





EQUITY CROWDFUNDING IN MALAYSIA: LEGAL AND SHARIA CHALLENGES



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ABSTRACT

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Equity crowdfunding (ECF) emerged as an alternative for Small and Medium Enterprises as well as start-ups (Issuer) to raise funds by selling securities to the public by using online portal-based platform (ECF Platform). Individuals who invest in the company are called equity-holder (Investor). Since the introduction of regulatory framework of ECF by Securities Commission in 2015, the number of funds raised through ECF platform has increased each year and so do issuers who have successfully reached the fundraising target. However, the funds raised declined in 2018. This happened due to among others, the presence of challenges faced by parties in ECF transaction which are investor, issuer and ECF platform operator. Hence, besides analyzing the concept of ECF, this study highlighting some of legal and potential Sharia challenges surrounding its application. This qualitative research utilizes primary and secondary data gained from scientific database analysis and library research including guidelines, statutes, books, articles, reports and precedents on ECF. The method of data analysis are jurisprudence and comparative assessment. The finding shows that the risk of loss, fraud and liquidity are common concern. Perhaps less obvious, but nevertheless present, are Sharia challenges due to indefinite power of Sharia Adviser and the differing thoughts on the structure of equity. The article concludes by stressing on the need to find the right balance between protecting investors and facilitating access to financing that can reduce the financial constraints on entrepreneurs. Failing which drive funders out of market.

Contribution/ Originality: This study is one of very few studies which have investigated legal and potential Sharia challenges of equity crowdfunding (ECF) faced by parties to the transaction namely investor, issuer and ECF platform operator. The challenges require attention from Securities Commission to ensure its sustainability given the benefits it may bring to society.

1. INTRODUCTION

The Internet has created a new dimension in conducting business. The technological advancements not only offer innovation in the creation of devices, but also implementation of new methods in doing business (Sheela and Rahmah, 2017). Crowdfunding for instance, is a novel method for funding various new ventures, allowing individual

founders of for-profit, cultural, or social projects to request funding from multiple individuals, often in return for future products or equity, typically through the Internet (Schwienbacher and Larralde, 2010; Mollick, 2014).

Crowdfunding has emerged as a form of alternative financing and owe much of its success to the failure of traditional banks to fulfil the demand of Small Medium Enterprises (SMEs) financially (Caldwell, 2013). Freedman and Nutting (2015) listed several types of crowdfunding such as reward, donation and peer-to-peer (P2P) crowdfunding, but the focus in this article is on equity crowdfunding (ECF). Vulkan *et al.* (2016) differentiated ECF with other types of crowdfunding, since through ECF investment, the investors' takes of an equity stake in the business is much the similar way as in venture capital funding works. Ahlers *et al.* (2015) defined ECF completely as a form of financing in which entrepreneurs make an open call to sell a specified amount of equity in a company on the Internet, wishing to attract a large group of investors. In ECF, a third-party intermediary leverages the Internet to offer a forum whereby investors and issuers are able to assemble and finance profitable enterprise.

This article first will highlight ECF industry in Malaysia. Next, there will be lists and elaboration on legal challenges in ECF transaction from investor, issuer and platform operator's perspective. The article will further discuss on the Sharia challenges, if the ECF platform operators intends to practice Sharia compliant ECF. Besides that, solutions to some of these challenges are proposed as well. Finally, this article will highlight the implications if the policy maker fails to balance between the need of protecting investor through regulatory rules and facilitating access in financing to reduce entrepreneurs financial constraints.

2. ECF INDUSTRY IN MALAYSIA

Several types of crowdfunding such as donation and reward have successfully proven in raising capital for various purposes. However, unlike ECF, these types of crowdfunding are not regulated by Securities Commission (Andrew, 2017). In Malaysia, there is still no specific act on ECF. However, Securities Commission has introduced new rules in ECF platform registration and provision of good governance for ECF platform operators through Section 377 of Capital Market Services Act 2007 (CMSA) read together with CMSA Subdivision 4 Division 2 Part II and the publication of Guidelines on Recognized Market (GRM) (Item 1.01 GRM).

