TOWARDS A SHARĪ'AH COMPLIANT EQUITY-BASED CROWDFUNDING FOR THE HALAL INDUSTRY IN MALAYSIA

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ABSTRACT

While Malaysia is set to become the global halal hub by 2020, there is still the challenge of product differentiation that meets customers' needs and more importantly, access to credit facilities for halal start-up small and medium sized enterprises (SMEs). In order to increase the competitiveness of the Malaysian economy, and while relying on a combination of qualitative methods of survey-cum-interview and legal analysis of relevant laws and policies, this study examines the need for an effective Sharī'ah-compliant financing platform for the halal firms based on the Guidelines issued by the Securities Commission Malaysia that provide the requirements for the registration of equity crowdfunding platform and an effective governance arrangement for such platform. Nevertheless, the guidelines have not specified the type of Sharī'ah-compliant equity crowdfunding platform that can be utilized by halal SMEs who need to raise start-up capital through Sharī'ah-compliant means. With the increasing need to provide such an alternative financing source to the budding SMEs in the halal sector, this study explores the relevance of crowdfunding to SME financing, examines the specific financing needs of such SME halal firms, analyze the new legal framework for equity crowdfunding, and propose potential Sharī'ah-compliant equity crowdfunding model based on existing modes of financing commonly used in the Islamic financial services industry. The study concludes that though it is often argued that equity crowdfunding is generically Sharī'ah-compliant, a closer look at the models reveal the importance of coming up with unique Sharī'ah-compliant equity crowdfunding for a sustainable halal industry.

Keywords: Equity Crowdfunding; Crowdinvesting; Halal Industry; Halal Smes; Islamic Finance.

1. INTRODUCTION

Malaysia envisions becoming an advanced economy by 2020. This goal is determined by its level of social and economic development. The prosperity of the nation as well as the healthy growth of the economy is pivotal for the country to achieve its mission and vision. The largest contributor to Malaysia's economic growth in terms of Gross Domestic Product (GDP) and exports has been the services sector. For example, in the Tenth Malaysia Plan which spanned from 2011-2015, all economic sectors experienced impressive growth, especially the services sector that was most contributing. The services

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sector remained the largest contributor to the GDP at 53% and grew 6.3% annually. The largest constitution (90%) of the services sector is the small and medium enterprises (SMEs) sector, which contributed 20% to the overall GDP (Economic Planning Unit, 2015). Consequently, the Eleventh Malaysia Plan, 2016-2020 is expected to witness continuous growth of the services sector that include the wholesale and retail trade, financial services, communications subsectors, construction and the modern and knowledge-intensive industries such as halal, ecotourism and information, communications and technology (ICT).

Malaysia exports for halal-certified products have been increasing over the years; it increased from RM15.2 billion in 2010 to RM32.8 billion in 2013, which is approximately 4.6% of total exports. It is interesting to note that by 2013, the number of halal certified companies by the Department of Islamic Development Malaysia (or JAKIM as popularly called in Malay) pitched 34% to 4,443 companies compared with 3,316 in 2012. A large percentage (75%) of these firms were SMEs, and 25% were the MNCs. The majority of these firms (80%) were owned by the non-Bumiputera or non-Muslims generally (Economic Planning Unit, 2015).

As Malaysia aims to become the halal hub globally, it is important for the halal companies to be resilient and sustainable. Thus, this study is carried out to provide an alternative for the halal firms that are mainly of the SME size to involve in Islamic crowdfunding activity to gain access to financing that conforms to Sharī'ah principles but powered by fintech. Hence, this paper begins with an overview of the halal's industry in Malaysia. It is followed by discussions on Crowdfunding and SME Financing; and the financing needs of the SME sized Halal firms in Malaysia. Consequently, the paper presents the new legal framework for equity crowdfunding introduced by the Securities Commission Malaysia. It then proposes Sharī'ah-compliant Hybrid Equity Crowdfunding Models that can be applied, and finally provides some recommendations and conclusion.

2. AN OVERVIEW OF THE HALAL VALUE CHAIN

Realizing that Malaysia aims to become the global halal hub, it is thus important that its halal compliance is comprehensive and encompasses every aspect of the industry value chain. The comprehensiveness refers to conformance of all sectors to Sharī'ah principles and the objectives, aims, vision and mission are driven by Islamic values to attain profit for society, family and individual wellbeing. In this regard, the value chain of a halal industry takes effect from the inception of an idea to initiate halal business, to attaining financing to run the business that includes obtaining raw materials and process them to final product, commercialize and consequently after sales activity. Thus, it is important to ensure that 'halal' encompasses every aspect of the halal industry, including its financing, which must be fully free of interest-based debt financing. It would be supremely ironic if the products of the *halal* industry, including the food that becomes part of Muslims' bodies, are tainted by *riba* in the processes of acquiring financing t produce those products. Therefore, this paper attempts to unveil the important role Islamic finance has to play in the comprehensive compliance of Sharī'ah in the halal industry through Islamic crowdfunding driven by financial technology (fintech).

Though the *halal* industry has grown rapidly, with continuous increasing demand from the Muslim population all over the world, not all of these *halal* institutions or firms are financed Islamically or in a Sharīʻah compliant manner. It is therefore crucial for the *halal* industry to be certified *halal* not only for the production and preparation of the products but also by the means of its financing (Abdullah & Zainal Abiddin, 2014). Kavilash Chawla, the *halal* industry expert and managing director of Nur Global Strategies, aptly stated: "Trying to provide *halal* certified products without financing them through Islamic facilities demonstrates a fundamental disconnect from a belief perspective" (IFN, 2014). He went on to say, "If your product is produced using *halal* methodologies and processes and sourcing, but your company is financed in a *haram* way, technically one would assume that your output is *haram*" (IFN, 2014).

