

**AN ASSESSMENT OF MUḌĀRABAH AND MUSHĀRAKAH CONTRACTS FOR ISLAMIC EQUITY CROWDFUNDING**

Abdul Muneem <sup>i</sup>, Nor Fahimah Mohd Razif <sup>ii</sup> & Abdul Karim Ali <sup>iii</sup>

<sup>i</sup> PhD, Department of Fiqh and Usul, Academy of Islamic Studies, Universiti Malaya (UM). a.muneem@yahoo.com

<sup>ii</sup> (*Corresponding Author*). Associate Professor, Department of Fiqh and Usul, Academy of Islamic Studies, Universiti Malaya (UM). norfahimah@um.edu.my

<sup>iii</sup> Professor, Department of Fiqh and Usul, Academy of Islamic Studies, Universiti Malaya (UM). abdkarim@um.edu.my

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<b>Abstract</b>	<p><i>This study aims to address the current practice of adopting Shari'ah contracts in Islamic equity crowdfunding in Malaysia, and to analyze the compliance, issues, and challenges associated with these contracts. A qualitative research approach was utilized, with data collected from various secondary sources. The collected data was subsequently analyzed using descriptive and explanatory methods. The study reveals that ensuring Shari'ah compliance in Islamic equity crowdfunding necessitates the incorporation of specific Shari'ah contracts. These contracts are compatible with modern technology-driven financial systems. The concept of crowdfunding aligns with several Shari'ah contracts, making them suitable for implementation in Islamic equity crowdfunding. However, certain Shari'ah issues and challenges emerge in practice due to market dynamics and demands. For example, the muḌārabah contract appears appropriate for ventures at the ideation stage but is less suitable when the issuer contributes capital to the venture. This is because, under muḌārabah, capital must solely come from the rabbul māl (investor), while the muḌārib (issuer) provides labor. In contrast, the mushāarakah contract can be applied at any stage of a business, irrespective of the issuer's capital contribution. Both contracts, however, face challenges regarding risk-sharing and the potential for loss. The rights and responsibilities of investors under these contracts differ when applied in the crowdfunding context. Future research may focus on examining the implementation of specific Shari'ah contracts within an Islamic equity crowdfunding platform.</i></p> <p><b>Keywords:</b> <i>Islamic Equity, Crowdfunding, Mudarabah, Musharakah, Malaysia.</i></p>
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**INTRODUCTION**

Crowdfunding has emerged as a disruptive force in the financial market, revolutionizing the way individuals and businesses raise capital (Mrass, 2024; Bouziani, & Azegagh, 2024). Among its various forms, equity crowdfunding (ECF) and peer-to-peer (P2P) financing have gained particular prominence due to their inclusion and significance in the contemporary financial landscape. Equity crowdfunding allows individuals to invest in early-stage companies in exchange for ownership equity, democratizing investment opportunities and providing access to funding for startups and small businesses. On the other hand, peer-to-

peer (P2P) financing platforms connect borrowers directly with lenders, bypassing traditional financial intermediaries and facilitating more efficient capital allocation. Together, these crowdfunding models expand access to capital, foster innovation, and diversify investment portfolios, contributing to the vibrancy and resilience of the modern financial market (Ahmad, et al., 2021a; Kallio & Vuola, 2020).

Islamic equity crowdfunding (IECF) has not only transformed the conventional financial market but also holds significant implications from a Shari'ah perspective. IECF adheres to Shari'ah principles by ensuring that investments are made in businesses that comply with Islamic laws and ethical standards. IECF platforms operate within the framework of Shari'ah-compliant financing, facilitating transactions based on profit-sharing or sale arrangements rather than interest-based loans (Andaleeb, & Mishra, 2016; Haniff, et al., 2019). From a Shari'ah perspective, these crowdfunding models promote economic activities that are in line with Islamic principles, such as avoiding *ribā* (interest), *gharar* (uncertainty), *maisir* (uncertainty) and other *ḥarām* (forbidden) activities. By incorporating Shariah compliance into crowdfunding practices, these platforms provide Muslim investors with opportunities to participate in the financial market while adhering to their religious beliefs, thus contributing to the growth of Islamic finance and fostering socio-economic development in accordance with Islamic values (Marwa, et al., 2023; Biancone, et al., 2019; Nivoix & Ouchrif, 2016).