Section 15 (g) of Malaysia Securities Commission Act 1993 clarifies that the function of these regulations is to regulate the ECF's activities and protect the interests of the parties involved, especially investors. ECF platform operators need to satisfy the criteria in the GRM before Securities Commission can issue ECF licenses (Item 2.01 GRM). Since the launch of ECF regulation, Liz (2015) reported that countless efforts have been done by Securities Commission together with registered ECF platform to educate people and entrepreneurs on the company's alternative financing.

Referring to one of the ECF platforms, 'Pitchin' 2018 Annual Report, at the end of 2017, MYR 23.3 million was raised through ECF platform, and 22 projects which utilize ECF, have succeeded in achieving their target collection. In fact, the amount raised has been increasing steadily since the launch of ECF in 2015. However, it is worth to highlight that ECF industry in Malaysia experienced tough market conditions in 2018. The number of successful campaigns dropped to 14 in 2018 and the amount raised also plunged to MYR 18 million in 2018. As of August 2019, there were 10 operators of ECF platform in Malaysia regulated by Securities Commission. ECF industry's gaining popularity and acceptance in Malaysia brought several challenges that need to be taken into consideration by Securities Commission to protect the investors, especially retail investors.

3. LEGAL CHALLENGES IN EQUITY CROWDFUNDING TRANSACTIONS

There are several legal challenges faced by the investors, issuers and ECF platform operators in ECF transactions. Some of the issues have their own solution while others require further attention by regulatory body.

3.1. Investors

Three types of investors are eligible to invest in ECF. They are angel investor who is a tax resident in Malaysia with total net personal assets exceed MYR 3 million, or its equivalent in foreign currencies, or whose gross total annual income is not less than MYR 180,000, or whom having a joint gross total annual income exceeding MYR250,000 with his or her spouse (Item 13.01 GRM). Next is sophisticated investor, refers to any person who falls within the categories of investors set out in Part 1, Schedule 6 and 7 of the CMSA and includes a Venture Capital corporation, Venture Capital Management Corporation, Private Equity corporation and Private Equity Management Corporation registered with Securities Commission (Item 1.17 GRM), and a retail investor who is also known as individual investor.

It worth to note that Securities Commission has imposed rules by setting an investment ceiling on each type of investor. Retail investors may only invest on ECF platform with a maximum amount of MYR 5,000 per issuer and MYR 50,000 within 12 months. Angel investors however may invest up to a maximum of MYR 500,000 for 12 months, meanwhile there is no restriction applicable to sophisticated investors (Item 13.24 (a) (b) & (c) GRM). The specified investment limit also applies to local and foreign investors (Item 13.25 GRM). The justification behind those fundraising provisions is to reduce risk of loss, especially for retail investors as in general they are not experienced. Since its inception, the amount successfully raised by ECF among retail investors make up 54% of the investor base, followed by sophisticated investors by 27% and 18% from angel investors (Securities Commission Malaysia, 2018).

The risk of loss, problem with liquidity, fraud and difficulty in taking legal action on issuer are among the challenges faced by investors. Details and elaboration can be seen below.

3.1.1. Risk of Loss

Though ECF is seems capable in offering financial solution to the issuers who are seeking for additional funds to expand their company. However, in reality it may only benefits one party. The retail investors may likely lose their investment due to adverse selection of businesses ECF platform had offered. Since SMEs and start-ups are primary target of ECF platform, the business viability will be the main concern. This is because, a study by [Ahmad and Seet \(2009\)](#) has found that the SMEs in Malaysia faced high rate of failure with an estimation 60% failure, and start-ups are even riskier. [Nur et al. \(2015\)](#) added that equity investments in SMEs are at a risk of failure due to entrepreneurs' dependence on debt and lack of efficiency.

The start-ups in Australia and the US faced similar issue. [Marmer et al. \(2011\)](#) have found that in the first ten years of their existence, the failure rate of small businesses in Australia and the US are 95% and 90% respectively. While in the United Kingdom (UK), over 50% of start-ups failed in their fifth year of operation ([Anderson, 2014](#)). In fact, [Marina \(2017\)](#) found that the entrepreneurs lack of experience especially for start-ups can be the reason of company failure.