Since the financing needs of the *halal* industry are not being properly met, the industry may be regarded as not functioning at full compliance with *Sharīʻah* principles. Hence, there is growing realization that the long-term sustainable growth of the *halal* industry depends largely on the development of complete compliance of *Sharīʻah* principles through Islamic financing.

3. CROWDFUNDING AND ISLAMIC FINANCE

Crowdfunding is not a new concept but is a new term used in the financing realm to define the type of financing activity which gathers a pool of money that ranges from small to medium-size contributions from a crowd of people from different background, age group, religion and races to participate in an economic exercise that aims to mutually finance each other based on certain needs with reference to some specified criteria (Beaulieu, Sarker, & Sarker, 2015). It is defined as a type of participative online activity in which an individual, institution, non-profit organization, or company proposes to a group of individuals of varying knowledge, heterogeneity, and number, via a flexible open call, the voluntary undertaking of a task which always entails mutual benefit, and the crowd participates bringing work, money, knowledge and/or experience (Estellés-Arolas & González-Ladrón-De-Guevara, 2012). In a similar vein, Mollick defined crowdfunding as "the efforts by entrepreneurial individuals and groups—cultural, social, and for-profit—to fund their ventures by drawing on relatively small contributions from a relatively large number of individuals using the internet, without standard financial intermediaries" (Mollick, 2014) . The definitions denote three important elements of crowdfunding, which are technology, capital funding, and the power of the crowd. These three important elements enable many small efforts to accumulate to a significantly huge financial outcome (Beaulieu, Sarker, & Sarker, 2015).

Technology is not only the core element in crowdfunding exercise but also the backbone of it which provides a platform for those founders to expose their projects to a large number of potential backers, and the platform also facilitates communication between the founder and backers (both potential and actual) through features such as a comment section, project update capabilities, and email exchanges (Zohrabyan, Fernandes, Lopes, & García, 2017; Goodman, 2013, p. 84). The founder is an individual or a group of people with different knowledge and experience seeking for financial assistance to envision a product or project and then present their ideas clearly and compellingly to would-be backers, or to test-market an idea (Helmer, 2014), to gain exposure for future funding (Dingman, 2014), to gain validation (Gerber, Hui, & Kuo, 2012), and to build relationships by fostering open communication and collaboration with backers (Gerber et al., 2012). Meanwhile, backer's role extends from contributing money to testing the market and providing judgment on the idea proposed by founders and to considering whether a project is worth pursuing (Beaulieu, Sarker, & Sarker, 2015).

In terms of its operations, each crowdfunding campaign is set for a goal amount of money and a fixed number of days, and often the most successful projects receive about 25-40% of their revenue from their first, second, and third degree connections, which may consist of friends, family, or acquaintances, while the unrelated consumers or investors start to support campaigns they believe in once a project has gained some traction (Prive, 2012).

There are four categories of crowdfunding platforms (CFPs): equity-based, lending-based, donation-based, and reward-based crowdfunding (Massolution, 2012). Equity-based crowdfunding enables the funders to receive compensation in the form of fundraiser's equity-based or revenue, or profit-sharing arrangements. Meanwhile, in lending-based crowdfunding, the funders receive fixed periodic income and expect repayment of the original principal investment. The donation-based crowdfunding is when the funders make donations without any expectation to gain anything such as a social cause; and lastly is the reward-based crowdfunding, where the funders fund a project to gain a non-financial reward.

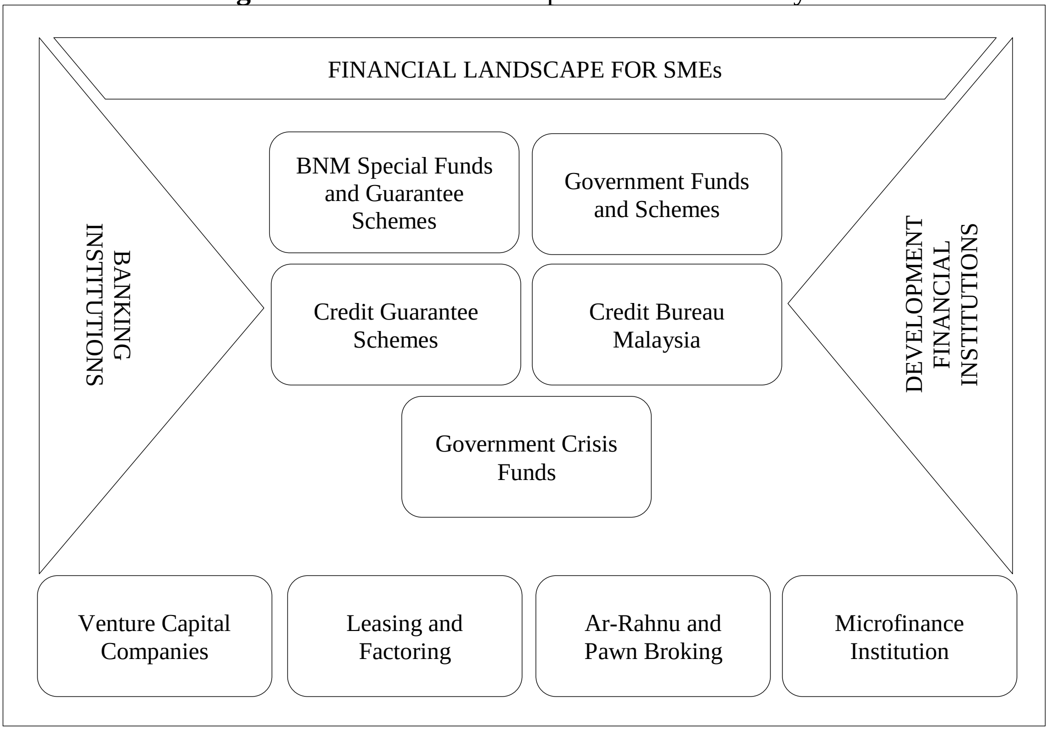
Therefore, crowdfunding could be a veritable tool for halal financing when the Islamic finance principles are applied appropriately in structuring the crowdsourcing ecosystem.