In addition, IECF is required to adopt Shari'ah contracts as a part of Shari'ah compliance requirement for the contractual relationship among the contracting parties. Various research proposes Shari'ah contracts for IECF. For instance, the *muḍārabah* (profit and loss sharing) contract has been a good choice in regard to IECF (Jamaluddin, et al., 2022; Ishak, & Rahman, 2021; Azganin, et al., 2021; Rahman, et al., 2020; Aderemi, & Ishak, 2020; Ishak, et al., 2022). Additionally, the *mushārah* contract is also named by many researchers to be adopted in IECF (Azganin, et al., 2021; Muhammad & Ngah, 2020; Hendratmi, et al., 2019; Biancone et al., 2019).

However, a number of issues and challenges are also reported by many studies in terms of practicality and compliance of Shari'ah contracts to IECF (Basir et al., 2023; Ramli, & Ishak, 2022; Muhammad Al-Bashir, 2019). Such as the concept of the contracts, rights and responsibilities of investors do not reflect their fundamental conditions in some practices by the crowdfunding platforms. In other words, in crowdfunding, these matters are usually modified or adopted in a way that it fulfills the objectives of crowdfunding rather than the objectives in these contracts for the rights, responsibilities, and concepts. Moreover, the risks that come with *muḍārabah* and *mushārah* contracts, make many investors including the platform, worried about investing in or opening an investment fund while having such risks. The guarantee of capital or part of it is also not allowed in Islamic finance, therefore, many platforms are reluctant to adopt such contracts. Furthermore, the issue of preference share can be relevant to the *mushārah* contract and requires rigorous study to adopt such a type of share in *mushārah* based IECF (SC, 2022; Ahmad et al., 2021b; Ahmad & Bakar, 2017).

Therefore, it is necessary to address those issues and challenges and to resolve them from the Shari'ah perspective in order to allow this growing financial market to advance its facilities and advantages. Hence, this study aims to address the current practice of adoption of Shari'ah contracts in Islamic crowdfunding, especially in Islamic equity crowdfunding platforms in Malaysia and to analyze the compliance, issues, and challenges of Shari'ah contracts in the practice while providing viable solutions for them.

## **LITERATURE REVIEW**

### **Concept of Islamic Crowdfunding**

Islam places a strong emphasis on the principles of social solidarity and equity, aiming to foster a cohesive and just society. Central to this ethos is the idea of wealth distribution and cooperation among believers. On one hand, Islam encourages individuals to pursue wealth

through lawful means, as outlined in the holy al-Qur'ān and Ḥadīth. However, it also mandates the sharing of a portion of one's wealth with those less fortunate in society (Gadhoom, 2017; Muhammad, et al., 2013). This obligation serves to alleviate the financial burden on the needy and promote social equality. Additionally, Islam promotes collective righteousness and cooperation in virtuous endeavors while discouraging involvement in sinful activities. This principle is encapsulated in the holy al-Qur'an (05:02), which urges believers to assist one another in acts of goodness and piety but warns against aiding each other in wrongdoing, it states (al-Qur'ān, 05:02):

﴿وَتَعَاوَنُوا عَلَى الْبِرِّ وَالتَّقْوَىٰ وَلَا تَعَاوَنُوا عَلَى الْإِثْمِ وَالْعُدْوَانِ﴾

Translation: "Help you one another in Al-Birr and At-Taqwa (virtue, righteousness and piety); but do not help one another in sin and transgression" (translated by Al-Hilali & Khan, 1996).

Furthermore, Islam strictly prohibits the unjust appropriation or utilization of others' property without their consent or through invalid contracts. The holy al-Qur'ān (04:29) underscores the importance of mutual consent in transactions and interactions among believers, emphasizing fair and ethical conduct in financial matters. In essence, Islam advocates for a society founded on principles of justice, compassion, and mutual respect, where wealth is earned and distributed equitably, and individuals collaborate in righteous endeavors while refraining from sinful behavior. The holy al-Qur'ān (04:29) says:

﴿يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالِكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِّنْكُمْ﴾

Translation: "O you who believe! Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent" (translated by Al-Hilali & Khan, 1996).

The verse (al-Qur'ān, 04:29) emphasizes the importance of conducting business and engaging in financial activities in accordance with Islamic principles and values. It underscores the concept that cooperation in business endeavors should be guided by ethical considerations and must adhere to religious restrictions (Mathkur, 2019; Mohammed, 2013). Crowdfunding is highlighted as a financial mechanism that allows individuals to pool their resources to invest in various ventures or projects, thereby democratizing investment opportunities and enabling entrepreneurs with innovative ideas to bring their products or ventures to fruition (Mrass, 2024; Bouziani, & Azegagh, 2024; Ahmad, et al., 2021a). From an Islamic perspective, crowdfunding can serve as a means of uniting believers in supporting ventures that align with Shariah principles, thereby benefiting both investors and society as a whole (Abdeldayem & Aldulaimi, 2022; Munshi, 2021; Wahjono et al., 2015).