The situation was getting worse when the investors were more likely to view crowdfunding as a social phenomenon ([Belleflamme et al., 2014](#)) It was not a good thing as they were generally inexperienced ([Kelly, 2017](#)). [Bradford \(2012\)](#) claimed that this problem often happened to retail investors, as they have no financial intelligence to understand the nature and nuances of the investment especially regarding the concepts related to financial risk and portfolio management. [Fisch \(1998\)](#) admitted that the situation worsened when the start-ups were unable to generate sufficient financial information to be presented to prospective investors.

In addition, there might be an impression that investors were perceived to understand the information disclosed by the issuer, despite the fact that even experienced investors found it difficult to evaluate the quality of information. As a result, retail investors who do not have this financial expertise may be forced to keep on investing and rationalize early losses as a normal part of a small business development, until eventually their companies experiencing bankruptcy.

In ECF context, it is important to note that the success of obtaining funds does not guarantee business success. If the business fails, the investors will not get any return until all creditors have been paid. This puts them in a weak position. The failure of Rebus is one of good examples of this situation. Rebus was said to be the largest failure ever occurred in ECF operations in the UK. Initially, Rebus Group managed to raise GBP 816,790 from 100 investors through the ECF platform named 'Crowdcube' in March 2015. This was to finance the expansion of the company, aimed at delivering returns to investors up to 10-fold in three years. However, they have experienced loss between GBP 5,000 to GBP 135,000 worth of investment.

Dorff (2014) believed that the only solution that will protect investors is to abolish ECF for the unaccredited investors while Andrew (2017) recommended ECF platforms in Malaysia not to accept start-ups as their issuer and prioritize existing or developing companies to reduce risk of failure in business. However, it was contrary to Securities Commission Malaysia (2014) which encouraged start-ups to leverage on ECF for capital to reduce dependency of entrepreneurs to seek financial assistance from banks and governments.

3.1.2. Liquidity Risk

Risk of loss is one thing, liquidity risk is another. ECF is always associated with liquidity problems. Ivo *et al.* (2017) agreed that the liquidity issue in the secondary market exist in ECF industry since access to capital, particularly equity, for SMEs are very limited. This liquidity risk arises from the shortage of secondary market. Aznan and Syahnaz (2016) added that it is possible for investors to be unable to resell their equity holdings unless the company is listed in stock exchange or a strategic investor acquires the company.

Although Aznan and Syahnaz (2016) argued that there were some platforms that provide equity sales in the secondary market, but not all platforms have such facilities. Due to the lack of such facilities, Apnizan (2017) explained that investors were unable to resell the securities purchased within a certain period of time set by the platform from the date of purchase, therefore making ECF securities very illiquid. In addition, investors were unlikely to receive any payment because of early-stage and growth-focused businesses rarely pay dividends (Ivo *et al.*, 2017).

3.1.3. Fraud

Fraud is endemic to the security industry; stringent regulations may reduce the possibility of fraud. However, it will never be sufficient to eradicate it, especially when transactions mostly happen online. The event of fraud may take place before and/or after the campaign.

As stipulated under item 13.22 GRM, the issuer has obligation in disclosure requirement to submit relevant information to the ECF platform and ensure that all information are true and accurate and shall not contain any information or statement which are false or misleading or from which there is a material omission. Nevertheless, this rule does not guarantee the transparency of the company since the issuer is still able to sugarcoat the real company's performance by falsification of important information (e.g. financial statements) before the campaign commencement.

Dagmar (2017) believed that the actual fraud always happened after the campaign has launched. The impersonal nature of the Internet has denied traditional relationships between investors and entrepreneurs, which allowed investors to engage in the enterprise as well as to find solution to any problems (James, 2013; Darian, 2015). Such opportunity was taken by the issuer to take control of their business without any interference from the investors. Coupled with the lack of financial knowledge, the retail investors may not realized that the company they invested in is in trouble. Thus, potential for intentional fraud among issuer is high and expanding disclosure requirement may not be a bad idea.

While it is the duty for the issuer to disclose information regarding how the funds acquired are used as postulated under item 13.21 GRM, there is no guarantee that fraud will not occur. As a result, the investors may lose some or all of their investments.

