managed to raise their targeted amount within the campaign period through the equity crowdfunding platforms in 2016. Sources: SC Annual Report 2016.

As for 2017, Securities Commission Malaysia stated that another 23 companies have successfully raised RM22.34 million of fund through the equity crowdfunding platforms, with the highest amount of fund raised by a single crowdfunding campaign was RM3 million (SC, 2018). Hence, between 2016 to 2017, there is an increase of 115% in fund raised



as well as 64% increase in number of companies that are successful in their crowdfunding campaigns. According to Securities Commission Malaysia (2018), the growth of fund raised indicates a strong demand of equity crowdfunding and demonstrates its inclusive nature as the alternative funding avenue for business start-ups.

### **3.0 Data and Methodology**

This chapter utilises the qualitative method through content analysis. According to Sekaran and Bougie (2010), content analysis is an observational research method that is used to systematically evaluate the symbolic contents of all forms of recorded communications. Elo and Kyngas (2007) stated that it was first used as a method for analysing hymns, newspaper and magazine articles, advertisements and political speeches in the 19th century. It has a long history of use in communication, journalism, sociology, psychology and business, and during the last few decades its use has shown steady growth. Nowadays, it is used to analyse websites, recordings of interviews and the like. Besides that, the method of content analysis enables the researcher to analyse textual information and systematically identify its properties, such as the presence of certain words, concepts, characters, themes, or sentences (Sekaran & Bougie, 2010). In this study, content analysis is set up through investigating the important writings regarding the matter and information from journal articles, annual reports, act and guidelines from the SC of Malaysia. This is to concentrate on the present advancement, issues and problems of the equity crowdfunding market in Malaysia.

### **4.0 Findings and Discussion**

#### **4.1 Potentials of *Shari'ah*-Complaint Equity Crowdfunding in Malaysia**

The issuance of the Guidelines on Recognised Markets provided greater avenue and potential for Islamic equity crowdfunding to grow in the future. This is the suitable law that can regulate the operation of the equity crowdfunding. Since the equity crowdfunding falls under the capital markets, involves the issuance of shares and provision of financial returns, it is important to safeguard the interest of the investors who participate in the crowdfunding activities. According to the guidelines, those entrepreneurs who wish for their fundraising campaigns to be hosted on the equity crowdfunding platform must set up a private limited company that are locally incorporated. They are not allowed to



use more than one equity crowdfunding platforms at the same time for their campaigns. In addition, they deserve to raise a maximum amount of RM5,000,000 to fund their projects provided that they use only one equity crowdfunding platform during the campaign period. Therefore, they are required to disclose accurate information and documentation pertaining to their companies to the equity crowdfunding operators such as the key characteristic, purpose of the fund raising, total funding targeted, business plan and audited financial statements. On the other hand, the equity crowdfunding operator is responsible to reveal the information pertaining to the entrepreneurs' business and company on the platform. Any fees and charges that the operators impose on the entrepreneurs and investors must also be disclosed. In regards to the investors, both local and foreign investors are allowed to invest in the projects or businesses, however, subject to a certain investment limit. For those who are angel investors, the maximum limit of their investment is RM500,000 within a 12-month period. As for retail investors, the maximum limit is only RM5,000 per company, however, the total amount of investment must not exceed RM50,000 within 12-month period. Finally, the SC does not impose any investment limit to the sophisticated investors and also does not stated the minimum investment limit for all of them. This is to ensure that the start-ups are able raise small amounts of money from large number of individuals as well as to attract participation from first-time investors to start investing in the equity market at a young age. Hence, this reflects the inclusive nature of equity crowdfunding as an alternative market-based financing avenue and in line with the SC's digital agenda to enhance access to financing in the capital market (SC, 2018).

Any applicant who wishes to be registered as the equity crowdfunding operator must be a body corporate or a limited liability partnership. The equity crowdfunding operators bear the responsibilities to provide communication channel between the investors and the entrepreneur on the platform, ascertain all information regarding the entrepreneur business, ensure the fundraising and investment limit are not breached, have in place the procedures for dispute resolution, inform the possible risks that may be borne by the investors and also the fees and charges that may be imposed on both parties. On top of that, the operators must carry out due diligence exercise to these entrepreneurs