However, it is essential to ensure that Shari'ah principles and guidelines are strictly adhered to throughout the crowdfunding process. This includes avoiding practices such as *ribā* (interest), *gharar* (uncertainty), and *maisir* (gambling), as well as unethical activities like adultery, theft, and bribery (ISRA, 2016; Ayub, 2007). Compliance with these principles is crucial at every stage of the business venture to maintain its Shari'ah compliance and ethical integrity. Furthermore, maintaining good behavior, upholding justice, and ensuring fair distribution of profits are emphasized as essential aspects of conducting business in Islam. Believers are encouraged to approach crowdfunding ventures with integrity and a commitment to ethical conduct, as outlined in Islamic teachings and scholarship (Mathkur, 2019; Rexhepi & Ramadani, 2017; Abuznaid, 2009).

In the context of Shariah-compliant crowdfunding, it is essential to understand how the principles of Islamic finance are applied to various crowdfunding models, including donation, reward, equity, and peer-to-peer (P2P) crowdfunding. Donation-based crowdfunding aligns with the concept of *sadaqah* (charity) in Islam, where individuals voluntarily contribute funds to support a cause or project without expecting any material return. From a Shari'ah perspective, such donations are encouraged as acts of charity and goodwill, provided they are directed towards lawful and beneficial purposes that adhere to

Islamic principles. Reward-based crowdfunding involves backers contributing funds in exchange for non-financial rewards or benefits, such as early access to products or special perks. In Shari'ah-compliant reward-based crowdfunding, the rewards offered should be permissible and not involve any elements that contradict Islamic teachings (Abdeldayem & Abdulaimi, 2022; Munshi, 2021; Biancone et al., 2019).

Equity-based crowdfunding allows investors to acquire shares or ownership stakes in a business venture in exchange for their financial contribution. From a Shari'ah standpoint, equity-based crowdfunding must adhere to principles such as risk-sharing, profit-and-loss sharing, and avoidance of *ribā* and speculative transactions (*gharar*). Investments should be made in ventures that engage in permissible activities and comply with Islamic ethical standards (Haniff et al., 2019; Andaleeb & Mishra, 2016). Peer-to-peer (P2P) crowdfunding platforms facilitate direct lending transactions between individuals or businesses, bypassing traditional financial intermediaries. Shari'ah-compliant P2P crowdfunding platforms operate within the framework of Islamic finance principles, ensuring that all transactions adhere to Shariah-compliant contracts and are free from interest-based transactions (Hassan et al., 2022; Pişkin & Kuş, 2019).

In addition to these models, Shari'ah-compliant crowdfunding platforms prioritize investments and projects that comply with Islamic principles, such as supporting halal businesses, ethical entrepreneurship, and social welfare initiatives. By channeling funds towards Shari'ah-compliant ventures, these platforms contribute to the equitable distribution of wealth and the development of halal markets, in line with the objectives of Shari'ah. Therefore, Shari'ah-compliant crowdfunding platforms play a vital role in promoting ethical finance and providing avenues for Muslims to engage in socially responsible investing while adhering to the principles of Islamic finance (Abdeldayem & Abdulaimi, 2022; Azganin et al., 2021; Abdullah & Oseni, 2017).

As per Islamic Finance News (IFN) (IFN Fintech, n.d.), the collective count of Shari'ah-compliant crowdfunding platforms, encompassing donation, reward, and equity models, tallies up to 49, positioning it as the third most prevalent category among global Islamic fintech platforms, following alternative finance, trading, and investment. Notably, a substantial number of peer-to-peer (P2P) platforms worldwide also operate in compliance with Shari'ah principles. Furthermore, these Islamic crowdfunding platforms are poised to offer considerable advantages to numerous small and medium enterprises (SMEs) and halal markets. Consequently, they contribute to the objectives of Shari'ah in finance by equitably redistributing wealth and alleviating financial pressures on SMEs and halal markets (Thaker et al., 2020).

## **METHODOLOGY**

The research adopts a qualitative research approach to obtain the research objectives. Data collection for the research is collected from various sources such as books, research articles, conference proceedings, websites of Islamic crowdfunding platforms and Shari'ah standards. The search for the materials is done through a general Google search and an additional search is also performed in Emerald, and ScienceDirect to find more research articles for this study. Based on the objectives of this study, a significant number of research papers are reviewed rigorously, and the findings of those studies are considered for this research. After collecting sufficient information and data for this study, the researchers adopt a descriptive analysis method to explain the issues and challenges that Islamic crowdfunding encounters in adopting Shari'ah contracts. Moreover, the researchers also follow an explanatory analysis method to describe potential solutions for the issues and challenges and to recommend suitable contracts that might be viable for the practice.

