

Islamic Micro Financing: Crowd-Funding as a Drive to Improve Financial Inclusion in Malaysia

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Abstract

Micro-financing is one of the least developed areas in Islamic finance as it stands at less than 1 percent of the global Islamic finance services industry. Given a huge financial inclusion in most of the Muslim-majority countries, Islamic micro-finance has a major role to play for the economics development of Muslim societies. Islamic financial system promotes equity-based and risk sharing instruments to comply with Shari'ah principles. Therefore, the equity-based crowd-funding is seen to be the best alternative form of financing that meets the general Shari'ah requirements. As crowd-funding platforms is gaining momentum in European countries, following an initial success in the USA, the Islamic banking and finance industry in Malaysia should explore the possibilities of implementing their models into our Islamic micro-financing facilities. This concept paper outlines the few factors that lead to the formation of crowd-funding, the benefits and the barriers of crowd-funding, as well as the recommendations to think the vision and mission of making crowd-funding as a drive to improve financial inclusion in Malaysia.

Keywords: *Micro-financing, crowd-funding, financial inclusion, Islamic banking and finance*

1. Introduction

Crowd-funding is the practice of funding a project or venture by raising small amounts of money from a large number of people. [1] defined crowd-funding as “an open call, essentially through the Internet, for the provision of financial resources either in a form of donation or in exchange for some form rewards or voting rights”. Although crowd-funding has long existed, today's crowd-funding is different from the conventional in approach when it utilizes the convenience of Internet. In year 2000, ArtistShare was the first internet based crowd-funding site being established for music artists. Since then, a lot of crowd-funding sites were formed, such as Kickstarter, Ethis Kapital and Ata Plus. According to [2], crowd-funding is seen to be an alternative to quest for financial resource from people who are connected to the Internet. It was the technological advancement which made it easy to seek funding by collecting monetary contributions from numerous investors, which later to be used for identified projects. Due to cost effectiveness of online financial transactions, there are quite a number of banking regulators in the developing and emerging markets have encouraged the presence of crowd-funding as a drive to improve financial inclusion in their respective continents. Generally, crowd-funding has become a viable tool for small, micro-business venture as well as in business sectors especially among the Small and Medium Enterprises (SMEs) to attain financial aid directly from public to the investment market [3]. It is measured as a great marketing tool as it indirectly promotes business plans or products as it enables the investors and entrepreneurs to have a discussion and to look into their business proposal. Besides, it provides a great opportunity for the entrepreneurs to ratify their business concepts while the investors can still experience low risk of

investment by getting the real-time feedback from the entrepreneurs.

2. Review and Literature

According to [4], “Islamic finance and crowd-funding are inherently compatible and mutually reinforcing” to promote *maslahah mursalah* (unregulated public interest). To comply with *Shari'ah*, Islamic crowd-funding can only be applied for *halal* projects, which prohibits gambling and speculations (*maysir*), uncertainty (*gharar*) and interest rate (*riba*). Thus, among the four types crowd-funding, only lending-based crowd-funding does not comply with *Shari'ah* since it consists the element of *riba*. The reward based crowd-funding, which is almost similar to the concept of *Bay as-Salam*, gives specific rewards, services or gifts to investors who fund the projects or businesses via crowd-funding. This model is suitable to companies which are looking for financial assistance to create a new device or gadget by asking public (investors) to pre-purchase the product via internet. Once the device or gadget is successfully invented, it will be delivered to the investors who have initially funded the project [5]. Mystartr (Malaysia) is one of Malaysia's largest reward-based crowd-funding platforms for creative projects. The platform connects filmmakers, musicians, artists, and designers to backers who are interested in supporting their projects. Since its inception in 2012, Mystartr has funded more than 1 million MYR (US\$264,000) worth of projects. The donation-based crowd-funding (charity) is made through social media and other campaigns and is widely used by non-profit or charitable organizations to seek donations from the public. Before this type of crowd-funding is being named, its concept has been used by large charitable organizations in fund raising [6]. In Malaysia, donation crowd-funding is

dedicated to support donation based campaigns which do not expect any return for the money invested. The philanthropic approach upholds *maslahah mursalah* in practical, where the funds can be used for starting up businesses, to assist existing businesses, or for social and personal reasons such as medical and education expenses. There are several active donation crowd-funding platforms in Malaysia such as Skolafund, Bitgiving and Ekoperasi. They serve as point of contact for both, donators who like to spend money for the good cause and for persons who need financial aid through a modest capital injection. The equity-based crowd funding (ECF) is defined as an approach that “match startups with investors and facilitate investment transaction via online” [7]. ECF is essentially a fundraising campaign where people invest in a company (commonly SMEs) in exchange for shares in that company. The investors then become a partial owners of the company and have an opportunity to partake in the company’s profits. The investors also stand to gain from the eventual sale of the shares in the company if it continues to be successful and goes public in the future. This crowd-funding is very much like *mudarabah* type of financing, which also involve real market activities with proper management and distribution of wealth. Malaysia is the first country in ASEAN to introduce a regulatory framework to facilitate equity crowd-funding in 2015, with six registered equity crowd-funding (ECF) platform operators to fully operationalize by 2016 to provide an alternative venue for capital-raising to SMEs and innovative new businesses.