4. FINANCING CHALLENGES OF SMALL AND MEDIUM SIZED HALAL FIRMS

Since it has been established that crowdfunding could fit into the Islamic financial services framework once all the laid down rules, particularly the prohibitive aspects are excluded from the financing arrangements, one would then wonder whether SMEs could benefit from such crowdfunding concept. But before that it is pertinent to examine the current financing challenges of the SMEs halal firms in Malaysia.

One of the most challenging situations faced by start-ups or potential and current SMEs is financing (Oseni, Hassan, & Matri, 2014). Generally, SMEs in Malaysia have diversified financial landscape where they get financial assistance. The primary source of financing for SMEs are financial institutions, and these generally include both financial institutions established under the Financial Services Act 2013 (Act 758) and the Islamic Financial Services Act 2013 (Act 759), and the development financial institutions (DFIs) established under the Development Financial Institutions Act 2002 (Act 618). The government and the Central Bank of Malaysia also provide a number of funds and schemes where SMEs can access required financing. Figure 1 below provides an overview of the financial landscape for SMEs in Malaysia.

Figure 1: Financial Landscape for SMEs in Malaysia



Source: National SME Development Council, 2014, p. 84.

While the above sources present a robust landscape for SMEs financing, Sharī'ah-compliant SMEs who are the key drivers for the Halal industry face financing challenges as they are excluded from the most common financing opportunities which are tainted with interest element prohibited in Islamic commercial law. In fact, one additional factor that exacerbates this situation is the fact that Islamic banks operating in most jurisdictions across the world are not lending institutions when compared to their conventional counterparts. Hence, they are not primarily established to provide financing facilities through lending to customers but they do engage in structured Sharī'ah-compliant transactions that facilitate financial intermediation (Erol & El-Bdour, 1989). As such, the Halal SMEs are left with meagre funds raised from family and friends, as they are not in any way considered as priorities in the business of modern Islamic banks. In an extensive research carried out on Halal SMEs in Malaysia, the sources of funds and some of their financing challenges were revealed.

4.1. Methods and Data

The study adopted qualitative research method and doctrinal legal analysis which analysing relevant laws and policies. Interviews with selected 48 SME halal firms in Malaysia were conducted to identify their financing needs and to ascertain their readiness to utilize newly introduced equity crowdfunding platform. Out of the total number of 48 Halal SMEs respondents, 25 of them are small enterprises, while the remaining 23 are medium-sized enterprises. Also, a top executive of HDC was interviewed. Being a government agency that was set up to coordinate the overall development of the Halal industry in the country, HDC focuses on developing relevant Halal standards and provides Halal auditing and certification. Apart from providing capacity building initiatives for the relevant products and services, HDC promotes Halal SMEs and companies and facilitates their competitiveness in the local, regional, and global markets.

The information on the Halal firms was obtained from comprehensive halal directory, which is available on official website of HDC (HDC, 2015). In total and as of 29 August 2015, there were 6,736 halal certified firms that are from the categories of small/ small and medium/ multinational firms. The total number of small firms was 3,364, number of small and medium firms was 2,720, and number of large/multinational was 643 firms as at the date of this study (29 August 2015). From the SME total number, this study decided to focus on the firms located in the following 13 states of Peninsular Malaysia: Johor, Kedah, Kelantan, Melaka, Negeri Sembilan, Pahang, Pulau Pinang, Perak, Perlis, Selangor, Terengganu, Wilayah Persekutuan Kuala Lumpur and Wilayah Persekutuan Putrajaya. To have a fair distribution, about 20 firms were randomly selected from each state, which gives a total of 260 firms. Nevertheless, only 48 firms responded to the survey; some of these firms responded promptly, while others were followed up a few times due to different reasons and excuses.

The firms are regarded Sharī'ah compliant as they hold the halal certificate which requires the firms to conform to Sharī'ah principles in meeting the requirements for halal certification. The questionnaire was sent accordingly and was followed up with series of telephone calls. For those who were unable to answer the questionnaire, the following questions were asked via phone calls: What is your source of financing? If financing was obtained, was it from an Islamic bank or conventional bank? What were the challenges faced, particularly financing challenges? And what would they like to highlight in terms of financing or other pertinent matters?

4.2. Results and Discussion

The results of the survey and interview are presented in this section while focusing on a number of issues that directly relate to the objectives of this study. The results and analysis are presented under two distinct but related subsections: sources of funds for Halal SMEs and challenges of Halal SME firms.

4.2.1. Sources of Funds for Halal SMEs

In the survey conducted among the Halal SMEs, the following four major sources of financing were identified: self-funding, bank loans, special grants from development agencies and schemes established by the government, and special financing from parent company received by a subsidiary firm. Table 1 presents the breakdown of each source of financing and the descriptions.

