



Challenges and Opportunities of Islamic Crowdfunding as a new Innovative mechanism to finance Startups

Sotehi Djaber ¹, Zeghbid Nassim Lotfi ²

¹ University of Islamic Sciences Emir Abdelkader (Algeria), Sotehi.djaber@univ-emir.dz

² Graduate School of Accounting and Finance of Constantine (Algeria), nzeghbid@escf-constantine.dz

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Abstract:

This study aims to explore the applicability of Islamic crowdfunding as an alternative fund to finance Startups Islamic crowdfunding platforms are based on cooperation (Taawun) and are designed to comply with the Shariah principles but is open to both Muslims and Non-Muslims. The funding should not have any element of interest (Riba), gambling (Maysir), non-permissible (Haram) and speculative (Gharar). These are some basic features, which distinguish from Conventional Crowdfunding platform and also the existence of Shariah supervisory board to ensure the transaction structures, processes and agreements are in compliance with Islamic law The study delves into the key components of Islamic crowdfunding, elucidating how it operates within the framework of Islamic finance. It scrutinizes various models of Islamic crowdfunding, including donation-based, reward-based, equity-based, and profit-sharing models, each catering to the diverse needs of entrepreneurs and investors. Additionally, the research explores the implications of these models on the startup ecosystem, considering the potential benefits and challenges faced by both startups and investors. In conclusion, this abstract underscores the potential of Islamic crowdfunding as a viable and ethical alternative for startup financing. And explores the burgeoning intersection of Islamic finance principles and contemporary startup financing through crowdfunding platforms. Traditional Islamic finance is rooted in Shariah law, which prohibits the charging or receiving of interest and promotes ethical and socially responsible investments. In contrast, startups often rely on conventional financing methods that may conflict with these principles. Islamic crowdfunding emerges as an innovative solution to bridge this gap, providing a Shariah-compliant avenue for entrepreneurs and investors alike.

Keywords: Islamic crowdfunding, Islamic finance, Entrepreneurs, Startups.

Introduction:

In recent years, the global entrepreneurial landscape has witnessed a surge in innovation and creativity, with startups emerging as powerful drivers of economic growth and job creation. However, access to capital remains a critical challenge for many aspiring entrepreneurs, particularly in regions where traditional banking systems may not fully align with their values and principles. This is where Islamic crowdfunding, a rapidly evolving and innovative financial tool,

has emerged as a dynamic solution, bridging the gap between startup financing needs and Islamic finance principles. Islamic crowdfunding is a unique blend of financial innovation and adherence to Islamic ethical standards, making it a compelling choice for entrepreneurs who seek capital while staying true to their faith. This form of crowdfunding operates in accordance with Islamic finance principles, such as prohibition of interest (riba) and avoidance of excessive uncertainty (gharar), and focuses on ethical and socially responsible investments. In this era of financial inclusivity and technological advancement, Islamic crowdfunding has become a powerful tool in supporting startups by providing a Sharia-compliant platform for raising funds. and in the realm of startup financing. It will explore how this financing model serves as a bridge between the entrepreneurial spirit and Islamic financial ethics, enabling entrepreneurs to secure capital without compromising their faith. Furthermore, it will delve into the various facets of Islamic crowdfunding, highlighting its potential to catalyze the growth of startups, foster innovation, and contribute to the broader economic and social development in accordance with Islamic values.

This study aims to determine the role of Islamic Crowdfunding in the context of startup financing, exploring how it facilitates access to capital, promotes ethical investment, and contributes to the growth of innovative businesses. Furthermore, it will discuss the various models and instruments of Islamic crowdfunding, shedding light on its potential to reshape the entrepreneurial landscape by fostering innovation while staying true to Islamic values.

The problem of this research came under the following question: **What advantages and benefits does Islamic crowdfunding offer in the context of startup financing?**

Under this main question fall sub-questions:

- What is Islamic crowdfunding? What types of Islamic crowdfunding mechanisms?
- What are the potential benefits of Islamic crowdfunding? What advantages of Islamic Crowdfunding?
- Are there any challenges or limitations of Islamic crowdfunding? What are the future prospects and trends for Islamic crowdfunding?

Importance of Research:

The importance of this research is on the role of Islamic crowdfunding in financing startups is instrumental in advancing knowledge, facilitating ethical financing options, and promoting economic growth while aligning with Islamic principles. It serves as a foundation for informed decision-making and the development of supportive frameworks in this emerging field. **Research Objectives:**

To Investigate Sharia Compliance in Islamic Crowdfunding for Startups and Analyze the extent to which Islamic crowdfunding platforms adhere to Sharia principles in their financing mechanisms and how this affects their effectiveness in supporting startups.

Research Methodology:

The research methodology follows a path of Exploratory Research that Begin with an exploratory approach to gain a comprehensive understanding of Islamic crowdfunding and its impact on startup financing. And a descriptive Research: Utilize descriptive research methods to provide a detailed overview of Islamic crowdfunding platforms, startups, and investors involved.

1- Islamic crowdfunding concept:

A. Islamic crowdfunding definition

Islamic crowdfunding can be defined as the minimal money utilisation obtained from the masses or organisations to fund a business or project through an online platform based on Shari'ah principles. The operations of crowdfunding and Islamic crowdfunding are basically the same except that

Islamic crowdfunding raises financing through online Shari'ah-compliant platforms. This is to ensure that there are no prohibited projects, no Riba and the risks of the investment are fairly and equitably shared there are four parties involved in an Islamic crowdfunding, namely (i) project initiator/fundraiser, (ii) funders/investors, (iii) crowdfunding operator, and (iv) Shari'ah board (Munirah, Salina, & Mohamed Asmy Mohd Thas, 2021).

B. islamic crowdfunding model

Islamic crowdfunding, also known as "Islamic crowdfunding," is a method of fundraising that complies with the principles of Islamic finance, such as Sharia (Islamic law). It is a system where a group of individuals, often online, financially contribute to a specific project or cause in accordance with Islamic principles, which prohibit interest (riba) and promote fairness and equity in financial transactions. Here's a simplified model of how Islamic crowdfunding typically works (Rafay, 2020):

- A. Fundraisers will propose their project or cause for which they want to raise money as shown in figure 1.
2. The securitization of the project will be done by the Shari'ah Board to check Shari'ah compliance based on qualitative and quantitative criteria. The qualitative benchmarks concerning to the type of business in which project cannot operate, this includes all activities are designated Haram by Shari'ah, namely: alcohol and pork products, pornography, tobacco, gambling, interest-bearing financial assets, weapons and defense, biology and animal genetics (cloning). In quantitative criteria, the financial reports of projects are appraised for amounts which should not exceed certain limits and thresholds are different in the percentages and formulas between different global indices.
3. The Islamic crowdfunding platform will make all documents and reports public on its platform for funders to read. All contract clauses and pre-determined rates are made public to bring transparency. If funds are raised for donation there should be proper verification of cause and credibility of the fundraiser.
4. Funders will show their interest in different projects according to their needs and interest.
5. Funders will contribute money towards the project or cause in the bank attached to the platform.
6. Funds will be returned to the funders if the target amount has not been achieved. So Islamic crowdfunding will work on AON "All-or-nothing" model.
7. Funds are transferred to the fundraisers if the target is achieved.
8. The crowdfunding platform will receive information about the amount and take their pre-determined fee for paying the salaries of employees and profit for their efforts.