## FINDINGS AND DISCUSSION

### Shari'ah Contracts for Islamic Equity Crowdfunding

Islamic equity crowdfunding requires Shari'ah contracts that share equity, profit and losses (Aderemi & Ishak, 2020). In such a case, *muḍārabah* is a contract which allows a venture to be established by a party offering capital whereas another party offers labor (al-Kāsānī, 1974; al-Anṣārī, n.d.). Such a contract resembles the practice of equity crowdfunding where investors are offering capital, and the venture owner is offering his expertise and labor to extend the business and share the profit with the investors. Additionally, the *mushārah* contract also plays the same role as *muḍārabah* except that it allows capital contribution from both parties and allows a party to take over the management and other necessary control in order to realize the profit over the capital investment that they made together. The below discussion will shed more light on the flexibility of both contracts to practice in Islamic equity crowdfunding and the issues and challenges that the contracts might encounter in embodying them into the practice.

### Application of Muḍārabah Contract in Islamic Equity Crowdfunding

The *muḍārabah* contract is a fundamental concept in Islamic finance, representing a type of partnership where one party provides capital (the investor or *rabbul māl*) while the other party provides labor and expertise (the entrepreneur or *muḍārib*) (al-Kāsānī, 1974; Al-Anṣārī, n.d.). In this contract, the profits generated from the investment are shared between the two parties based on a pre-agreed ratio, while any losses incurred are borne solely by the investor, provided that the losses are not due to negligence or misconduct by the entrepreneur. Some of the key features of the *muḍārabah* contract include (Jamaluddin, et al., 2022; Sapuan, 2016; BNM, 2015a; Ayub, 2007):

- a. Capital Contribution: The investor provides the capital required for the business venture, while the entrepreneur contributes labor, skills, and management expertise.
- b. Profit-sharing: Profits generated from the investment are distributed between the investor and the entrepreneur according to a pre-determined ratio agreed upon at the outset of the contract.
- c. Loss-bearing: The investor bears the entire loss in case the investment fails, except in cases of negligence or misconduct by the entrepreneur, in which case the losses are borne by the party at fault.
- d. Limited liability: The liability of the entrepreneur is typically limited to the extent of their investment in the venture. However, the liability of the investor is not limited, as they bear the risk of loss.
- e. Management authority: The entrepreneur is usually responsible for managing the business operations, while the investor has limited or no involvement in the day-to-day management decisions.
- f. Types of *muḍārabah*: *Muṭlaqah* (unrestricted) and *muqayyadah* (restricted). If the *rabbul māl* does not specify any business sector or type of business, it will be an unrestricted *muḍārabah* contract where the *muḍārib* is free to choose the business. On the other hand, if there are restrictions from the *rabbul māl* in terms of types or sectors of business, it will be called restricted *muḍārabah*. Thus, the *muḍārib* has to follow the instructions given by the *rabbul māl*.

The *muḍārabah* contract is used in Islamic finance for various investment activities, such as financing entrepreneurial ventures, trade, and project financing. It promotes the sharing of risks and rewards between capital providers and entrepreneurs, aligning with Islamic principles of fairness, risk-sharing, and ethical conduct in business transactions (Hamid & Allaymoun, 2019; Fianto et al., 2018; Kamal et al., 2009).

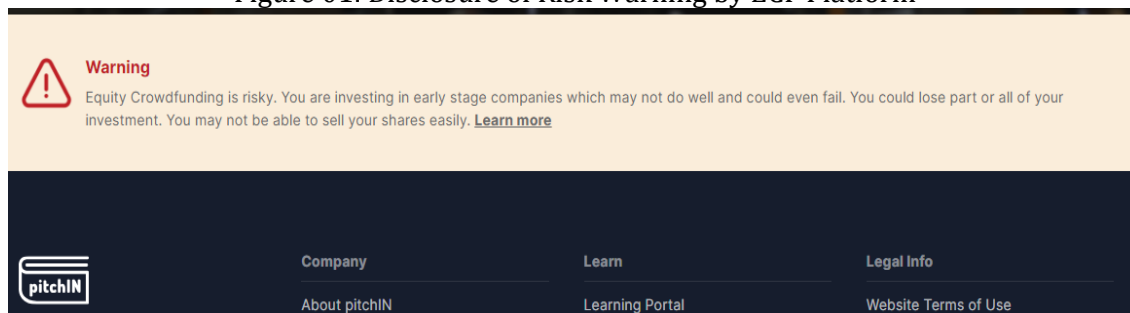
Based on the above explanation, the practice of *muḍārabah* contract seems to be suitable to the concept of equity crowdfunding due to the similarities between the two