From Table 1, it is clear that majority of the Halal SMEs got their financing through self-funding which generally includes family, friends, savings, and subsequently, rolling capital. Though 75% of the respondents relied on self-funding, some of them combined

Table 1: Survey Results: Sources of Financing of Halal SMEs

Source of Financing	Percentages	Description and Source
1. Self-funding	75%	Family, friends, and rolling capital
2. Bank Loans - *Islamic*	27%	Some combined the two in their quest
- *Conventional*	17%	for financing
3. Other Loans (Agencies)	15%	Government agencies
4. Special Financing	2%	From a parent company

Source: Authors

such funding with other sources, and such category amounts to about 23% of the total number of SMEs surveyed. For banking loans, a total of 44% of the respondents relied on it but surprisingly, 17% of the respondents either combined loans from Islamic banks with conventional banks or relied fully on conventional bank loans. This has far reaching implications, as such firms present themselves as Sharī'ah-compliant but unfortunately their sources of financing are questionable. Though there are specific regulations in investment in securities relating to purification of funds and relevant screenings for Sharī'ah-compliant investments (Derigs & Marzban, 2008; Khatkhatay & Nisar, 2007), there is no regulation of interest-bearing loans taken by Halal SMEs from conventional banks.

It is pertinent to note that a number of government agencies provide SME financing and this has helped so many budding SMEs in Malaysia. About 15% of the respondents either rely wholly on such agencies or combine such financing with other sources. Some of such agencies include MARA Business Financing Scheme, Perbadanan Usahawan Nasional Berhad (PUNB), and Bantuan Tekun Nasional, Bantuan RISDA. There are also, and for the purpose of this study, just one of the respondents, that do not have financing challenges since it is a subsidiary of a parent company that bankrolls all its financing needs.

4.2.2. Challenges of Halal SME Firms

From the perspective of the Halal SMEs surveyed, it is clear that financing is a major challenge they are still facing in enhancing their productivity and competitiveness within the local and regional Halal markets. Some of the respondents complained that the procedure of getting financing from banks is cumbersome and it is difficult to meet the requirements of the procedures laid down by such banks. This accounted for the resort to other sources of financing or reliance on meagre sources which invariably affect their performance, productivity and plans of expansion. In addition, irregular business flows and decrease in sales were also considered as challenges faced by some of the Halal SMEs. This might be due to lack of diversification and differentiation of products. There are different Halal products and services that can be offered by any SME firm rather than duplicating or replicating what other established firms are offering.

From the survey findings, it is revealed that apart from competition from other Halal firms, it is difficult for them to favourably compete with non-Islamic SME firms operating in the country, mostly owned by Chinese who are more active in marketing and productivity. Even in the production of Halal products, it appears the Chinese firms are dominating the market and the Muslim-owned or Sharī'ah-compliant SME firms cannot meet up with the level of sophistication involved in the marketing strategies adopted by their counterparts.

This has significantly affected their productivity and profits, and in a way, negatively impacted on their ability to redeem their loans.

From the survey conducted, it was also showed that some of the Halal SMEs are facing challenges of expanding their businesses. They cannot extend their tentacles to new business frontiers or even favourably compete with other Halal entities within the ASEAN region due to paucity of funds. While the issue of expanding the business ventures appeared often in the survey analysis, some other firms also complained of difficulties in buying raw materials and packaging. This may be overcome through relevant training workshops organized by HDC for the Halal firms.

It is interesting to note that one of the Halal SME complained of the time spent in production and packaging since most of the operations carried out in the firm are done manually. This is where the information and communication technology (ICT) might play a significant role in transforming the Halal industry. Introducing automated processes will enhance the businesses of the SMEs and provide them the competitive edge in an increasingly competitive globalized Halal market. For instance, in the Small and Medium Enterprises (SME) Annual Report of 2008, there was emphasis on "the instrumental role of ICT such as Internet, e-payments and e-commerce in enhancing efficiency, productivity and performance of SMEs" (SME Corporation Malaysia, 2013).

5. THE NEW LEGAL FRAMEWORK FOR EQUITY CROWDFUNDING IN MALAYSIA

In order to overcome the major financing needs faced by SMEs and start-ups, Malaysia has introduced a new legal framework to regulate equity crowdfunding. This will benefit the halal SMEs in the country, as they face more financing challenges owing to the unique nature of their businesses which are expected to shun certain prohibitive elements such as financing involving *riba*, *gharar*, and prohibited transactions generally. The Malaysian Securities Commission issued relevant guidelines that provide the requirements for the registration of equity crowdfunding platform and an effective governance arrangement for such platform. Nevertheless, the guidelines have not specified the type of Sharī'ah-compliant equity crowdfunding platform that can be utilized by halal SMEs who need to raise start-up capital through Sharī'ah-compliant means. It is however noted that the Securities Commission has proposed the use of all-or-nothing (AON) funding model which is preferred over the keep-it-all (KIA) model.

A proper legal framework for crowdfunding should ordinarily provide for all relevant procedures from incorporation to bankruptcy. The legal framework for equity crowdfunding in Malaysia is premised on the Guidelines on Recognized Markets 2016 (GRM 2016) which replaced the Guidelines on Regulation of Markets earlier issued under Section 34 of CMSA of Capital Markets and Services Act 2007 (CMSA 2007). The new GRM 2016 was issued by the Securities Commission pursuant to section 377 of the CMSA 2007 which is to be read together with subdivision 4, division 2 of Part II of CMSA 2007.