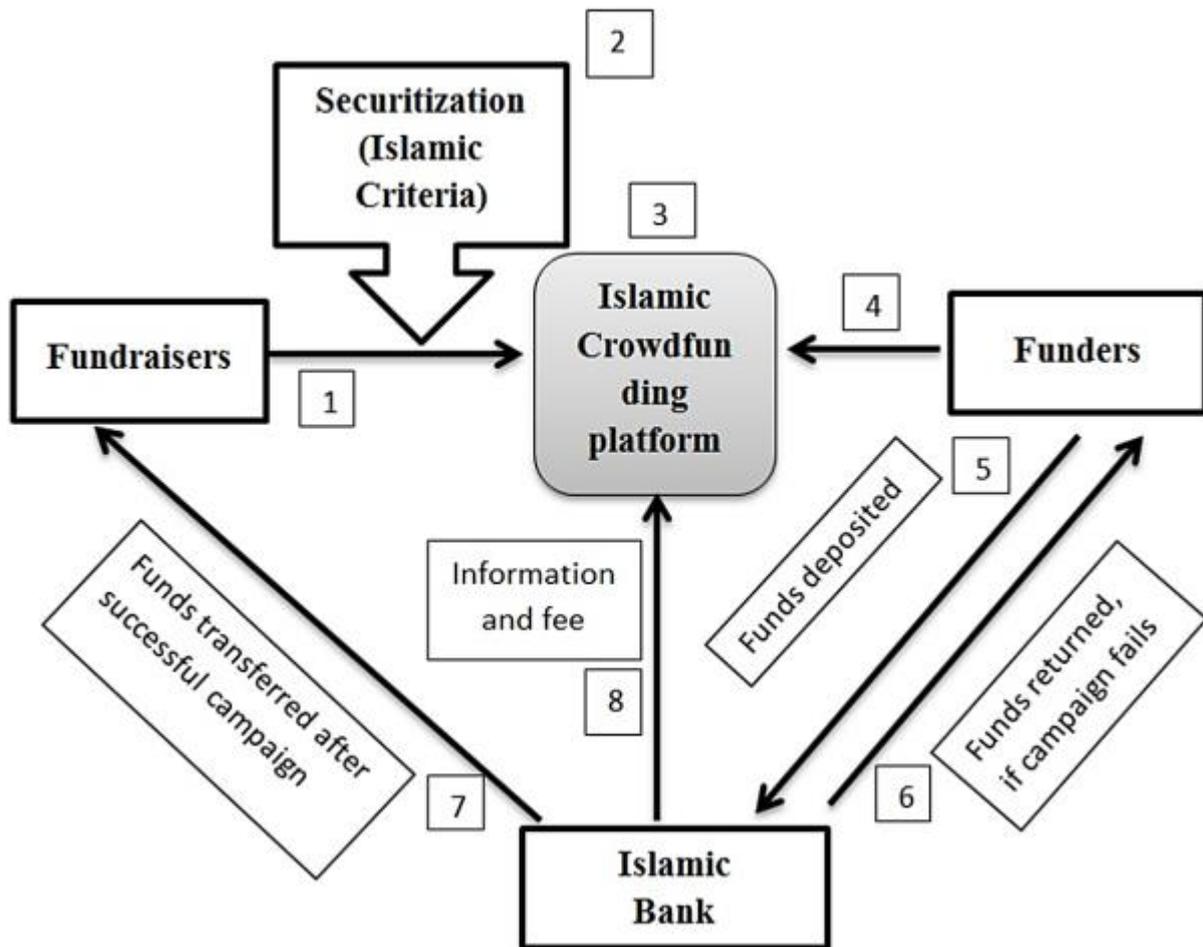


Figure 1. Mechanism of Islamic Crowdfunding

C. Difference between Conventional and Islamic Crowdfunding

Conventional crowdfunding and Islamic crowdfunding are two different approaches to raising funds for various purposes, but they differ significantly in their principles, practices, and compliance with Islamic finance principles. Here are the key differences between them (**Salman, 2018**):

1) Basis of Funding:

Conventional Crowdfunding: Conventional crowdfunding is based on secular principles and does not necessarily adhere to any specific ethical or religious guidelines. It is primarily driven by profit motives, and backers/investors expect financial returns or rewards in exchange for their contributions.

Islamic Crowdfunding: Islamic crowdfunding, on the other hand, operates within the framework of Islamic finance principles, which are rooted in Sharia (Islamic law). It is designed to comply with Islamic ethical and financial guidelines, and the funds raised and invested must be Sharia-compliant.

2) Interest (Riba):

Conventional Crowdfunding: Conventional crowdfunding may involve loans, equity investments, or other financial instruments that often include interest (riba). In Islam, riba is prohibited, so this aspect is not acceptable in Islamic crowdfunding.

Islamic Crowdfunding: Islamic crowdfunding platforms and projects must be structured to avoid riba. Instead of earning interest, investors receive a share of profits or returns based on the performance of the underlying project or business.

3) Risk and Profit-and-Loss Sharing:

Conventional Crowdfunding: In conventional crowdfunding, investors may not necessarily share in the risks and profits of the project or business in a meaningful way. Their returns are often predetermined or based on interest rates.

Islamic Crowdfunding: Islamic crowdfunding adheres to the principle of profit-and-loss sharing. Investors and project owners share both the risks and rewards. If the project succeeds, profits are distributed according to agreed-upon ratios. If it incurs losses, investors may share in those losses.

4) Asset-Backed Financing:

Conventional Crowdfunding: Conventional crowdfunding projects may or may not be asset-backed. Assets might not necessarily back the investments or loans.

Islamic Crowdfunding: Islamic crowdfunding typically requires investments to be asset-backed, ensuring that there is an underlying tangible asset or service that supports the investment. This aligns with the Islamic principle that wealth should be tied to real economic activity.

5) Ethical and Social Considerations:

Conventional Crowdfunding: Conventional crowdfunding projects may or may not consider ethical or social impact criteria. The primary focus is often on profitability.

Islamic Crowdfunding: Islamic crowdfunding emphasizes ethical and social responsibility, and projects should adhere to Sharia-compliant principles. Investments are expected to benefit society and comply with Islamic values.

6) Regulation:

Conventional Crowdfunding: Conventional crowdfunding platforms are subject to regulatory frameworks that vary by country. They often follow standard financial regulations.

Islamic Crowdfunding: Islamic crowdfunding platforms must comply with both standard financial regulations and specific Sharia-compliant financial regulations, which can be more complex and require specialized knowledge.

In summary, the main difference between conventional and Islamic crowdfunding lies in their underlying principles and compliance with Islamic finance. While conventional crowdfunding is profit-driven and may involve interest-based transactions, Islamic crowdfunding operates within the ethical and religious guidelines of Sharia, focusing on profit-and-loss sharing, asset-backed financing, and social responsibility. Islamic crowdfunding seeks to align financial activities with Islamic values and principles.

Table 1. The differences between conventional and Islamic crowdfunding

Crowdfunding Type	Conventional	Islamic
Reward-based crowdfunding	Materialism	The materialism that may include elements of al-Falah
Donation-based crowdfunding	Humanitarianism	Based on religious beliefs such as waqf, zakat, sodakoh, and so on
Equity crowdfunding	Angel investor, venture capitalist	Based on the Mudarabah contract, or Musyarakah
Debt crowdfunding	Lend with interest	Based on sales contracts such as <i>Murabaha</i> , <i>Tawarruq</i> and <i>Ijarah</i>

Source: (Trisninik, Bimo, & Dian, 2020)

D. Types of Islamic crowdfunding

Islamic crowdfunding is a type of crowdfunding that adheres to the principles of Islamic finance, which prohibits certain activities such as charging or paying interest (riba) and engaging in speculative or unethical investments. There are several types of Islamic crowdfunding models that have emerged to cater to these principles:

1) Qard al-Hasan-Based Crowdfunding Model

As the current strategy of funding are not capable to fulfil the monetary need of micro and small enterprises, there is a necessity to look out for an additional dynamic and well-organized model of financing to help micro and small enterprises. A Qard al-Hasan crowdfunding model is proposed with the aim to be a viable alternative choice for the current micro and small enterprises strategy of financing as shown below.