3.1.4. Difficulty in Taking Legal Action on Issuer

Item 6.01 (vi) in GRM requires ECF platform to disclose material information to investors regarding complaints handling or dispute resolution and its procedures. Some ECF platform has already utilized chat space where peer review has helped to resolve disputes (SCM, 2014). This remedial action may provide little comfort to retail investors.

However, there is extent in which the implementation and commitment to be carried out by ECF platform is not known. There is possibility for ECF platform and the issuer are negligent in discharging their responsibilities, thus resulting to the possibility of fraud. Plus, the chances for investors to take legal action in the event of any breach of regulation by the issuer or ECF platform are practically difficult, especially for retail investors who invest small amount of money to issuer business. Even if there is element of fraud exercised by issuer, the damages these investors entitled are limited to the amount they invested, which for them may be less than the cost needed to impose a summons. Hence, given the difficulty of bringing securities fraudulent actions against the issuer, then class action claims may be the only option that can be exercised by a number of investors. However, Pesok (2014) opined that this might be problematic since the profits for lawyers managing for such cases are limited.

The same problem occurred in the United States (US). However, in the US, investors who have purchased securities from the offer from crowdfunding are entitled to take action in the event of fraudulence by the issuer under § 77d-1 (c) Securities Act 1933. The private action under Title III Jumpstart Our Business Startups Act (Jobs Act) is unique, which the plaintiffs do not have to prove that the alleged fraud has caused their losses, instead, shifting the burden of proving the loss is due to the defendant as subjected under § 771 (b) Securities Act. The defendant may avoid liability by proving that the depreciation of the value is due to other things that are different from what is said to be fraudulent. The burden of proof under Section 302 (b), 4A (c) of Title III of the Jobs Act also does not require the plaintiff to prove that the defendant is acting with the scienter. The defendant may, however, avoid liability under Section 302 (b), 4A (c) (2) (B) of the Jobs Act by indicating that they do not know, and while exercising the enterprise reasonably may not know, untruth or omission.

3.2. Issuer

Section 43 of Malaysia Companies Act 2016 prohibits private companies from offering shares to the public. However, for ECF purpose, only locally incorporated private companies and limited liability partnerships (excluding exempt private companies) will be allowed to sell shares to the public through ECF platform (Item 13.14 GRM). ECF may provide a financial solution for issuers looking for extra capital to expand their ventures or transform their ideas into reality. However, there is a requirement to limit fund raised through an ECF Platform that need to be complied. An issuer can only raise up to MYR 3 million within a year, irrespective of the number of campaigns an issuer may seek for funding during that one (1) year period (Item 13.19(a) GRM). Further, an issuer can only utilize the ECF platform to raise a maximum amount of MYR 5 million, excluding the issuer's own capital contribution or any funding obtained through a private placement exercise (Item 13.19(b) GRM). In order to obtain funding, a firm has to impress potential investors with their idea, which obviously involves divulging on what it is and how it works. This is how intellectual property risk comes into picture.

3.2.1. Intellectual Property Risk

Utilizing the social network to launch an ECF campaign will reveal entrepreneur's business ideas and strategy, thus exposing misappropriation of that information by others. Since ECF platforms merely unite entrepreneurs

with investors and do not protect the intellectual property rights of the projects posted on the site, the need for protection of the issuer's intellectual property through patents, copyrights and/or trademarks are necessary. Besides increasing the chances of success in ECF (Aleksandrina and Peter, 2016) the protection of intellectual property can be perceived as a plausible signal that conveys information to investors about innovation capabilities, the ability to stake technological claims, as well as firm's characteristics and managerial skills (Long, 2002).

The 'Lunatik Watch Kit' can be taken as an example. Through the Kickstarter Crowdfunding platform, Karish and Pushkala (2014) reported that they managed to collect USD 942,578 out of 13,512 investors. However, Alexis (2015) noted that due to the absence of intellectual property rights for their innovation products, their sales were unsuccessful and suffered huge loss when their products were replicated and sold on the market in large scale.

In spite of this, there are some suggestions that can be taken to protect the issuers intellectual properties and this includes patenting the product before the product is advertised on the ECF platform. Issuers can register with the Intellectual Property Corporation of Malaysia to protect what is trademarked from usage and/or misusage by competitors while building brand loyalty among repeat customers. Even though the application will be costly, the failure to do so will cost even more.