Section 316A. (2) of the Capital Markets and Services (Amendment) Act 2015 (CMSA 2015) is the most recent provision that supports Sharīʻah-complaint equity crowdfunding platforms. It specifically provides for Islamic capital markets products under which the Sharīʻah-compliant equity crowdfunding platform is classified. The new amendment to the law provides that the Securities Commission may specify in the guidelines made under section 377, such as that relating to equity crowdfunding, the following:

(a) any model agreement or documentation relating to a transaction or arrangement in respect of Islamic capital market products;
(b) the duties and responsibilities of the different parties involved in a transaction or arrangement in respect of Islamic capital market products; and
(c) any other matter as may be deemed appropriate, in giving full effect to the principles of Sharīʻah in relation to a transaction in respect of Islamic capital market products.

Beside the above general provision, section 49 of CMSA 2015 provides for registered electronic facility deemed to be recognised market which includes the "registered electronic facility" (REF) for equity crowdfunding. For the sake of emphasis and clear appreciation of the relevant law, the provisions of section 49 are quite explicit as provided below:

(1) An electronic facility registered under subsection 34(1) of the principal Act before the effective date shall, from that date, be deemed to be a recognized market under this Act.
(2) Any condition or restriction imposed on such electronic facility shall be deemed to be a condition or restriction to its registration under subsection 34(1) as introduced by this Act.
(3) Unless otherwise notified in writing by the Commission, an application for registration as an electronic facility that is pending immediately before the effective date shall be deemed to be an application for a registration as a recognized market operator.

Subsection 34(1) of CMSA 2015 emphasises on the need for the recognition of a market operator upon the application by a person and subsequent registration by Securities Commission. Owing to the nature of the crowdfunding platform, sections 34(1) read together with section 49 of CMSA 2015 provide for untoward situations where there is an abuse by the recognised market operator. Section 34(2) of CMSA 2015 clearly provides for the powers of Securities Commission to add, vary, amend or even revoke any terms and conditions imposed under subsection 34(1).

5.1. General Requirements for a Registered Electronic Facility (REF)

The GRM 2016 are read together with subdivision 4, division 2 of Part II of the CMSA 2007. In line with all the requirements to properly regulate operators of electronic facilities that are meant to raise funds through the equity crowdfunding platform, the requirements for registration of what the guidelines call REF are clearly spelt out. Chapter 3 of the GRM 2016 provides for the criteria for an electronic facility to be registered as REF. These criteria cater for due diligence and also extend to risk management issues. First, an operator of such platform must be able to operate an orderly, fair and transparent market and protect the interest of financial investors. Second, the fit and proper criteria are also applicable to the governance structure of the electronic platform. This is also meant to ensure that financial investors are adequately protected and financial consumers are not unnecessarily swindled. The fit and proper criteria apply to the board of directors of such electronic platform, chief executive, and any other person who is responsible for the operations and financial management of the crowdfunding platform.

Third, the operator must convince the Securities Commission that it will be able to handle and properly manage risks associated with the business and operation of an electronic crowdfunding platform. Fourth, the operator must appoint a responsible person as the chief executive officer of the business who will be responsible for the overall business and operations. Such a person will be the main contact person for the Securities Commission in any matter relating to the business. Fifth, the Securities Commission must be convinced that the operator is able to take reasonable and appropriate action against any person found wanting in the operation of the business including reasonable steps for remedial measures to protect the rights of the investing public. Sixth, the rules of the REF must contain the following satisfactory provisions: protection of investors and public interest; proper functioning of the market; fairness and transparency; management of any conflict of interest that may arise; fair treatment of its members or any person who applies for its membership; fair treatment of any person who is hosted, or applies to be hosted, on its platform; proper regulation and supervision of its members, or any person utilizing or accessing its platform, including suspension and expulsion of such persons; and an avenue of appeal against the decision of the operator. And seventh, the operator must have sufficient financial, human and other resources for the operation of the REF, at all times.

5.2. Specific Requirements for a REF that is an Equity Crowdfunding Platform

Apart from the general requirements set out above relating to REF, there are other specific requirements for REF that is an equity crowdfunding platform which is the main focus of this study. A review of the requirements will establish to what extent the Malaysian regulations comply with international best practices and facilitates Sharī'ah-complaint transactions. The GRM 2016 clarifies that an "ECF operator" means an operator who operates a REF that is an equity crowdfunding platform for prospective issuers who will be using the platform. So, it is a two-way regulation. While the Securities Commission regulates the operations of the REF which is owned by the ECF operator, the latter has to conduct due diligence on prospective issuers who are the end-users of the platform. The "issuers" are persons who are hosted by the ECF platform to offer its shares to the public.

Besides the due diligence exercise expected of the ECF platform, which include reasonable steps to conduct background checks on all prospective issuers in line with the fit and proper criteria stated above, and the verification of the business proposition of such issuers, the operator must also comply with some prudential guidelines.

As part of the regulatory reforms introduced, the Securities Commission approved six platforms which began operations by the end of 2015. The approved ECP are: FundedByMe, Ata Plus, Crowdo, Eureeca, Equity.pitchIN and Crowdplus.Asia. Even though most of the ECF have foreign origins, the Securities Commission Guidelines require them to be locally incorporated before they can be licensed.