which can be discussed in a few aspects. (a) The nature of profit sharing in both concepts is the same in a way that investors in ECF and investors in *muḍārabah* both deserve and receive a profit that is agreed upon. (b) Like profit sharing, the loss is also borne by the investors in both concepts. The exception in ECF is that in some ventures, the entrepreneur also bears the losses since the entrepreneur also contributes a significant portion of capital to the venture. Moreover, in the context of *muḍārabah*, it is known that the entrepreneur loses his efforts and hard work in managing the venture. (c) Both ECF and *muḍārabah* pose a business risk to the investors rather than to the entrepreneurs as mentioned in the previous point. (d) The management of the venture often relies on the entrepreneur in both ECF and *muḍārabah muṭlaqah*. In the current practice of ECF, the investors are allowed to raise their concerns in case of any issues they notice, and at the same time, the entrepreneur is also required to provide periodical reports to the investors. Similarly, the investors in *muḍārabah* also receive updates on the venture and other information that they need.

Despite the similarities, some features are not equal between the two (ECF and *muḍārabah* contract) and in addition, the *muḍārabah* contract might face some issues and challenges in the application. As mentioned earlier, in *muḍārabah*, the investor is the one who provides capital to the venture and the entrepreneur provides his skills and expertise. However, in the practice of ECF, usually, a venture is already established by the entrepreneur, and he seeks additional funds from the investors to expand the business or boost the capital of the business and sustain it as usual. Thus, the discrepancy between the ECF and *muḍārabah* comes in the context of capital contribution to the venture. In other words, the capital in *muḍārabah* comes only from the *rabbul māl* whereas, in ECF, it can come from the entrepreneur as well in the scenario where the venture is established by the entrepreneur. Moreover, in regard to the management or the selection of venture, in *muḍārabah muqayyadah*, the *muḍārib* has to follow the types or sector of business that is specified by the *rabbul māl*, other than that the *muḍārib* is free to manage the venture as his expertise and skills. The *muḍārib* will be liable (*dāmin*) for any losses or damages if he uses the capital for a business other than the specified businesses or types in *muḍārabah muqayyadah*. On the other hand, ECF has open selections and choices for investors to invest in where they are interested in an idea or the potential of business. Moreover, ECF in the current practice adopts the Companies Act or legislation that is provided by the government.

In addition to the above, the issue of risks in both the concept of equity crowdfunding and the *muḍārabah* contract might raise some concerns among the investors. It has been reported by many studies that a significant number of Islamic banks adopt other financial contracts (debt-based contracts) to mitigate the risk level in their function and due to the risks, equity-based contracts (*muḍārabah* and *mushārahah*) are adopted at a tiny level by the current Islamic banks (Khan, et al., 2020; Mohamed Naim, et al., 2018; Sapuan, 2016; Farooq, 2015). Study shows that *muḍārabah* contract usually comes with risks such as asymmetric information (Bensalem & Bouherb, 2021; Islam & Ahmad, 2020). Asymmetric information problems can occur due to the ideas and strategies that an entrepreneur uses in the venture which he might not share with the public in order to keep its business copyright and privacy. Asymmetric information problems might also lead to *gharar* issue in a case where an entrepreneur hides information which is supposed to be disclosed to the contracting parties. Such an issue can also occur if an entrepreneur is using the funds for a venture other than the agreed and approved venture by the investors and ECF platform or he does not report on profit truthfully to the investors and ECF platforms (Zafar & Siddiqui, 2022). In regard to the risks in equity crowdfunding, it must be known that the ECF platforms are required to disclose a warning notice to the investors that investments in ECF have potential risk of losses and they have to be aware and agree on losing their capital if that happens. Such a notice from an ECF platform can be illustrated in Figure 01.