In this study, the researcher propose the Qard-al-Hasan based crowdfunding model. This model merges the concept of crowdfunding for entrepreneurs using Shari'ah contract known as Qard-al-Hasan as an instrument. One of the characteristics of Qard-al-Hasan is that it flexible to assist the progress of any idea for the benefit of its assets without any pre-specified restrictions by the Shariah. From the prism of Shari'ah, a Qard-al-Hasan is neither certainly a transaction nor a gift, nonetheless, it occur within the two, which implies that Qard al-Hasan merge the two features together; the features of being a transaction and that of a gift. Subsequently Qard-al-Hasan is suitable and applicable to all purposes, its capital cost is very low and the borrower will face a very low risk, while the lender will face moderate risk.

The contract will be benevolent loan or Qard-al-Hasan which no interest shall be included. The management costs will be covered by donors and the cost will be charged with fixed amount instead of being in percentage rate. Next, in other for this model to be implemented, a platform is needed.

Qard-al-Hasan-based crowdfunding platform is created to endorse and support small and medium enterprises ventures that is in compliance with Shariah. As Muslims, its forbidden to engage in any transactions that contain elements of Gharar (Uncertainty), Riba (Interest) and Maysir (Gambling). As it is also illegal for them to take part in any transaction that consist of outlawed activities in Islam. For instance, any venture or trade that comprises pornography or alcohol must be avoided. In this case there is a need for Shariah compliant crowdfunding platform that will offer loan without engaging in Riba or any prohibited activities. Thus, the proposed Qard-al-Hasan-based crowdfunding platform offers and endorses projects and contracts that are in compliance with Shari'ah.

in this proposed Qard al-Hasan-based crowdfunding there are four parties, namely (**Aderemi & bin Ishak, 2020**):

1. Initiator of Project - which may consist of: individuals, association, and business;

2. Potential Funders;
3. Qard al-Hasan Crowdfunding platform
4. Sharia Advisory.

Explanation of the Four Parties

I. Project Initiator (Entrepreneurs)

The entrepreneurs are the first actors as well as the initiators in crowdfunding mechanism. This are set of people who are financially less capable, but they possess skills of entrepreneurial and the group of people who are in need of capital to nurture their businesses. The participants of Qard-al-Hasan based crowdfunding would be the entrepreneurs who did not have the viability to acquire the funds from other types of Islamic Crowdfunding (such as Mudarabah, Musharakah, Murabahah based crowdfunding) so they need to be assisted by using Qard-al-Hasan based crowdfunding.

II. Potential Funders (Crowd)

Crowd is the last actor and the most important actor among three actors. The crowd is a large group of ordinary people, who can take out some petty donations from their wealth to support the concepts they find promising. There are several names for the crowd: funders, investors, backers, or donors. The crowd will donate to fund the project within a certain time of period. The contract between the crowd and the platform is pure charity for the purpose of funding the entrepreneurs. The crowd will give a portion of the charity to pay the fee to the platforms under Wakalah contract. In this model, the crowd also represents those who are less fortunate financially.

III. Qard al-Hasan-Based Crowdfunding Platform

The platform provides an intermediate facility to act as an intermediary between a businessperson and potential crowdfunding. In this study, the proposed platform is also acting as a manager. The platform is based on Shariah, in which one of its duties is to ensure that the business idea presented or pitched to them is Shariah compliant. Any idea which passes the screening or due diligence process will be promoted to the crowd or the public.

IV. Board of Shariah

The board of Shariah are the Shariah advisor provided by the proposed platform. The Shari'ah advisor have their responsibilities and objectives. They are to ensure that the idea posted by the entrepreneurs is complies with Shariah law (no alcohol, gambling, usury activities, speculation, Gharar, illegal items, etc.). A due diligence group ensures business owners are eligible for the service.

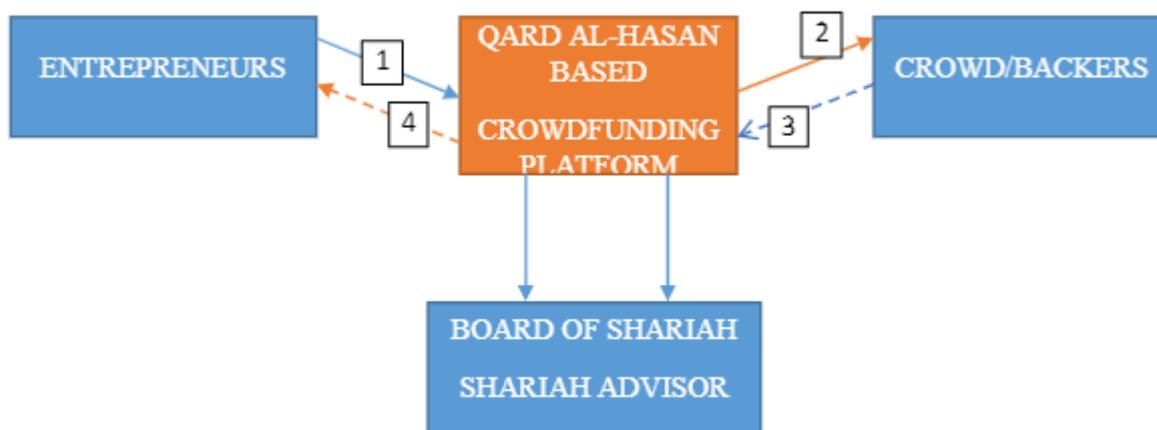


Figure 2. Qard al-Hasan-based Crowdfunding Framework

Flow of the Figure

1. The entrepreneurs pose or pitch their business ideas to the platform. In this stage, Shariah advisor appointed by the platform will ensure the idea complies with Shariah law (no alcohol, gambling, usury activities, speculation, Gharar, illegal items, etc.). A due diligence group ensures business

owners are eligible for the service.

2. The platform promotes the selected ideas to the crowd or public as an agent for the entrepreneurs. Because of the agency contract (Wakalah), the platform will get paid. It is known as the Wakalah contract that involves a fee (Wakalah bil Ujrah). The fee is paid using funds donated by the donor.

3. The crowd or investors give donation or Sadaqah to the project via platform. After the funding period expired, the fund collected will be given to the entrepreneurs under the contract Qard al-Hasan between

the entrepreneurs and the platform.

4. The entrepreneurs are obliged under Wa'ad contract, to repay the loan without imposing any interest to the platform within a certain time frame. The contract will be incorporated with Kafalah to ensure that the entrepreneurs repay the loan at the given time. The amount of every repayment is small and affordable to the platform. During the project operation, Shariah advisor of the platform will monitor the project to always abide to the Shariah laws.

5. This proposed model will include a number of extra Islamic contracts such as Wakalah (Agency), Kafalah (Guarantee) and wa'ad (Promise). Wakalah is an agency contract between the funders and the platform. In this study, the proposed platform acts as a manager. As a Shariah-compliant platform, one of its duties is to ensure that the business idea presented or pitched to them is in compliance with Shariah. Since the platform aims to offer an Islamic product, it is recommending for the platform to employ a Shari'ah advisor in order to ensure that the proposed activities comply with Shariah laws. As well, the Shariah advisor ensures that to be approved ventures run in accordance with Shariah laws, in a way that any business ideas which transcend the screening or fair diligence procedure will then be publicized to the public or the crowd.