Table 2: List of Registered Market Operators for Equity Crowdfunding Platforms in Malaysia

	Name	Website	Origin	Type	Year Established
1.	FundedByMe	https://www.fundedbyme.com/	Sweden	Reward based, Loan based, Equity based crowdfunding	2012
2.	Ata Plus	http://www.crowdfundinsider.com/tag/ata-plus/	Malaysia	Sharīʻah-compliant Equity crowdfunding	2015
3.	Crowdo	https://www.crowdo.com/	Singapore, U.S., Japan	Equity, Peer to Peer Lending, White Label, Reward Crowdfunding	2013
4.	Eureeca	http://eureeca.com/	U.K., Jordan, UAE	Equity crowdfunding or crowdinvesting	2013
5.	Equity.pitchIN	http://pitchin.my/	Malaysia	Reward crowdfunding (non-equity projects)	2012
6.	Crowdplus.Asia	http://www.propellarcrowdplus.com/	Hong Kong, China, Taiwan, New Zealand	Equity crowdfunding	2014

Source: Authors (data mined from various websites on crowdfunding)

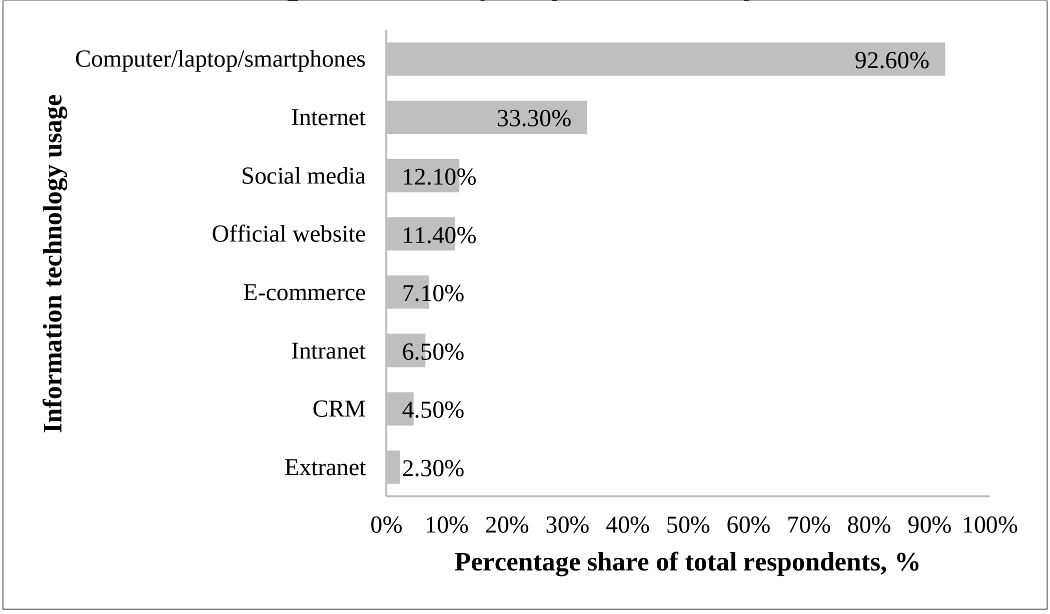
For the Halal SMEs in Malaysia, the equity crowdfunding or what is now technically known as crowdinvesting is more appropriate. Crowdinvesting is a mechanism through which businesses, particularly the SMEs, raise funds from the crowd in exchange for equity or shares in such start-ups using an online or electronic platform. This appears to be one of the main ways of overcoming the financing needs of Halal SMEs in Malaysia. The crowdinvesting platform can support both start-ups and existing SMEs. Halal businesses who require financing could be pitched to potential investors online who share the same Sharīʻah-compliant sentiments. From a close study of the six platforms registered in Malaysia, it appears that Eureeca is ready to host Halal SMEs but there are still some additional Sharīʻah requirements which need to be considered. Besides Eureeca, one of the most suitable ECF for the Halal industry in Malaysia is Ata Plus which is originally a Sharīʻah-based equity crowdfunding platform specifically focuses on shared risk and partnership businesses based on Sharīʻah principles. Ata Plus adds a number of additional Sharīʻah compliance filters such as the requirements that the business must be ethical and of good for the wider community. It seeks to provide support socially responsible investments and give preference to social and environmental accountability and maintains the general philosophy of principle before profits.

5.3. Management of the Funds Raised and Specific Limitations

Issuers cannot take the possession of funds raised immediately, as the ECF acts like a trustee for all prospective issuers who seek the use the platforms. This is why the GRM 2016 mandate the ECF operators to establish and maintain a trust account in a licensed financial institution. Such account is specifically designated for the funds raised on the platform in relation to a particular listing. The funds deposited in the trust account will only be released to the issuer upon the satisfaction of the following conditions: first, the targeted amount sought to be raised has been met; second, there is no material adverse change relating to the offer during the offer period; and third, the cooling-off period of six (6) business days have expired. The phrase “material adverse change” is not defined anywhere in the GRM 2016 but specific description of some instances which may amount to such a change that will warrant the withholding of funds raised are identified in the GRM 2016. Such are meant to protect the investors’ interests, as the GRM 2016 further provides that the ECF operators may impose additional conditions that must be met before funds raised are released. It is however noted that the Securities Commission has proposed the use of all-or-nothing (AON) funding model which is preferred over the keep-it-all (KIA) model.

With the exception of microfund listed on the ECF platform, all other issuers listed on an ECF platform must comply with the monetary limit of RM3 million within a 12-month period regardless of the number of projects undertaken by the issuer. Besides, an issuer is only allowed to utilise the ECF platform to raise a maximum amount of RM5 million. As for the individual investors, there are limits set out in the GRM 2016. For the purpose of maximum investment limit, prospective investors are classified into three main categories: *sophisticated investors* (unlimited), *angel investors* (RM500,000 in a 12-month period), and *retail investors* (RM5,000 per issuer with a total amount of not more than RM50,000 within a 12-month period). With the above regulatory framework, the Halal SMEs can easily tap into the crowdinvesting business ecosystem to overcome their financing challenges. From the findings of the interviews conducted with the Halal SMEs, most of them have never thought of the possibility of exploring the fintech to further their business objectives.