Figure 01: Disclosure of Risk Warning by ECF Platform

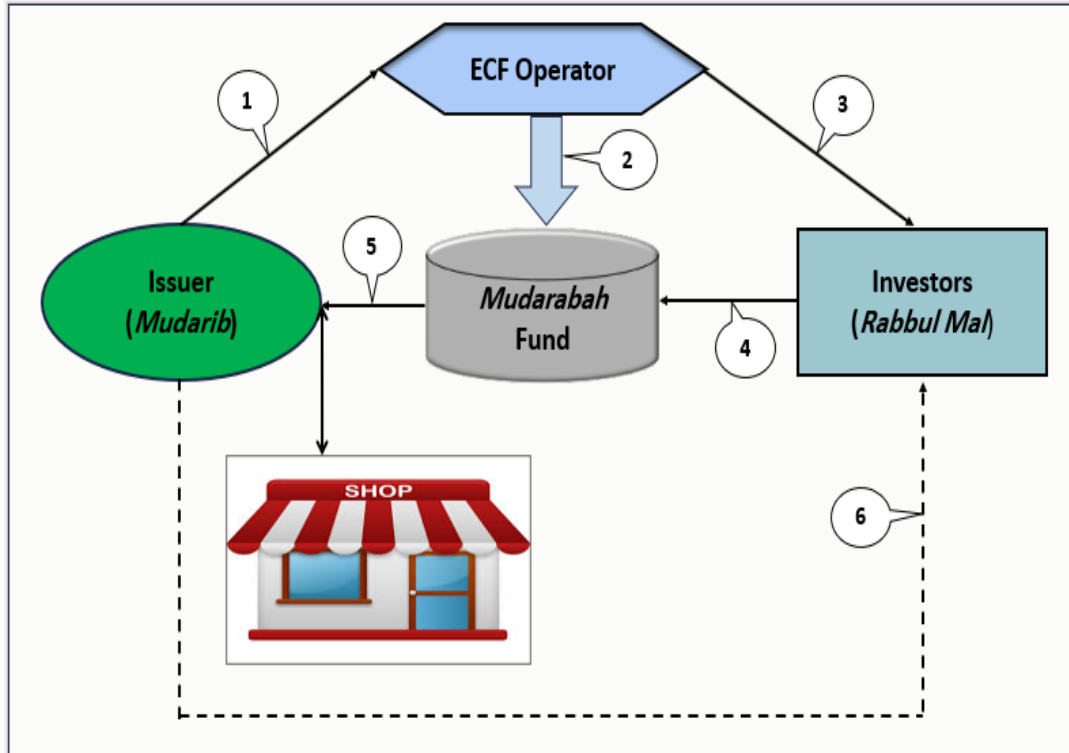


Source: pitchIN (n.d.)

Therefore, it is understood that both *muḍārabah* and ECF concept possess some risks and challenges that investors should consider before contributing their funds to the campaigns. Moreover, it is known that the capital in the *muḍārabah* contract cannot be guaranteed by the entrepreneur. The entrepreneur is liable for the fund if any losses happen due to misconduct, negligence or breach of conditions.

According to the researchers, the application of a *muḍārabah* contract is a good option for the IECF. It should be noted that since the nature of the ECF inherits risks and returns, the *muḍārabah* contract serves the same purpose as well. Moreover, *muḍārabah* is one of the best options for equity-based financing in Islamic finance and it will boost the equity portion of the Islamic financial system since the majority of Islamic banks prefer to offer financing through debt-based contracts due to risks that equity-based contracts that possess some risks (Muneem et al., 2024). The issues and challenges that IECF encounters in practicing *muḍārabah* contract that requires Shari'ah resolutions and *takyif fiqhī* (fiqhī adaptation). In regard to the issue of capital contribution in *muḍārabah* and IECF, the researchers believe that a venture can be funded based on a *muḍārabah* contract when the venture is in the ideation stage and the entrepreneur does not contribute any capital to that except for the structure and model that he prepares for the venture. In such a venture, the investors provide the capital, and the entrepreneur provides his idea, efforts, and hard work hence it meets the nature of *muḍārabah* in the practice.

Furthermore, the management of the venture in IECF can be done by the entrepreneur while the investors can provide their ideas, concerns and suggestions to improve the venture through a general meeting, online investors get-together, or a field visit. Such a practice will give both parties opportunities to communicate and to build confidence and trust among them. Hence, it will meet the specifications of the *muḍārabah muṭlaqah* as well. In regard to the practice of *muḍārabah muqayyadah* in IECF, the investors have various options of campaigns to choose from for the investment based on their interests, and based on such option, IECF enables the concept of *muḍārabah muqayyadah* to be embraced in IECF. A model of *muḍārabah*-based equity crowdfunding is illustrated in Figure 02.

Figure 02: Application of *muḍārabah* contract in equity crowdfunding

Source: Authors' own

An issuer (*muḍārib*) approaches an ECF platform operator for funding. The ECF Operator performs due diligence on the venture. If the venture is suitable for such funds, the ECF operator creates a campaign on its online platform and initiates a trust fund. Then, the operator opens the campaign for all and invites investors to contribute to such a campaign. The investors consider the details of the venture as provided in the online platform and invest in the campaign while accepting the risk and return of such a campaign. Once the campaign meets its target of funding and passes the campaign period, the fund is transferred to the issuer for further utilization. The issuer utilizes the funds and provides dividends to the investors based on the agreement.