6. Thus, wa'ad contract will take place between the platform and ventures on compliance with the conditions specified and in line with Shariah. Wa'ad is considered as a monitoring tool on business or an ongoing project. Any misconduct committed by ventures will be penalized by the platform. A significant difference between this proposed model to the existing ones is that this Qard-al-Hasan-based model is purely meant for Small scale business and with no any interest involved. Through the Qard al-Hasan-based crowdfunding model, entrepreneurs can do business while increasing their quality of life. In return, their businesses will help the community in creating jobs and facilities.

2) Sadaqah-based Crowdfunding

Sadaqah means gift as it is among good deeds in Islam that has been promised by God with a special reward in the hereafter. Sadaqah can be applied as an Islamic crowdfunding instrument, as it can adopt the current practice of donation model. According to donation-based crowdfunding, the funders contribute their money without expecting the return. In fact, they are motivated to contribute to any campaign based on their spiritual intelligence and to expect intangible benefits in return. Sadaqah-based model can be illustrated as follow (**Kamaruddin & Ishak, 2020**):

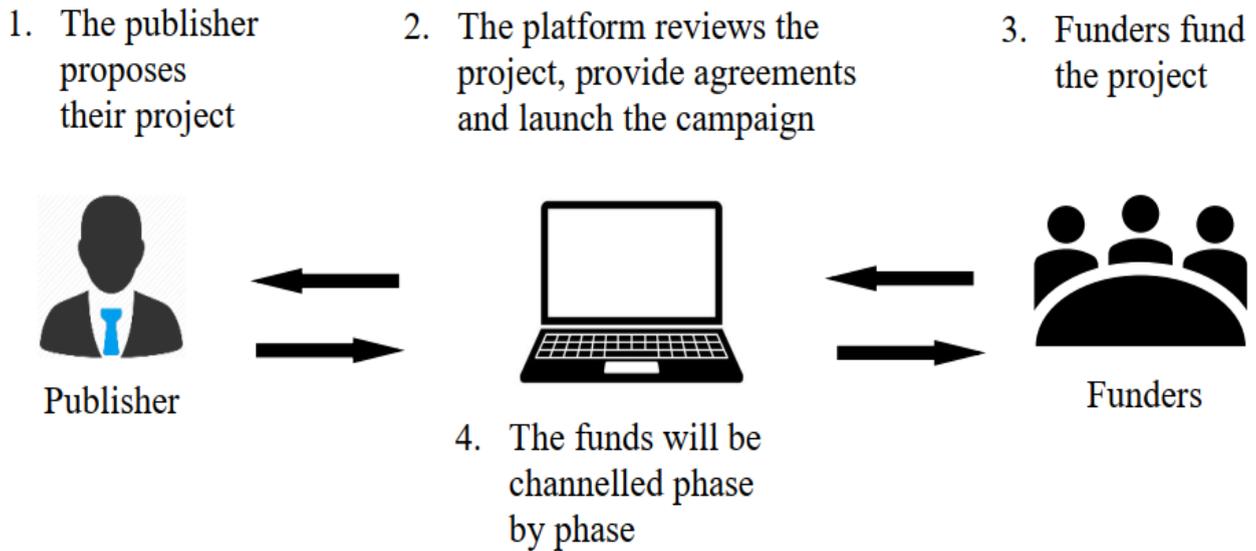


Figure 3. Sadaqah-based crowdfunding

Explanation:

1. The publisher applies the fund under the name of sadaqah from this platform. In proposing the project, he/she must provide details, including the topic and the summary of its content, the amount needed, the number of printed books, the targeting market and its strategy, end-to-end process from printing to selling and the ratio of profit.

2. The platform acts as a wakil (agent) on behalf of the funders to deal with the publisher. It plays a vital role in reviewing the proposal. If the proposal is accepted, the campaign will be launched.

3. The funders contribute the fund in form of sadaqah to the project.

4. For the purpose of transparency, the funds then will be channelled to the publisher phase by phase to avoid misuse of funds.

Since funders fully sponsored the money, this model may be suitable for charity purpose. For example, to publish books for the sake of donation for educational institutions or waqf projects.

3) Hibah-based Crowdfunding

Hibah means gift as giving hibah is also encouraged in Islam as a good deed. Hibah-based model can adopt the current reward-based crowdfunding, in which it provides an initiative token as a reward for funders. This reward includes album covers, tickets to the event, and free giveaways like donation-based, funders channel their money for the sake of social contribution or personal intention. At the same time, their contribution are based on desire and expect non-monetary benefits in return from the sponsorship of the campaign. It is understood that reward-based crowdfunding can be practiced into two approaches: “keep it all” like what has been practicing by Kick starter or “all or nothing” like Indie Go Go . The former requires the targeting amount must be achieved during the campaign otherwise, the pooled amount would be returned to the funders, while the latter allows the fund to be channelled to the project regardless the collected amount at the end of the campaign

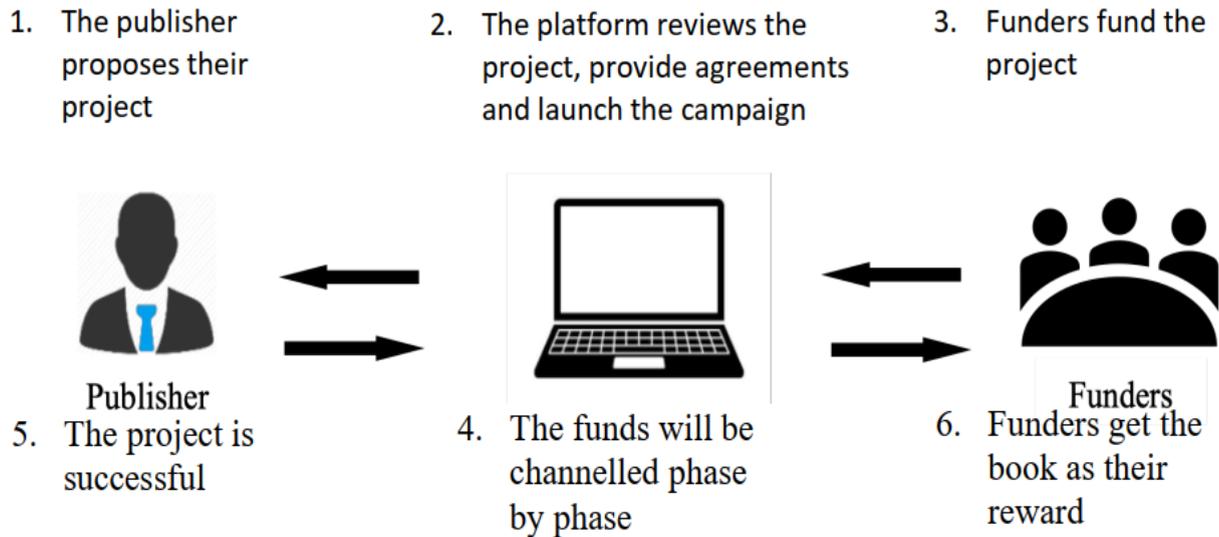


Figure 4. Hibah-based crowdfunding

Explanation:

1. The publisher applies fund from this platform. In proposing his book project, he must provide details, including the topic and the summary of its content, the amount needed, and the number of printed books.

2. The platform acts as wakil (agent) on behalf of the funders to deal with the publisher. It plays a vital role in reviewing the proposal for the project. If the proposal is accepted, the campaign will be launched.

3. The funders provide the fund to the project in exchange with the book when the project is successful.

If the amount successfully meets the target, it would be channelled periodically to the publisher. Otherwise, the campaign may be extending more than the original period. If the amount is still below the target, then the platform will return the money back to the funders. It is unfair for publishers to provide rewards for their funders at the same time the amount does not reach their target (**Kamaruddin & Ishak, 2020**).