Figure 2: ICT adopted by SMEs in Malaysia



Source: National SME Development Council, 2014, p. 37.

But in order to be able to tap into the fintech, the Halal SMEs must be exposed to the unlimited benefits of such technological advancements such as the ECF platform. In a survey conducted by SME Corporation Malaysia in the First Quarter of 2014, a total number of 2,079 SMEs respondents were involved. One of the key areas the survey focused on was information and communication technology (ICT) adoption in their businesses (National SME Development Council, 2014, p. 33). In spite of the numerous benefits associated with the adoption of ICT tools with specific reference to enhanced productivity and high efficiency in business, the survey revealed that the adoption of ICT was relatively low regardless of the economic sectors involved and size of firms. Figure 2 shows the results of the survey which reveal that: "Majority of the respondents use computers/ laptops or smartphones (92.6%) and Internet services (33.3%) but for personal purposes and not for business operations. Consistent with these findings, the Survey also revealed that only 7.6% of the respondents were involved in online transactions. Of those involved, 74.7% cited that online business saves cost and 58.9% stated that it helps in increasing their business efficiency" (National SME Development Council, 2014, p. 37).

It is thus clear that most of the SMEs still rely on traditional methods of seeking for financing which have proved to be less helpful.

6. RISK-SHARING THROUGH SHARĪ'AH-BASED EQUITY CROWDFUNDING

The implementation of the risk-sharing concept, namely through *mudarabah* and *musharakah* seem to be less favoured by the Islamic financial institutions simply due to the high risk that is associated with them. As presented by Mohamed Naim, the Islamic banks are reluctant to implement such concepts because the Islamic banking framework in Malaysia and elsewhere is still based on the conventional banking infrastructure, which creates a number of legal barriers and stakeholder barriers (Mohamed Naim, 2013). Mohamed Naim recommended a few suggestions to mitigate risk, including incentives from the government regarding new product development and the establishment of special entities by the Islamic banks to offer such products with the support of the Central Bank. This paper would support the latter suggestion by proposing an innovative financing tool, namely crowdfunding based on Sharī'ah principles to financially assist the SME halal entrepreneurs.

Crowdfunding aims to ease financial difficulty to particular group of people or entrepreneurs who are in need of financial assistance, which is a noble exercise and reflects the principles of *mu'amalat* (facilitating transactions) in Islam. The real essence of *mu'amalat* in Islamic commercial law promotes dealings between two or more parties to buy or, and sell products or services with reference to Sharī'ah principles and emphasizes on being just and fair to each other in the deals made. Nevertheless, there are three main differences between conventional and Islamic crowdfunding: Sharī'ah-compliant crowdfunding invests in halal socially responsible projects/products, shares the risks of the investment, and is characterized by the absence of interest or *riba* (Marzban, Asutay, & Boseli, 2014). With that, they developed Sharī'ah based crowdfunding models and instruments as illustrated in Table 3.

Table 3: Sharīʻah-compliant Crowdfunding Models and Instruments

Financing For	Crowd Model	Potential Beneficiary	Instrument with End Client
Islamic Charity	Donation	Microfinance	Hiba Qard-Hasan Murabahah
Product	Reward	Microfinance Small Enterprises Startups	Sale
Investment	Debt	Microfinance	Murabahah Ijarah
		Small Enterprises	
	Equity	Small Enterprises	Diminishing Musharakah Musharakah
		Startups	Musharakah

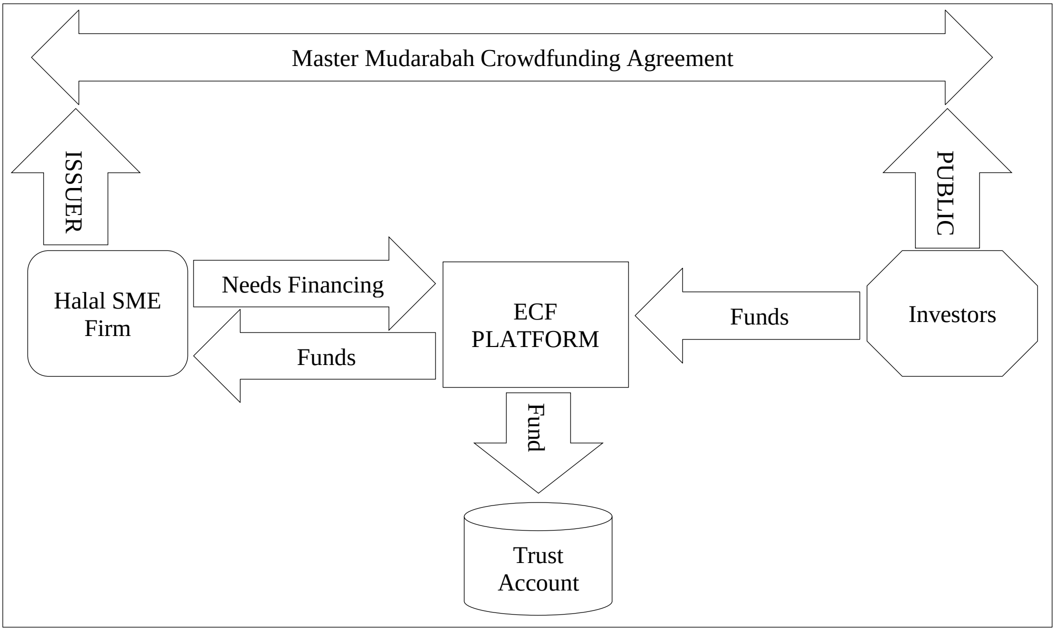
Source: Marzban, Asutay, & Boseli, 2014.