### Application of *Mushārahah* Contract in Islamic Equity Crowdfunding

The *mushārahah* contract is a key concept in Islamic finance, representing a partnership agreement between two or more parties who contribute capital to a business venture or investment. Unlike the *muḍārabah* contract, where one party provides capital and the other provides labor and expertise, in *mushārahah*, all parties contribute capital, expertise, and effort to the partnership (Ḥaidar, 2003; al-Anṣārī, n.d.). This type of contract is based on the principles of joint ownership, profit sharing, and shared responsibility. Some key principles of the *mushārahah* contract include (Sarpini, 2019; ISRA, 2016; BNM, 2015b):

- a. Joint ownership: All partners jointly own the assets and investments of the business venture in proportion to their respective capital contributions. Each partner has a share in the ownership of the business and its profits.
- b. Profit and loss sharing: Profits generated from the business venture are distributed among the partners which can be proportionate to their capital contribution or based on a mutually agreed profit-sharing ratio. Similarly, any losses incurred are shared among the partners in proportion to their capital contributions.
- c. Shared management and decision-making: In *mushārahah*, all partners have the right to participate in the management and decision-making process of the business venture. Decisions regarding operations, investments, and strategic direction are made collectively by the partners.

- d. Limited liability: The liability of each partner is typically limited to the extent of their capital contribution to the *mushārah*. This means that partners are not personally liable for the debts and obligations of the business beyond their invested capital.
- e. Equal treatment: All partners are treated equally in terms of their rights, responsibilities, and entitlements within the *mushārah* agreement. There is no distinction between active and silent partners, and each partner is entitled to an equal say in the affairs of the business.

*Mushārah* contracts are commonly used in Islamic finance for various purposes, including project financing, real estate investments, trade financing, and joint ventures. It promotes the principles of partnership, risk-sharing, and mutual cooperation, aligning with Islamic ethical and moral values in financial transactions (Ali et al., 2024; Moriguchi et al., 2016).

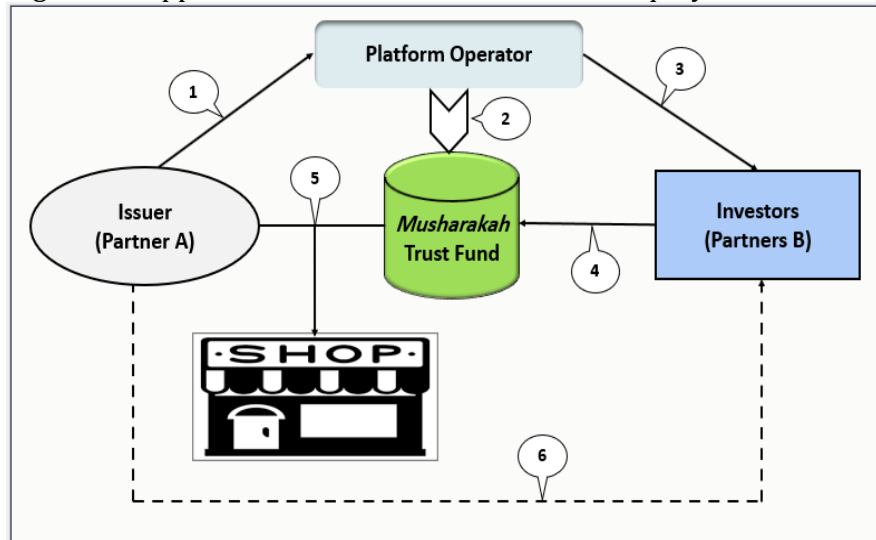
The practice of equity crowdfunding seems to be similar to the concept of *mushārah* as discussed earlier. The similarities between the two can be recognized from different aspects such as sharing the capital to invest in one campaign/venture and sharing the losses as well if that happens. In other words, in equity crowdfunding, the capital comes from the investors and also the entrepreneur and the investors agree on a joint investment contract between the two parties (investors and entrepreneur). They share the profit based on the agreed ratio or percentage that has been offered to the parties at maturity, which can be annual or any other periodical interval. They also bear the losses among them if unforeseen happens to the venture. A partner is liable to indemnify the losses/damages if that happens due to his negligence, misconduct, or breach of contract. Similarly, principles are applied in *mushārah* contract where the partners receive the profit and distribute among them based on a mutually agreed ratio or based on their capital contribution and bear the losses as well if that happens. Similar to the ECF, a partner in the *mushārah* contract is liable for misconduct, negligence and breach of contract. Moreover, as in ECF, the entrepreneur offers a certain portion of shares from the venture to the investors for their capital contribution, the partners in *mushārah* contract also receive a share portion from the venture based on their capital contribution.