Financial inclusion is defined as “the process that ensures the ease of access, availability, and usage of formal financial system for all members of an economy” [8]. Like crowd-funding, it also plays a vital role in providing socioeconomic benefits to community as it can reduce poverty and narrow the gap of income inequality. Likewise, [9] concluded that financial inclusion is a delivery of financial and banking service to disadvantaged and low income group of people at an affordable cost. Hence, it is affirmed that financial inclusion is to be in correlation with desirable economic outcome [10]. But then, these groups will not enjoy the economic growth if they are still being excluded from financial system. As per World Bank statistical data, there are still more than 2.5 billion adults are excluded from the financial system [11]. Financial inclusion should not only consist of opening of bank accounts but should also create an awareness in financial products and to educate people about financial planning as avoidance to get involved in fraud money saving schemes. In Malaysia, there was a claim saying that Islamic finance can help the disadvantaged and low income group to access financial services through financial inclusion [12]. The Bank Negara Malaysia (BNM) has long realized that an inclusive financial system is vital for sustainable economic growth in long term. Thus, a Financial Inclusive Framework was introduced by Agent Banking Initiative in 2011 through four areas, which is to provide convenient accessibility, expanding take-up of financial products and services, promoting responsible usage and enhancing consumer satisfaction (Bank Negara Malaysia, n.d.)

3. Research Methodologies

Our research draws from secondary sources of literature which are related to our topic. We searched literature from various books, journals, articles, etc. Statistical data and some materials produced by related institutions were also referred as we did not test any hypothesis in the study. The main objective of our study is to identify:

1. The relevant macro-environmental factors that enabled the emergence of Islamic crowd-funding;
2. The potential benefits of Islamic crowd-funding towards the improvement of Islamic financial inclusion.

4. Results and Discussions

Based on our research, it is found that the emergence of internet and social media is one of the major factors that lead to the succession of crowd-funding. According to Internet Users Surveys 2017 by Malaysian Communications and Multimedia Commission, the percentage of Internet users in 2016 was 76.9% with approximately 24.5 million Internet users, an increased from 24.1 million in 2015. This answered to the rapid growth of crowd-funding in Malaysia [13], as evidenced by a number of online crowd-funding platforms including several Islamic-based crowd-funding platforms, such as Alix Globa, Ata Plus, and Ethis Venture. The growing popularity of social media among online users nowadays such as Facebook, Twitter and Instagram also serve as fundamental drivers that facilitate the implementation of crowd-funding. Effective social interactions through networking which enables efficient flow of information between fund-raisers of crowd-funding and online investors [14] have made the fundraising process went better [15]. Another contribution factor is the limited access to financing for SMEs. According to International Finance Corporation (IFC), it was found that close to 45 to 55 percent of the formal SMEs in the emerging markets do not have access to formal institutional loans or overdrafts despite a need for one. In 2017, 97% of business establishments in Malaysia are SMEs, which contributed 37% to the country’s GDP, 65% to employment, and nearly 18% to exports (SME Corporation Malaysia, 2016). Although these SMEs including Islamic-based enterprises have been growing aggressively, its growth capacity were often neglected and obstructed by the difficulty in accessing to suitable and affordable external source of funding from formal banking and financial institutions as compared to well-established multinational enterprises [16]. This phenomenon occurred mainly because SMEs were frequently deemed as high risk enterprises by the major banking institutions with lack of proven track record and credit worthiness. Hence, Islamic finance has emerged to have made an extra effort to motivate not only Islamic-based SMEs but also conventional SMEs to use Islamic-based financing tool instead of other traditional funding instruments [17]. By providing Islamic crowd-funding, it enables the accessibility of a huge amount of investment inflows for SMEs from a significant number of small investors [18]. Nevertheless, according to Malaysia International Islamic Financial Centre, Islamic finance should continuously play its vital role in improving financial inclusion as to promote the Islamic value of fairness and equality in society especially for the poor community and SMEs. However, this effort required more Islamic-based financing alternatives especially the equity based crowd-funding in order to work hand-in-hand with SMEs to enhance financial inclusion [19]. Islamic crowd-funding was also expected to reduce the overall cost and time taken for SMEs in accessing sufficient funding needed for start-ups and early stage of their businesses as well as to tackle the poverty issues as SMEs are the dominant contributors to the economy [20]. All these could improve the overall financial inclusion and at the same time to support the continuous growth of Islamic-based SMEs in future. Similarly, the growth of SMEs was capable of giving rise to more entrepreneurship and job opportunities, thus contribute to overall welfare of the society. Adequately, our financial technology (Fintech) firms have already focused on shifting to development of non-banking financing platforms, such as crowd-funding.

5. Conclusion

At present, the reality of adopting crowd-funding falls short of its ideal vision. But the fact that crowd-funding in Islamic finance has established itself as a drive to improve the overall financial inclusion in Malaysian society cannot be denied. Indeed, it is a

source of hope to support the growth of Islamic-based SMEs, to enhance social welfare among societies and to mitigate investors' risk in an unfriendly environment. Although there are several identified major barriers that obstructed the development of crowd-funding, fresh ideas and recommendations are needed to facilitate the implementation of crowd-funding especially in the banking sector. Further research on the role of institutional bodies is needed to make crowd-funding as an essential tool to improve overall financial inclusion and enhance social welfare alongside with Islamic finance in Malaysia.

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