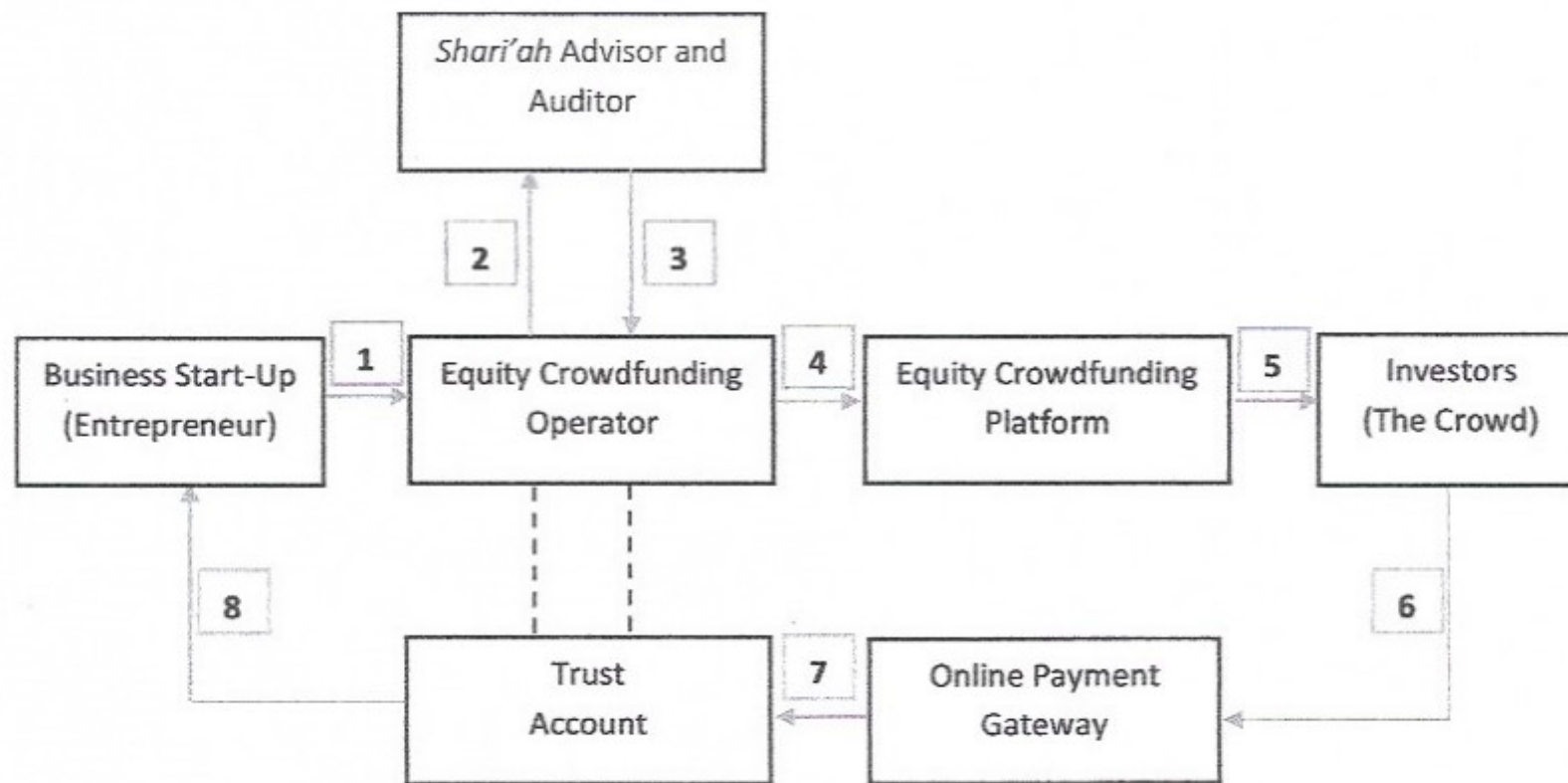


who apply to use their platform whom are prohibited to accept all the application without performing the exercise. They must also have a proper anti-money laundering mechanism to prevent illegal parties from investing in the crowdfunding activities.

For matters related to *Sharī'ah*, the operators who wish to be certified as the *Sharī'ah*-compliant equity crowdfunding operators have responsibilities to appoint a *Sharī'ah* advisor to guide and structure the equity crowdfunding operation according to principles of Islamic law. The advisor must be a registered *Sharī'ah* advisor with the SC. However, the operators can also appoint an Islamic bank or investment bank that operates Islamic banking business as the advisor. Nonetheless, the *Sharī'ah* requirements in the Guidelines on Recognised Market are not sufficient in order for such equity crowdfunding operators to run based on *Sharī'ah* principles holistically. The guidelines should highlight which *Sharī'ah* contracts that are suitable to be applied in the operation. In this case, the possible contracts would be *Mudharabah*, *Musyarakah* and *Wakalah*. In addition, the *Sharī'ah* parameter for the business or business screening should be introduced for investors and entrepreneurs to learn the criteria of the businesses that are eligible to leverage on the equity crowdfunding platforms. In this case, the products and services that are going to be developed and advertised during the crowdfunding campaigns must be lawful and permitted by the *Sharī'ah*. The guidelines should also incorporate another provision pertaining to the funds from the investors. This is to ensure that the funds are coming from halal sources. It is suggested that regular assessment on the *Sharī'ah* compliance for the equity crowdfunding activities and operations should be ongoing and not for some cases only. Hence, if there are issues regarding *Sharī'ah* non-compliance, immediate rectification can be done. These steps can be added with the *Sharī'ah* audit processes in order to provide an independent assessment from time to time. The aim is to have an effective *Sharī'ah*-compliant internal control system for the equity crowdfunding operators. The *Sharī'ah* auditing process should cover the financial statements of the operators, accounting treatments, legal documentations, people, process, IT system and so forth.