4) Waqf-Based Crowdfunding

Waqf-based crowdfunding is an innovative and socially responsible way to raise funds for various charitable and community development projects. Waqf is an Islamic philanthropic concept where individuals donate assets or money for the purpose of charitable causes, and the capital remains intact while the profits generated from the assets are used to fund charitable projects.

In recent years, there are few number of studies emphasize of utilization of waqf particular on cash waqf for financing purpose. Some researcher sees potential of waqf as an external financing source for entrepreneur or start-up business .Lahsasna (2010) recommended financial approach by using cash waqf model in financing micro and medium-sized enterprise (MMEs). According to him, cash waqf is a reliable source for micro credit and micro financing, it is strong source for the medium size enterprise and entrepreneurship to create more project, business opportunities, and more employment. More advanced, Mohd Thas Thaker et al. (2016) has developed Integrated Cash Waqf Micro Enterprise Investment (ICWME-I) model as a source of funding for micro enterprises. This model is expected to provide financial services by using cash waqf fund and involved the participatory between non-profit organization and micro enterprises. Different with the financing by existing financial conventional institution, the proposed model do not need collateral requirement, interest rate and any stringent requirement. Waqf-based crowdfunding is the unique hybrid product of crowdfunding in the form of waqf represents a new mode of financing mechanism for the entrepreneur by using Islamic mechanism and regulation. According to Syauckani (2015), waqf is

one of redistributed wealth mechanism that very effective, while crowdfunding is known as an efficient system to collect fund, thus crowdfunding is fit to act as fundraiser waqf medium to finance social development purpose such as the cost of disaster management in Malaysia. The combination between this two mechanisms known as Waqf-based crowdfunding. Wan Shamila et al. (2016) stated that waqf based crowdfunding is similar to the waqfbusinesses, in which the profits from the businesses will be distributed to the beneficiaries. The business is expected to project continuous profits that could ensure the continuity of fund to the beneficiaries.

In order to combine both crowdfunding and waqf, there is important to understand how these two mechanisms work. In hence, this part will explore the fundamental process of crowdfunding and waqf to get more picture how possible both mechanism to be combined and finally identified the some aspect that both have in common.

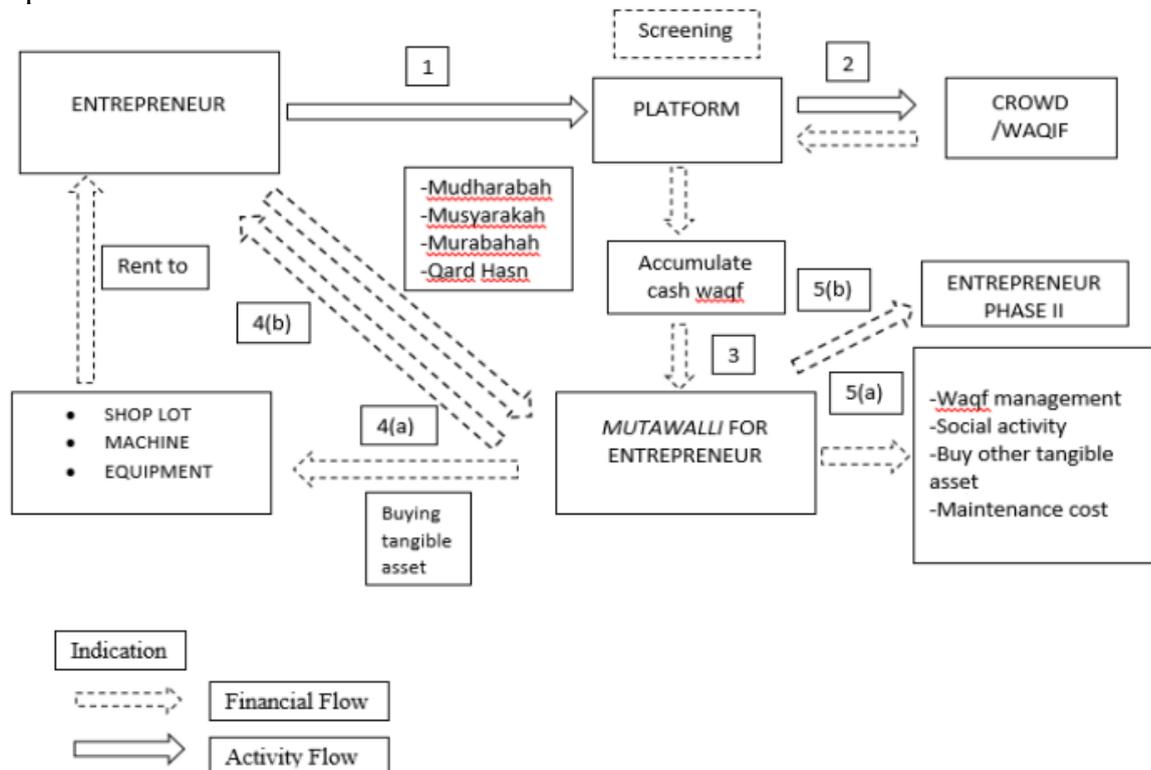


Figure 5. Waqf-based Crowdfunding for Entrepreneur Development

The flow of figure 5:

1. Entrepreneur present their project information to the public through the platform. Shari'ah advisor will make a screening process to make sure the project comply with shari'ah principles before the platform campaign or promote the project to the crowd.
2. Crowd who agree to perform waqf, will transfer some of the cash via the platform
3. Accumulated cash waqf will be given to mutawalli who is responsible for managing, monitor and distribute cash waqf to beneficiary.
- 4(a). Using the waqf fund, mutawalli buys tangible asset that needed by entrepreneurs such as shop lot, machine or any equipment asset needed according to their project or business information before. The tangible asset then will rent to entrepreneur under Ijarah contract with the amount agree by both parties.
- 4(b). Mutawalli will play a role to manage and distribute cash waqf to the beneficiary as stipulated by donor. There are two possible ways distribution made by mutawalli namely loan riba free (qard hasn) and investment through Islamic contracts such as Mudharabah, Musharakah and Murabahah.
- 5(a). Money from the rent of tangible asset will be reuse by mutawalli to buy other tangible asset needed or for maintenance cost of existing asset to increase their life expectancy, waqf management, and social activity.

5(b). Repayment of the loans is used to recharge the cash waqf pool and in turn become the source of funds for other needy entrepreneur (SAMSINAR , Shifa Mohd, & Suhaili , 2017).

5) Mudharabah-based Crowdfunding

Mudharabah that derived from *dharb fi ard* can literally be understood as hitting on the ground that means a person begins his travel for business . Technically meaning, Mudarabah is defined as a partnership venture between mudharib (manager) and rab al-Mal (capital provider). Through this venture, rab al-Mal funds his money while mudharib manages it based on his expertise and experience. This partnership requires both parties to cooperate for the sake of profit through money channelled by the rab al-Mal and skills contributed by the mudharib. This contract is argued by Ibn Muzir as part of *ijma'* (consensus) in terms of its legality .