3.3. ECF Platform Operators

Since ECF platform operators has the authority to select which project to be hosted on its platform, it is crucial for them to do their best to uphold their reputation in the sense of limiting fraud, and as well as to attract great potential projects because low quality projects will negatively affect their profits in the form of commissions. Moreover, the issuer success in distributing competitive return of investment will not only brings benefit to the investors per se, but also the ECF platform operator as it improves their image as a credible platform, ultimately will attract more new investors and retain the existing investors for their trust on a viable project.

Securities Commission place a considerable emphasis on regulating ECF platform operators as they provide a gatekeeper role. Upon obtaining license from regulatory body, ECF platform operators are responsible to follow all the guidelines stipulated under GRM which includes but not limited to have the means to monitor money-laundering activities (Item 6.01 (i) GRM).

3.3.1. Money Laundering / Terrorist Financing

Money laundering can be defined as the proceeds of unlawful activities that are related directly or indirectly, to any serious offences processed through transactions, concealments, or other similar means, so that they appear to have originated from a legitimate source (Item 4.1 of The Malaysia Guidelines for Anti-Money Laundering and Terrorism Financing for Capital Market Intermediaries) (The Guidelines). Anusha and Aspaella (2017) believe that it is a challenge to trace money laundering activities as the nature of the crime itself is carried out in the most devious ways possible. Not to mention, money laundering in ECF may visible in numerous ways. For instance, an issuer may conspire with investors to exchange money for securities in an illegal business under the disguise of a legitimate ECF offering which will be smoothly integrated into the financial system instead of using cash as a medium of transaction. The same method can be used to fund terrorist activity by channeling money out of the country.

Carry out due diligence to the prospective issuers may be the only solution to solve this problem (item 13.04(a) GRM). In addition,, employing external auditor and reporting suspicious transactions might be practical in combating money laundering issue.

4. SHARIA CHALLENGES IN EQUITY CROWDFUNDING TRANSACTIONS

It is worth noting that Islamic finance is based on *Maqasid Al-Shariah* (objective of the Sharia), which is a set of principles that aim to bring well-being to the individual and community. Nevertheless, Mehmet and Shehab (2014)

points out that Islamic banking and finance are regularly reprimanded for not being significantly contributing to the economic and social development of vast majority of Muslims. This is because, despite the global recognition, Islamic banking and finance primarily being limited to function as a high extent investment tool only for high net worth individuals. The emergence of ECF however can end the criticism as ECF offers issuers an access to capital to develop their business and a platform for retail investors to enjoy similar investment opportunity as the big industry players, based on the principles of wealth distribution and risk-sharing. Besides, Sharia-compliant ECF follows the same principles of Islamic finance such as honesty, the prohibition of interest, and transparency in dealings and social responsibility.

Until April 2019, there is no Sharia-compliance ECF platform in Malaysia. Although one of the platform, AtaPlus ensuring their platform to raise funds from the companies which provides Halal businesses, they did not mention the Sharia-compliance on their websites since there are extensive regulatory hurdles and processes involved. It is worth to note that many of Sharia questions raised below are not based on concrete cases. Islamic jurists prefer to discuss issues only when they have become concrete cases. Nevertheless, it is still useful to look somewhat ahead.

4.1. ECF Platform Operators

4.1.1. The Indefinite Power of Sharia Adviser

The appointment of Sharia Adviser is compulsory if the ECF platform offers Islamic capital market products (Item 12.01 GRM). However, for the purpose of ECF operation, the GRM does not specify their authority, thus creating an uncertainty to the extent of their power. The indefinite power of Sharia Adviser can be divided into two situations, which are before and post-campaign.

4.1.1.1. Before the Campaign

First, when is the right time to ensure the compliance of Sharia in a company? Logically, it must be done before the campaign, as prospective investors will have to first determine whether the company is Sharia-compliant or otherwise. Coupled with the issue of no specific Sharia parameter to assess, some platform just simply stated in their website that they only accept halal businesses as one of the conditions that need to be fulfilled.