Diagram 2: Modus Operandi of Equity Crowdfunding based on *Mudharabah*



1. Entrepreneur who wish to raise fund for their business start-up will engage with *Shari'ah*-compliant equity crowdfunding operator to discuss and disclose all required documents before the crowdfunding campaign can be hosted on the platform. This include: information about the company, purpose and targeted amount of fundraising, business plan and accurate financial information. The operator can advise the entrepreneur if it thinks that the documents are incomplete and also can provide consultation to the entrepreneur who want to improve knowledge and skills related to business, finance, marketing, management and crowdfunding. All fees and charges must be disclosed to the entrepreneur. Hence, apart from the crowdfunding services fee, the operator may want to charge the consultation fee to the entrepreneur. Besides that, with the assistance of *Shari'ah* advisor, the operator will discuss further with the entrepreneur in order to prepare a legally enforceable agreement for *mudharabah* venture. The agreement shall be acknowledged by the entrepreneur and the investors which include: the purpose and tenure of *mudharabah* venture, the contractual relationship and responsibilities of both parties, the amount of investment and also the profit sharing ratio which consist of its calculation and distribution.
2. After all agreements and documents have been submitted, the operator will consult with the *Shari'ah* advisor to review, advise and certify the structure of the entrepreneur's business operation, proposed structure of crowdfunding campaign as well as the



issuance of the equity. If the advisor believes that there is a high possibility of *Shari'ah* non-compliant risk to happen, the operator needs to reject the application or engage back with the entrepreneur to amend its business operation and the documentations involved.

3. If the requirements have been fulfilled, the operator will leave to the operator to develop the crowdfunding campaign.
4. The operator starts to develop the crowdfunding campaign on its web-based platform.
5. During the crowdfunding campaign, the operator shall disclose the background of the entrepreneur's company, overview of the business, the duration of the campaign, financial information of the company, minimum and maximum funding target, total equity offered, current number of investors, pictures and videos of the product or service, on the platform to attract the crowd. In addition, the operator can also promote the crowdfunding campaign on its social networking sites.
6. Those who are interested to invest in the business will channel their money through the online payment gateway subscribed by the operator.
7. All the fund raised will be transferred to the trust account established by the operator.
8. The fund will be disbursed to the entrepreneur business account after the targeted funding amount has been met after the campaign ended, no changes of material adverse related to the business during the campaign and six business days of the cooling-off period have been expired. The investors also must reach an agreement with the entrepreneur for the *mudharabah* venture and enter into the contract as mentioned before.

## 5.0 Conclusion and Recommendations

This study discussed the potentials of *Shari'ah*-compliant crowdfunding in Malaysia and suggestions to improve its regulations in the future. In essence, crowdfunding is a method of using small amount of money, obtained from a large number of individuals or organisations, to fund a project through an online web-based platform. Crowdfunding



can be categorised into four types: donation, reward, equity and lending. However, only equity and lending crowdfunding are regulated in Malaysia. As monetary return to the investors and lenders are involved, protection on investors and lenders' interest are crucial. If the equity crowdfunding operators wish to operate in compliant with the *Shari'ah*, a qualified *Shari'ah* advisor must be appointed. The *Shari'ah* advisor has a great responsibility in ensuring that all matters regarding the crowdfunding operations complied with *Shari'ah* principles and rulings from end to end. The year 2014 recorded a total funding volume of \$1.11 billion worldwide, an increase from \$395 million in 2013 through equity-based crowdfunding. In Malaysia, for instance, a total funding of RM10.41 million was raised by 14 companies with successful equity crowdfunding campaigns to support several types of business in 2016. The figure continues to increase in 2017 whereby 23 companies were managed to raise RM22.34 million through their campaigns. Therefore, this type of crowdfunding has great potentials to tap into the market for creating access to fund for business start-ups, as well as micro, small and medium enterprises.

In conclusion, equity crowdfunding certainly shows growth potential in the future and strong ability to provide access to capital. *Shari'ah*-compliant equity crowdfunding can definitely be operated successfully in Malaysia with proper structures, *Shari'ah* assessment and regulation. It is thus recommended that a special mobile application for the equity crowdfunding should be developed in the future to facilitate potential investors in arranging their investment. By using the application, the investors will then be able to choose between the myriad equity crowdfunding operators currently hosting creative and innovative campaigns from the entrepreneurs for the fundraising activities. Since the regulation for equity and lending crowdfunding has been finalised, new laws to regulate community-based crowdfunding should be issued as well in the future. This is because it is one of the good mechanisms to support non-governmental organisation activities, social causes and for financial inclusion. The crowdfunding market grows very fast nowadays, in line with the banking and finance industry as well as the financial technology. In the future, more complex structures of crowdfunding may exist with different purposes and target segments. The regulators, *Shari'ah* advisors, technical experts and researchers are thus required and must be well equipped with the up-to-date knowledge to ensure the operation of the crowdfunding is not contradictory with the laws, comply with *Shari'ah* and have additional value that differentiates it with its conventional counterparts.



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