In general, there are several requirements for Mudarabah. For example, the capital must be in the form of money so as it can avoid a dispute of the profit distribution later. This capital also must be provided once the contract is concluded . In terms of the profit, it must be clearly finalized before the conclusion of the contract, despite some scholars allow the change of its distribution after that if both contracting parties agree with it . Subsequently, the ratio of profit distribution later must be in a form of percentages, instead of fixed amounts . Another essential part of Mudarabah is its return. In general, if a project brings profit, then it must be divided based on the ratio agreed in the agreement. In contrast, if the project is unsuccessful, the rab al-Mal must bear the loss. This is fair since the mudharib has already experienced the loss in terms of idea, effort and time . However, if there is proof that the loss is due to mismanagement or negligence of the mudharib, he must take this responsibility. Also, the same rule is applied if the mudharib did not follow the agreement of Mudarabah in terms of limits and conditions of the project. In theory Mudarabah can be applied to Islamic crowdfunding investment instruments since it is equity-based. Several studies propose it, for example come up with a Mudarabah equity crowdfunding model as Shari'ah compliant financing that can financially support the halal industry. To adopt to crowdfunding, the platform needs to play its role as a wakil (agent). Meanwhile, views that a blockchain Mudarabah crowdfunding has several advantages in terms of improving privacy, reducing third parties and promoting transparency, in which in the end, it could attract potential investors. Nevertheless, the lack of training, the low of digital literacy in developing countries education, and weak business technology skills could be among the challenges for this idea. In terms of supporting entrepreneurs, views that Mudarabah could potentially play this role particularly in supporting a group of micro-enterprises. They argue that Mudarabah is a practical financing to extend the current business as well as an attractive investment since this contract is based on profit-sharing between the two parties. Meanwhile, in their study on the potential of Mudarabah found that this contract is risky at some points, including investing in fraud projects, the lack of regulations in terms of protection and the concept of Mudarabah is natural in the form of profit-loss sharing. However, all these risks can be minimized through technology, enhancing the current regulation, and promoting the concept of Mudarabah (Jamaluddin, Nur Syahirah, Shahrul, & Ifwat, 2022).

This model can follow the equity-based crowdfunding, in which it is as an investing medium for funders under the concept of equity . In this transaction, money is exchanged for a share in the company, project or enterprise, particularly same with other types of shares, the value will rise during a successful period otherwise falls during failing of the business. Pierrakis & Collins (2014) justify the definition of equity crowdfunding as the process of selling equity to the public by a private company typically via an online platform. This particular process slightly differs from the existing issuance of shares from the public listed company in the stock market because only private entity will approach this crowdfunding method

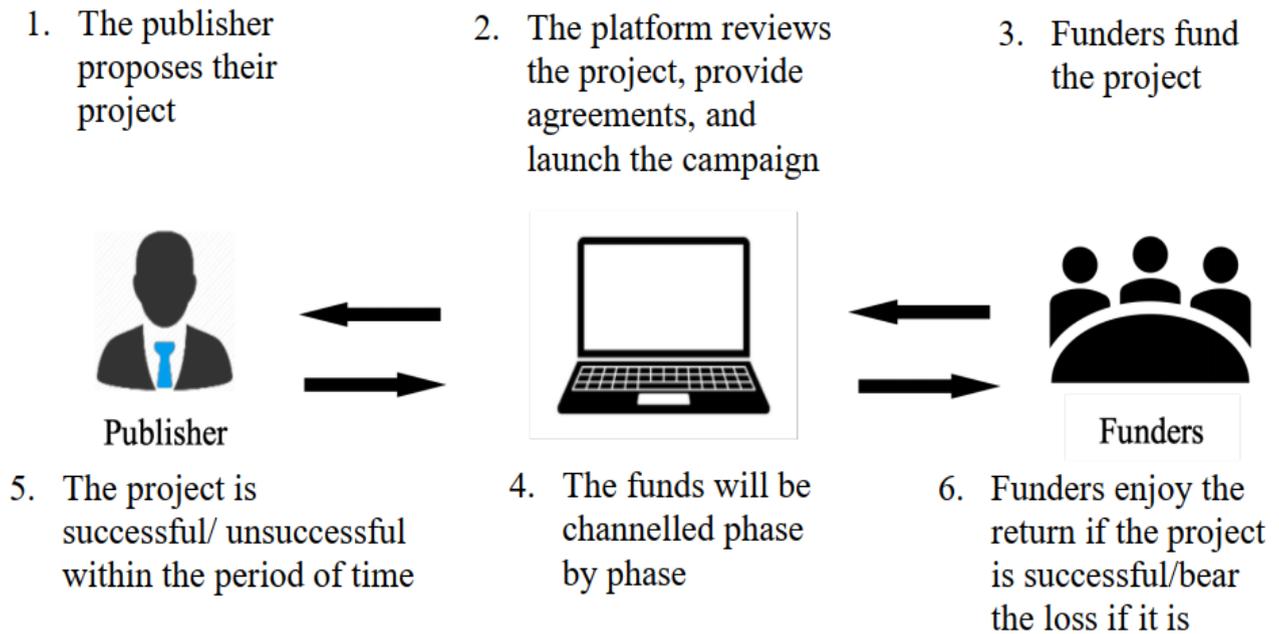


Figure 6. Mudharabah-based crowdfunding

Explanation:

1. The publisher represents as mudharib in this platform. In proposing his book project, he must provide details, including the topic and the summary of its content, the amount needed, the number of printed books, the targeting market and its strategy, end-to-end process from printing to selling and the ratio of profit.
2. The platform acts as a wakil (agent) on behalf of funders to deal with the publisher. It plays a vital role in reviewing the proposal of the project and its marketability. If the proposal is accepted, the campaign will be launched.
3. The funders act as rab al-Mal that provide the fund to the project. Thus, they should be clear regarding the regulation of mudharabah, particularly in the case of loss. At the same time, they deserve to know the details and progress of the project.
4. Fundraising is launched within a stipulated period. If the amount successfully meets the target, it would be channelled phase by phase to the publisher. Otherwise, the platform may extend the period. If the amount still below the target, then the platform will return, back the money to funders (Kamaruddin & Ishak, 2020).

6) Sukuk Through Islamic Securities Crowdfunding

When the sukuk publisher's want provides a return to wakif, Islamic securities crowdfunding Companies offer cash waqf to be channeled through nazir to mauqfalaih utilize in economic and social impact activities, one of which was the financing of MSMEs. The election to MSMEs is pivotal for the country economic backbone and many hiring people Thus, Islamic securities crowdfunding are expected to become a new player and will grow more significant in the future and can play a role as a new tool to raise more significant cash waqf and Channel to economic and social impact activities.

Looking at the last thing, the mechanism of cash waqf linked sukuk through Islamic securities crowdfunding proposed in this article is the wakalah bi al-istitsmar agreement by using land/projects that do not conflict with sharia principles as the underlying asset for sukuk issuance. Through this collaboration, a deployment that the waqf funds collected will intend to finance various projects such as the construction of halal industry, real estate, office-building, hotels, restaurants, schools, mosques, hospitals, foster beaches, and others.

Regarding the distribution of yields, submissions will be carried out from the issuer to the organizers of the Islamic securities crowdfunding when the project runs. The collection of cash waqf accomplished with the Islamic securities crowdfunding companies provides a feature returns

the investment will waqf in whole or only part of which for mauqf alaih through designated nazir institutions. Next, Returns the Investment conduct programs/activities that have a social and economic impact on the community, for example, providing business capital for MSMEs to accelerate economic recovery during a pandemic. The proposed conceptual model framework is as follows:

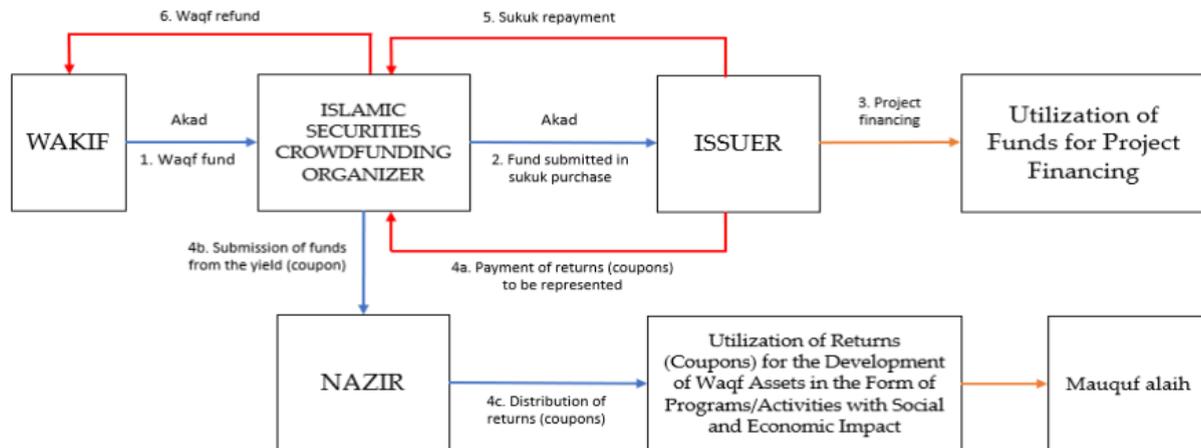


Figure 7. Sukuk Through Islamic Securities Crowdfunding

Here is an explanation of the mechanism scheme of implementation of cash waqf linked sukuk through Islamic securities crowdfunding above: (i) wakif represented the money he had by depositing waqf funds through Islamic securities crowdfunding platform for a certain period; (ii) then the waqf funds that have heightened are utilized to buy sukuk that the issuer has issued through the organizer of Islamic securities crowdfunding within a certain period; (iii) the issuer uses it for project financing; (iv) the issuer makes payment of sukuk returns (coupons) to the organizers of Islamic securities crowdfunding within a certain period; (v) the return from the issuer to the organizer of the Islamic securities crowdfunding offer to the nazir (in this section, will be an agreement between the organizer and the wakif, whether it will be 100% of the return channeled or according to the option what wakif wants); (vi) yields accomplished by nazir to be utilized for the development of waqf assets in the form of social and economic impact programs/activities (yields of 10% nazir and 90% mauqf alaih); (vii) the issuer returns funds to the organizer of the Islamic securities crowdfunding at maturity; (viii) the organizer of Islamic securities crowdfunding makes a refund of cash waqf to wakif (Imtiyaz Wizni, Anugrah Muhtarom, & Umi Khaerah , 2023).

2- The Benefits of Islamic Crowdfunding for Start-Up Businesses

Islamic crowdfunding offers several benefits for startups, making it an attractive financing option for entrepreneurs who want to adhere to Islamic principles while raising capital. Here are some of the key benefits of Islamic crowdfunding for startups:

2-1 raising capital for startup

Crowdfunding is a method of raising capital for startup businesses that has become increasingly popular in recent years. There are a number of platforms that allow entrepreneurs to solicit funds from a large pool of potential investors, and many startups have been able to successfully use crowdfunding to get off the ground.

There are a number of reasons why crowdfunding can be an attractive option for startup businesses. First, it can be a relatively quick and easy way to raise capital. Unlike traditional methods such as bank loans or venture capital, which can take months or even years to secure, crowdfunding can often be completed in a matter of weeks.

2-2 Credit score not required

When applying for loans at financial institutions, a nonexistent or low personal or business credit score is typically a barrier. But it's not an issue for most crowdfunding platforms, especially

rewards-based platforms, because entrepreneurs are not required to furnish or post their credit score when launching a campaign. Even if you are a so-called “credit invisible” and lack a credit history, crowdfunding can be an alternative to traditional financing to help you start or expand your business.

2-3 Serves as proof of concept

Proof of concept is the feasibility that the project or business idea can work. The speed and enthusiasm of donors’ contributions to a campaign is usually an indication of a business’s proof of concept and potential market demand. Generally, when a campaign hits its goal before the deadline or the amount of money raised greatly surpasses the original goal, it’s typically a good sign of proof of concept.

2-4 creates an organic customer base

Crowdfunding is a way to organically create your customer base and build engagement. Donors to successful campaigns often become loyal customers and brand enthusiasts because they have been on the entrepreneur’s journey from the beginning. This way, you organically build relationships with customers without having to spend on paid advertising and other marketing campaigns to engage customers.

2-5 A form of free marketing

If the business idea is remarkable and the campaign page is compelling, a successful campaign can be a form of marketing that leads to free publicity on the internet and social media—from viral social media posts to media attention. Buzzy campaigns can also attract investors. Make sure to track data on your campaign’s success, including funding amounts and conversion rates.

2-6 Funding from multiple sources

Entrepreneurs who complete a successful crowdfunding campaign will typically have hundreds of investors—some could be potential angel investors when you’re ready to scale. Having multiple sources of funding serves as a safety net in case an investor backs out.

2-7 Avoids bank loan interest costs

Crowdfunding can be a way to avoid taking out costly bank loans and incurring debt. Recent average interest rates on bank business loans range from 5.26% to 11.32%. While many crowdfunding platforms do charge platform fees—in some cases, 5% of funds raised, plus processing fees—costs are often lower than the expense of repaying most bank loans.

8. Fast method of raising capital

Most crowdfunding campaigns last one to two months, with several weeks or months of preparation time. Yet, crowdfunding is a relatively fast method of raising money for entrepreneurs compared to applying for bank loans or pitching to venture capital (VC) firms. Plus, with crowdfunding, you control the length of the campaign.

Securing a small business loan might take several months, from preparation to approval and receiving funds. In the best case scenario, pitching a VC firm, receiving an answer, and closing a deal also might take several months. Typically, you have to have a scalable startup and be well-connected to even be introduced to VCs. This excludes many small business owners who often haven’t cultivated the professional network for a colleague referral, or don’t have the capital and resources for scalability. Crowdfunding can help overcome these hurdles (**Shopify , 2023**).

3.challenges facing islamic crowdfunding platforms

Islamic crowdfunding platforms face several challenges that are unique to their operation and the adherence to Sharia principles. These challenges can include:

- the lack of regulation

In 2012, JOBS (Jumpstart Our Business Startups) Act was signed into law by the US President. The Act required the SEC (Securities and Exchange Commission) to adopt rules and formulate laws that will allow and provide for crowdfunding in the country. It led to opening up big and small crowdfunding platforms and created job opportunities in the country besides bringing an inflow of required capital or finance to the startups and SMEs. However, an insight into the Middle Eastern countries shows the absence of proper laws and regulations that would provide for financing

through Crowdfunding, let alone incentivizing the entire regime. In some of the regions, there is ambiguity regarding whether the fund raised through Equity Crowdfunding would result into issue of Capital and would be governed by the Securities and Contracts Laws of these nations. Since crowdfunding is a public fundraising, it cannot be considered as a private placement. Thus, without specific regulation, it is regarded as a public offering governed by highly complex processes similar to IPOs. To overcome this, some platform operates as a closed network of investors, this limits growth and prevents the utilization of social media and other public marketing to explicitly market its services, educate the public, and increase outreach. Furthermore, the lack of regulation creates uncertainty and concerns by the public on the legality of the investment platforms. A specified act or a law providing clear guidelines addressing such issues and governing crowdfunding investing would be indeed a significant step.

-weak technological infrastructure

Technological infrastructure is a cornerstone for crowdfunding, relying on internet and digital payment penetration. The internet is growing strongly in the Middle East and Africa, but still lag behind Penetrations in developed countries. In 2017, internet penetration rates in Africa was 35.2 percent from the population and in the Middle East was 64.5 percent, compared to 85.2 percent in the EU and 95 percent in North America Digital payments are the key challenge in developing countries. Diverse digital payment gateways that could reduce crowdfunding's transaction costs are lacking, and credit card penetration and online bank transfers are low in developing countries. Furthermore, online legal transactions need to be made possible through digital signatures and other verification technologies. This would strengthen the core value proposition of online crowdfunding. Currently, in countries like Egypt and Malaysia, to establish a company, to register shareholder rights, and for the legal documentation, crowdfunding investors must conduct several offline activities.