However, in terms of practice, the ECF might differ from the *mushārah* contract. For instance, the rights and responsibilities of management of the venture in the *mushārah* contract often depends on the investors and their rights in management of the venture seem to be significant. In the context of ECF, usually, the rights of management are dependent on the entrepreneur, and he is the one who controls and manages the venture. The investors in ECF do not have any rights to manage the venture or to instruct the entrepreneur on any matter regarding the operation of the venture. The investors in ECF are allowed to raise their concerns and discuss any matter during a periodical meeting or online session which is not necessarily directions or instructions from the investors. Therefore, it seems the rights of management in ECF are not shared or dependent on the investors but only the entrepreneur which is different from the rights of management for investors in *mushārah* contract. Moreover, since ECF follows the Companies Act and other legal provisions, it offers preference shares to investors as well, and it is known that Shari'ah scholars have disputes on the permissibility of preference shares. In this regard, the Shari'ah Advisory Council (SAC) of Securities Commission Malaysia (SC) (2022) issues a resolution stating that preference share is Shari'ah compliant when it meets certain criteria that are set by the SAC. On the other hand, other scholars and Islamic financial institutions resolve that preference share contradicts various Shari'ah principles and practices thus, it is impermissible to offer preference share by Islamic financial institutions (AAOIFI, 2015; IIFA, 2000). Therefore, the issue of preference share in the practice of ECF requires rigorous study from the Shari'ah perspective and additional resolution and guidance to adopt *mushārah* contract in ECF.

Based on the above discussion, the researchers believe that the practice of *mushārah* contract in equity crowdfunding is ideally suited. The issues regarding the

rights of investors could be resolved through a transfer of rights or withdrawal of rights following the principle of *isqāṭul haqq* as discussed by jurists. In such a principle, the investors withdraw their rights to manage the venture and appoint the entrepreneur as a *wakīl* (representative) of all other investors in the venture. Moreover, regarding the share that an entrepreneur offers to the investors, as discussed earlier that Sharī'ah scholars disagree on offering preference shares, hence, it is recommended for the entrepreneur to offer ordinary shares and not to be involved in any non-Sharī'ah compliance activities in contract. Figure 03 provides an overview of using *mushārahah* contract in equity crowdfunding.

Figure 03: Application of *mushārahah* contract in equity crowdfunding



Source: Authors' owns

An issuer (partner A) approaches an ECF platform operator for funding. The ECF Operator performs due diligence on the venture. If the venture is suitable for such funds, the ECF operator creates a campaign on its online platform and initiates a trust fund. Then, the operator opens the campaign for all and invites investors to contribute to such a campaign. The investors (other partners) consider the details of the venture as provided in the online platform and invest in the campaign while accepting the risk and return of such a campaign. Once the campaign meets its target of funding and passes the campaign period, the fund is transferred to the issuer for his further utilization. The issuer utilizes the funds and distributes the profits among all the partners including the issuer himself at maturity, or a specific interval based on the agreement that they signed earlier.

## CONCLUSION

Islamic equity crowdfunding can play a significant role in actualizing the socio-economic development of a country. Both concepts prove the advantages that they can offer to the current financial markets where a large number of people require alternative financing other than the conventional and mainstream financing systems. The rapid growth of the crowdfunding market is evidence that various sectors, such as business, agriculture, arts, technology and many others can be funded through crowdfunding, and it can benefit both issuers and investors through such financing. Moreover, since Islamic equity crowdfunding follows Sharī'ah compliance, they adopt Sharī'ah contracts for the contracting parties as an agreement and follow the Sharī'ah principles and guidelines for financial services. This study concludes that many Sharī'ah contracts are practicable in the concept of Islamic equity crowdfunding. In regard to equity crowdfunding, the *muḍārahah* and *mushārahah* contracts can be suitable contracts to offer Islamic equity crowdfunding due to the similarities in terms of sharing equity, risks and returns in all those concepts. The issues

that arise from the *muḍārabah* contract can be minimized by adopting such a contract for the ideation stage of the venture. The issue in the *mushārah* contract depends on the willingness of investors either to be part of the management of a venture or to withdraw their rights and allow the issuer to manage the fund and venture as long as the issuer does not breach the conditions or acts as negligent or misconducts with the fund.

Therefore, the authors recommend the inclusion of legal provisions to the current guidelines by the financial authorities to vitalize the benefits of Islamic equity crowdfunding. Additionally, Sharī'ah scholars might issue resolution and alternative *fiqhī* adaptation in order to reduce the Sharī'ah issues and challenges that the current crowdfunding market encounters. Future research might focus on a specific Islamic equity crowdfunding platform and scrutinize the practice, compliance and other challenges of Sharī'ah contracts for such financing.

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