It is worth to note that the assessment is not only limited to the nature of business per se, but also the contract used by the issuer need to be evaluated as well in order to observe whether the terms and conditions are indeed compliant with Sharia. Even if the company is acknowledged as Sharia-compliant, it is uncertain that the ECF campaign will succeed and if it fails, it would be a fruitless effort and cost ECF platform a lot of money because the service done by the Sharia Adviser is not free.

If the campaign is successful, there will be a new question that either the Sharia Adviser still has the power to continue to ensure Sharia compliancy of the company is still on-going, or need to seek confirmation from time to time. If the power of the Sharia Adviser is only limited to the completion of the fund-raising campaign from the investor, what about if the quality of Sharia deteriorated from time to time due to various reasons until it is no longer within the framework of Sharia-compliant company post-campaign?

4.1.1.2. Post-Campaign

As mentioned above, after the campaign ends and the company successfully raised fund target, the next question will arise, whether there is a need of continuous Sharia compliance monitoring. Reasonably, the answer is affirmative based on Chapter 8 GRM, which indirectly requires the ECF platform to provide for a copy of the report, by the Sharia Adviser confirming business and operating (company) is managed in accordance with the Sharia principles to the Securities Commission.

This provision raises another issue as whether the said report by the Sharia Adviser is merely an information provided by the issuer or Sharia monitoring. Aznan and Syahnaz (2016) distinguished between these two. According to them, the former is merely information for the purpose of compliancy with the GRM and it is not counted as Sharia monitoring on the issuer business, while the latter must be done by the Sharia Adviser on an on-going basis, or at least periodically, to ensure the quality of Sharia is preserved. This is important because the deterioration may not be realized by investors unless the company itself reporting this.

Some may argue that monitoring is not necessary, as the Sharia-compliant companies listed in the stock exchange also have no monitoring. Nevertheless, it is worth to note that the Securities Commission assesses the companies listed on the exchange through 'screening process', by observing some parameter into consideration periodically, in which ECF has none. Plus, this is a weak argument because unlike investment in ECF, investors in Stock Exchange still have the option to sell immediately such shares or waiting for the company to perform purification process. Simon and Rifaat (2018) believed that stock investment in the equity and Islamic Equity depends on the Sharia legal maxim:

'What may not be allowed initially can be tolerated in continuity'.

If that is the case, Sharia Adviser is obliged to monitor in detail each and every last businesses by issuer. It will be financially burdensome for the platform to prolong service of Sharia Adviser. Not to mention, if the company declares itself as Sharia-compliant or Islamic-friendly, the platform needs to prove it, and in order to prove it, it is better to make it trustworthy through the external Sharia Board, as the ECF platform must not be the judge and jury. Hence, there is a tendency for a platform to charge more in terms of commission for issuers who request their company to be recognized as Sharia-compliant. Alexis (2015) further added that there is a need of continuous monitoring on ECF in *Mudarabah* and *Musharakah* contracts. These types of contract are return-based or profit-sharing financing in which there will be equity repurchases in the future. Hence, if the exit mechanism of the company is taken through the initial public offering (IPO), then Sharia Adviser has to ensure the company will continue to be Sharia-compliant until the exit.

Even so, the Islamic Financial Services Board (2017) explained that the platform does not have to disclose all findings of the Sharia Adviser, but only the information related to the structure of the Islamic Capital Market Product. The structure of a Capital Market Product – for example, an equity share – will not change over its lifetime, and if the structure is considered Sharia-compliant at the beginning, it will remain so until the exit. However, it does not apply to the substance of the company financed by that structure. The business may passed the initial assessment and acknowledged as a Sharia-compliant company, but over time the Sharia quality may have depreciated due to a number of reasons e.g. a gradually increasing conventional debt financing. The investor may be not aware of such matter unless the company itself reporting this. Thus, clarification is needed whether this deterioration may fall under item 13.09 (c) GRM which requires ECF platform operator to report to the investors any material change or development on the issuer's business. If this is not so, then there is seems to be a regulatory gap that may be needed to be addressed in the future.

The situation where the company is no longer a Sharia-compliant is vital as investors are typically concerned about the investment carried out by the company and only agree to invest if the company is within the Sharia-compliant framework.