Table 3 indicates the different types of Islamic finance instruments that can be applied in the crowdfunding models; however, as this study intends to discuss the risk-sharing mode, the paper narrows the discussion to the equity model and the two Islamic finance instruments: *Mudarabah* and *Musharakah*. Even though these two modes of Profit and Loss Sharing partnership are not commonly used in the modern financial instruments utilised in Islamic banks, they are however prime candidates for equity crowdfunding.

Asutay and Marzban (2012) have identified a number of advantages of equity-based crowdfunding from an Islamic finance perspective that include promoting original form of financing which is based on a profit and loss sharing basis (*musharakah*); reducing the funding gap as access to capital is provided to a wide range of entrepreneurs; introducing new asset class for small and medium investors; minimizing risk through splitting limited capital across multiple start-ups; encouraging innovation and keeping the talent local; creating and increasing jobs opportunities with the establishment of start-ups; providing support to the growth of ventures to enterprises and possible future initial public offers (IPOs) in new sectors that are almost non-existing in the pubic equity markets in Muslim countries; and increasing diversification for fund managers.

A simple mode of Sharī'ah-compliant equity crowdfunding based on *mudarabah* model will work like this. The issuer is the *mudarib* (entrepreneur) while the ECF platform such as Ata Plus only acts as the agent based on the concept of *wakalah* and a fee could be imposed for such services of using the platform under the relevant Guidelines of the Securities Commission relating to equity crowdfunding. The *rabb al-mal* (capital provider) are the investors who have contributed their money online through the electronic platform. But it should be observed here that the Master Mudarabah Crowdfunding Agreement (MMCA) must clearly provide for the profit and loss sharing ratios in line with the basic principles underlying *mudarabah*. There should also be some form of Sharī'ah governance issues for the ECF platforms facilitating Sharīʻah-compliant funds and the business ventures undertaken by the issuers. Figure 3 below shows a proposed *mudarabah* equity crowdfunding.

Figure 3: A Proposed Mudarabah Equity Crowdfunding Model for Halal SMEs



Source: Authors

The first stage involves a Halal SME firm who requires Sharī'ah-compliant financing and has a very good business idea which does not only fulfil the objective of profit maximisation and Sharī'ah compliance but also ensures core social values based on the criteria of social responsible investments. The SME firm is the issuer and it is expected to set its funding goal on the ECF platform. For its relationship with the ECF platform, it needs to enter into a *wakalah* agreement where the electronic platform is merely appointed as an agent to manage the fund collection from the investors. The issuer prepares a Master Mudarabah Crowdfunding Agreement (MMCA) and shares it with the ECF platform, while the latter scrutinises all the documents in line with the requirements of the GRM 2016 and Sharī'ah opinion before approving the documents. Then, the investors enter into the MMCA with the issuer where the ECF platform acts as an agent to manage the whole process of collection of funds. Once the funding goal is met and after the expiration of the cooling-off period, the funds are released to the issuer subject to the applicable conditions stipulated in the GRM 2016. The Sharī'ah aspects of the operation of the process above, including the proposed MMCA, are not comprehensively outlined in the GRM 2016 but they are explained here to ensure the entire process of obtaining financing through equity crowdfunding is Sharī'ah-compliant.

7. MAJOR FINDINGS AND CONCLUSION

Through a combination of qualitative methods of survey and interview, and legal analysis of relevant laws and policies, this study has attempted to explore the imperatives of having a Shariah-complaint equity crowdfunding model for Halal SMEs operating in Malaysia to enhance their productivity and boost their competitive edge within the local, regional and global Halal markets. As argued in the paper, it is not enough to simply conclude that equity crowdfunding is Shariah-compliant. There is more to the model in terms of Shariah governance, nature of business, and types of products and services offered. Even the way the contract is executed, profits and risk are shared and allocated must have some Shariah bearings.

The most significant finding of this study is the financing challenges Halal SMEs in the country are facing which has led to resort of some seemingly Halal SMEs to explore interest-bearing loans from conventional banks. This is reminiscence of the saying of ʻUmar bin Al-Khattab where he is reported to have said "Poverty, in all probability, leads to unbelief (*kufr*)" (Ali, 1985, p. 22). Therefore, scaling up these start-ups may require innovative ways of raising funds though through a Sharīʻah-compliant mechanism. The study concludes that for a sustainable halal industry, there is a need for Sharīʻah-compliant model that will tremendously boost the funds injected into the industry. This research is significant in that it provides information to the SME and halal firms on source of financing that conforms to Sharīʻah as well as provides a common platform for investors with certain social cause.

In conclusion, the Securities Commission may come up with new guidelines for Shariah equity crowdfunding in order to guide the industry. Out of the six ECF platforms endorsed recently, only one of them, Ata Plus seems to be originally rooted in Shariah-compliant business. Others are successful conventional ECF which might need to provide Shariah-complaint principles for issuers and investors who are influenced by the Shariah-compliance sentiments. While this study has only given the example of *mudarabah* for equity crowdfunding, future studies may focus on other Islamic finance modes of financing that can be adapted to it. This is the time to go beyond mere theoretical abstractions of Shariah financing and crowdfunding. Major stakeholders in the Islamic financial services industry must put all hands on deck to ensure the practical application of Shariah principles in the increasingly prominent method of crowdfunding.

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