-shariah issues

Islamic crowdfunding is Islam-based crowdfunding, so project and product being offered must be halal and permitted by the religion of Islam. Likewise, the money used to finance a project must be guaranteed halal .To comply with Shariah, Islamic crowdfunding also needs to avoid gambling and speculations (maysir), uncertainty (gharar) and interest rate (riba). Thus, among the four types of crowdfunding, only lending-based crowdfunding does not comply with Shariah since it consists of element of riba. Reward-based crowdfunding is almost similar to Bay as-Salam's concept .To determine the halal of a project or product, it is necessary to establish Sharia Supervisory Board .The Shariah status and screening process are not clear for many Islamic crowdfunding platforms. For instance, the platform characterized in its Crowd surfer profile as a "Shariah-compliant equity platform for SMEs and start-ups in Malaysia" – AtaPlus, did not mention the Shariah compliance on its website. The only hint of Shariah compliance was the list of activities in which a fund-seeking entrepreneur must not be involved. One of the oldest equity crowdfunding platforms in Egypt – Shekra – quotes several previous Islamic awards on its website. It does not explain how it assures Shariah compliance. Finally, an Indonesian platform for student loans – Danadidik – applies a profit- (or income-) sharing model to calculate the returns for investors. Although this is vaguely reminiscent of Islamic financing techniques, the platform claims to adhere to Islamic principles.

-the lack of awareness and trust

Another challenge for crowdfunding in developing markets is the lack of general awareness and trust. Since crowdfunding is a recent phenomenon, there is little overall awareness among potential users (funders and fundraisers) of this innovation .Islamic financing is also new to most people, especially as conventional financing (interest-based) has become the norm in most communities. While Islamic finance structures such as Murabaha (cost plus profit margin) is relatively straightforward, most people are apprehensive in trying something new regarding finance and investment. Thus, significant effort in educating the public about Islamic finance and crowdfunding is required (Boulahbel, 2021).

- vulnerable to cybercrimes

Undeniably, crowdfunding has given rise to opportunities and greater efficiency for entrepreneurs to obtain funds. Nevertheless, there are still many challenges that those in the industry need to overcome in order to see more successful use of crowdfunding. The most fundamental problem concerning crowdfunding is the advancement of technology itself. Crowdfunding is an excellent alternative in places where internet service is efficient and easy to access. Internet access may be fine in certain countries. Yet, it is still a significant hitch for some parts of the world, especially in third-world countries. The next serious issue is the need for more stringent regulations and government policies that can lead to massive threats to this sector. Since crowdfunding is carried out through the internet or online, it is vulnerable to cybercrimes. There is always a probability of scammers and impostors' presence. Therefore to avoid falling victim, this financing alternative requires due diligence

-Develop an appropriate framework for Islamic equity crowdfunding

Develop an appropriate framework for Islamic equity crowdfunding, better known as Shariah-compliant equity-based crowdfunding in Malaysia. Adopting a sample of 200 entrepreneurs to analyse their intention of using crowdfunding to raise capital, they find that these entrepreneurs think that crowdfunding provides ease and convenience in raising capital. However, they are reluctant to share their thoughts and ideas online. Therefore, an appropriate framework must be implemented to protect the related parties and further enhance entrepreneurship development in Malaysia. Relatively, explore the development of global Islamic fintech by emphasising Malaysia's scenario through analytical research methods. In particular, they utilise available evidence on fintech to develop proposals to tackle the identified issues. They examine existing legal frameworks, including Bank Negara Malaysia's Regulatory Sandbox, to determine the capability of accommodating the rapid Fintech development. They suggest improving the current regulatory framework as there is room for a better regulatory mechanism.

-avoid fraudulent cases

Study the potential application of the Mudarabah principle on crowdfunding platforms. Mudarabah refers to a partnership where one party provides the capital, the other party offers labour, and both share in the profits. Their findings indicate that it is not ideal to incorporate the concept of Mudarabah in crowdfunding due to the high risk involved. This argument is especially valid for equity based Islamic crowdfunding because of its high risk. Sources of risk may include fake projects, insufficient regulations, and the structure of Mudarabah itself, which is a profit-sharing contract. They propose a greater monitoring level, tighter regulatory protection, better Mudarabah practice and higher awareness among parties. In relation to that, examine the applicability of the Mudarabah concept on crowdfunding as an alternative platform to fund the book publishing industry. They investigate the suitability of this fund alternative to be used, especially by the self-publishers and small publishers. They assert that Mudarabah crowdfunding could solve the book publishing industry's fund shortage. However, they conjecture that the project's progress must be scrutinised and closely monitored to mitigate the risk. Necessary steps should be taken to avoid fraudulent cases.

-Establish relationship between the entrepreneur and the potential crowdfunders

policymakers employ best practices from already success ful systems, reduce red tape and implement high-impact policies to improve the equity crowdfunding industry. Therefore, it needs better preparation and policy coordination between European countries so that proper actions can be taken to steer the industry in the right direction. The European policymakers' challenges is reforming their entrepreneurial ecosystems. The importance of investigating the companies' future ability to grow and introduce successful innovations after the funding process. In other words, more attention should be paid to the companies' post-campaign performance and not focus only on their potential or projected performance. In conjunction with that, the success probability of a campaign is influenced by the entrepreneurs' connections built before the campaign launch. They may establish a connection or relationship by providing a good participation record in previous campaigns. This strategy will make them known within the community, especially when they

already have followers or supporters. A good relationship between the entrepreneur and the potential crowdfunders helps attract enough support, thus ensuring the campaign's success. In brief, attracting funders depends on more than just the current event. Potential funders want to know the performance of the project and the entrepreneur in the future and the past. A good relationship with potential funders by providing relevant information and a good reputation will help entrepreneurs raise the needed funds (Norhafiza & Zaemah, 2023).

Conclusion

Islamic crowdfunding has emerged as a powerful and innovative mechanism for financing startups while adhering to Islamic financial principles. This model of crowdfunding has demonstrated its potential to foster entrepreneurship and economic development within the Muslim world and beyond. By leveraging the principles of Sharia-compliant finance, such as avoiding interest-based transactions and promoting risk-sharing, Islamic crowdfunding aligns with the ethical and moral values of the Islamic faith.

One of the key strengths of Islamic crowdfunding for startups is its inclusivity. It enables a diverse range of entrepreneurs, including those who may have limited access to traditional financing, to seek capital from a broad pool of investors. This democratization of investment opportunities can stimulate innovation and economic growth, particularly in regions with a strong Islamic finance presence.

Moreover, the rise of Islamic crowdfunding platforms has also fostered a sense of community among investors who share similar ethical and religious values. This sense of community not only provides startups with financial support but also valuable mentorship and networking opportunities. However, it is important to acknowledge that Islamic crowdfunding is not without challenges. The industry faces regulatory hurdles and the need for standardized Sharia-compliant practices to ensure transparency and trust among investors. Furthermore, the scalability and sustainability of Islamic crowdfunding platforms need to be continuously addressed to ensure their long-term success.

Nevertheless, the potential benefits of Islamic crowdfunding for startups and the broader economy are clear. As the industry continues to mature and develop, it is expected that more startups will turn to this financing model to realize their visions. Moreover, with continued innovation and collaboration, the ecosystem supporting Islamic crowdfunding is likely to expand, providing more opportunities for ethical investments and the growth of startups within the Islamic finance framework.

In conclusion, Islamic crowdfunding has the potential to be a transformative force in the world of startups and entrepreneurship, offering an ethical and faith-based alternative to traditional financing models. As the Islamic finance ecosystem continues to evolve and adapt, the impact of Islamic crowdfunding on startup ventures is likely to grow, contributing to economic development, job creation, and innovation in Islamic finance-compliant markets and beyond.

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