4.1.2. The Differing Thoughts on the Structure of Equity

The National Sharia Advisory Council has its own method of conducting the Sharia screening process on public listed companies in order to ensure their Sharia compliancy. Nonetheless, the same is not applied to companies wishing to utilize ECF platform. Therefore, Aznan and Syahnaz (2016) proposed that Sharia compliancy in ECF activity requires a specific Sharia parameter as a reference to the Sharia Adviser to assess and able to determine whether the company is indeed a Sharia-compliant or otherwise. Alexis (2015) added that the establishment of

specific Sharia parameter is to monitor and coordinate Sharia compliancy of that business. Without it, the Sharia Advisers will have differing opinions and hardly to reach consensus among them on any issue arise, which ultimately leads to uncertainty issue. It is important to note that the uncertainty about the Sharia compliancy of instruments or techniques may have become effective hindrances for Islamic finance to catch up in many areas.

In conventional ECF for instance, preference shares and convertible notes are among the most frequently used instruments, which have several advantages over ordinary shares in terms of rights and obligations. However, [Simon and Rifaat \(2018\)](#) stated that some Sharia Adviser might not have considered such instruments as Sharia-compliant because partnership rules according to Sharia, entail the justice and equity to be upheld and in the case of business loss, it is mandatory for each shareholder to incur losses in accordance to their respective capital contribution in the company.

Likewise, Resolution no. 63/1/7, Resolution and Recommendation of the Islamic *Fiqh* Conference Council 1985-2000 clearly prohibited preference shares. The same ruling done by Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which is a leading international organization primarily responsible for issuance of global standards for global Islamic finance industry. Nonetheless, Sharia Resolution from Securities Commission during 20th meeting dated 14 July 1999 allowed preference shares.

Aside from that, Sharia debate regarding redemption price of equity was also being raised. The Policy Document concerning *Musyarakah* pursuant to paragraph 23.2 guidelines of *Musyarakah* issued by [Bank Negara Malaysia \(2015\)](#) clearly states:

A partner may request the other partner(s) to give a promise (wa`d) to gradually purchase his shares of the musyarakah venture over an agreed period of time at market value, fair value or at an agreed price by the parties at the time of purchase.

However, [Aznan and Syahnaz \(2016\)](#) emphasized that, if an investment adopt the concept of *Shirkat al-'aqd* (partnership agreement) in equity financing by profit sharing, the redemption price of equity is likely to face Sharia issues in terms of profit manipulation. It is because the Islamic principles demand sharing of true profits, not just book profits ([Safdar and Arshad, 2011](#)). [Yousuf \(2018\)](#) agreed that there are different schools of thought on Sharia matters; however, he believes that it is up to the issuer preference on their target investors whether it is limited to one jurisdiction or the whole world. If the issuer selects the former, than the national Sharia ruling is applicable, while choosing the latter will necessitate the issuer to follow international ruling standard.

5. CONCLUSION

ECF grows fast in Malaysia due to countless support from government and industry players. The ability to efficiently resolve the financing difficulties of SMEs and provide satisfactory returns to the investors are not the only benefits ECF can offer. Sharia-compliant ECF for instance, is able to bring positive social impact in any community-based project. Not to mention, Sharia-compliant ECF demands highest levels of ethics and transparency, based on the universal principles of Islam, which is necessary to protect the investors. However, regardless whether it is a conventional or Sharia-compliant ECF, this kind of financing instrument is vulnerable in terms of supervisory regulation.

Various literatures already stressing the main challenges for policy makers in order to find the right balance between protecting investors and facilitating access to financing to reduce financial constraints on entrepreneurs. While the former requires more stringent regulation (which leads to higher costs for issuers), the latter requires less regulation so that the transaction cost the issuer must bear is low. The implication of failing to achieve the former can lead the potential investors to lose their investments due to adverse selection and weaknesses in regulatory regulation. Meanwhile, failing to achieve the latter can cause entrepreneurs not to utilize ECF to obtain funds. Undoubtedly, the failure of regulatory body to balance between these two will drive funders out of market. Hence, it is a necessity to perform a survey on ECF platforms and the investors to indicate their perceptions

towards the regulatory environment in order to recognize any potential weaknesses of ECF regulatory systems, so that ECF can always evolve to address new challenges.

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