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SHARIA-COMPLAINT CROWDFUNDING
A MICROFINANCIAL APPROACH

A Master's Thesis submitted for the degree of
"Master of Business Administration"

supervised by

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Affidavit

I, **MAGED INAIE**, hereby declare

1. that I am the sole author of the present Master's Thesis, "SHARIA-COMPLAINT CROWDFUNDING - A MICROFINANCIAL APPROACH", 47 pages, bound, and that I have not used any source or tool other than those referenced or any other illicit aid or tool, and
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Abstract

The growth of microfinance instruments has allowed millions of poor people around the world to receive small loans without collaterals and proof of their credibility, which would not be possible in the conventional financial institution. With the increasing number of refugees and displaced people in the MENA regions, a need for the Islamic microfinance products has notably grown. However, current Islamic banks rarely provide financial services to the poor. Accordingly, there is an urgent need to develop alternative financial instruments to respond to needs of the poor populations in the Middle East and to enhance the development of entrepreneurship in the region, which might contribute to the overall poverty alleviation.

Within this paper a Shariah-compliant crowdfunding platform is elaborated and discussed in details. The study was conducted by using qualitative analysis of the secondary data. The results showed that crowdfunding instruments can be employed in different models, whereas one of the most compliant in terms of Islamic finance principles is investment-based with equity sharing method. Therefore, the paper proposes that the *musharakah* crowdfunding model in form of equity represents an effective alternative method for financing entrepreneurial activities and micro-enterprises, whereby overcoming the funding gap and potential risk expected by financial institutions and aiming at poverty reduction in the long term.

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List of Abbreviations

IB	Islamic Banking
MF	Microfinance
MFI	Microfinancing Institution
OIC	Organization of Islamic Corporation
UNHCR	The United Nations Refugee Agency
MENA	Middle East North Africa
NGO	Nongovernmental Organization
PLS	Profit-and-Loss

1 Introduction

Due to the ever growing income inequality, the issue of the global poverty becomes ever more challenging. Despite countless efforts of global governments, NGOs or private initiatives against poverty escalation, the world's poor population continues to grow. Poverty levels are especially high in developing countries that are often demoralized by other serious problems, such as overpopulation, political instability, war conflicts, and high frequency of natural disasters or lack of natural resources. On-going and recent conflicts in the Middle East that forced millions of people flee from their homes to other countries have further escalated the problem of the global poverty.

It is a common stereotype in the developed Western world to believe that individuals' poverty is his/her own choice as no one is held back from receiving a certain degree of education or acquire practical skills for eventual employment. However, people tend to forget that many millions of people do not have access to the basic education and health care services, protection and security from government or any possibility of employment. Moreover, poor populations are excluded from the financial services by the conventional financial institutions, due to low creditworthiness, inability to pay interests, financial instability, lack of collaterals and similar. In this way, global society cuts out all possibilities for development of less fortunate populations.

The eradication of poverty is considered as one of the most important objectives of an Islamic thought and economic system. Islam explicitly addresses the problem of poverty in its religious writings by including donation payments as one of the first pillars of Islam. This shows that Islam is very commitment to fighting the poverty and income inequality, and on the contrary promoting social welfare of the Muslim society.

In the modern world, the Islamic thought of poverty eradication is reflected by the instruments of microfinance. The goal of microfinance products is to provide financial services to less fortunate populations of the world, who have very low or no income, and are no eligible to receive conventional financial support (Robinson, 2001, p. 4). Islamic economists believe that microfinance represents a good mechanism for fulfilling the aspirations of social justice, reducing poverty and unemployment, while enhancing Arabic entrepreneurial spirit with moral and Islamic values (Riwajanti & Asutay, 2015).

Nonetheless, while Islamic Banking is growing at an average annual growth rate of 19%, Islamic microfinancing institutions have not been as successful in penetrating the financial market (Riwajanti & Asutay, 2015). A possible solution for addressing this issue could be a development of crowdfunding platforms based on microfinancing ideas. Despite being a new phenomenon, global crowdfunding platforms have experienced an impressive growth on the world financial market in the past six years as an alternative financial instrument and may soon represent a serious rivalry to conventional bank loans. In response to these rapid developments, it may be assumed that Islamic crowdfunding instrument can offer benefits for the Islamic finance, crowdfunding industries, and societies.

1.1 Objective of the Master Thesis

One of the main reasons why crowdfunding platforms became popular is their social component of enhancing participation of each individual in shaping a better global society. Although most global NGOs follow the same goal by calling for donations, many common people avoid donations through such instruments because of being unsure how and where their money is being distributed. Crowdfunding platforms on the opposite are characterized by very transparent funding processes, whereas an investor can meet entrepreneurs online and choose the enterprise where he/she would like to invest. Adding an Islamic component to the crowdfunding ideas can develop a unique new financial instrument for addressing poverty in Arabic regions, where Shariah puts a certain limitations on loans or profit-and-loss contracts.

Hence, the objective of this thesis can be formulated as follows:

> To develop a theoretical framework and provide its empirical elaboration in the form of business plan for a practical implementation for a *musharakah* -based crowdfunding model. The framework will include the Islamic principles of poverty eradication, provision of financial services without interest and practices of microfinance dynamics. The ultimate goal of the proposed model is to alleviate poverty and increase of entrepreneurship among poor individuals, in particularly refugees, temporarily or permanently

living in the selected Middle East countries (i.e. Turkey, Jordan, Lebanon, Syria).

Further on, the model that is going to be developed in this paper would help in enhancement of economic cooperation and empowerment among the poor populace of the Middle East who wants to avail financial services according to the financing rules of Islam The underlying principle for the initiative is to help the poor who cannot avail the services of conventional banks due to either their higher fee levels, interest bearing products or exclusion from such services due to low creditworthiness.

Last but not least, the idea for this thesis was born during author's visits to Syria and Lebanon during war conflict times. Being taken aback by the poor conditions in the camps of displaced individuals in Syria and refugees in Lebanon, he wished to provide relief at least to some people, whom he met during his travelling. The author was stunned by the attitude of Syrian people towards the money he was trying to give them, despite the fact of his Syrian origin. Surprisingly, people refused taking the money because they wished to sign a contract in terms of Shariah that this amount will be not taken as a pure donation but in terms of shared asset. Hence, even in the harsh times, many refugees try to remain their dignity and believe in Islamic religious values and therefore require a working financial instrument to tackle their needs.

1.2 Structure of the paper

The paper is structured as follows:

First three chapters focus on the developing the theoretical basis for the further development of the empirical business model. Chapter 2 introduces the reader to the general concepts of Islamic Finance. By discussing Islamic banking practices both in theory and in modern interpretation, it highlights the discrepancy between Shariah laws and contemporary adjustments of religious regulation in Islamic banks.

Chapter 3 defines and presents the concept of microfinancing and illustrates the peculiarities of Shariah compliant microfinance instruments. Chapter 4 discusses the concept of crowdfunding in general, as well as from a perspective of Shariah compliance. By linking the principles of Islamic finance with microfinance, the chapter finds an appropriate financial instrument for each type of crowdfunding model. Literature review also illustrates the Islamic finance mechanisms on real business examples.

Further on, based on the knowledge collected by the secondary research, Chapter 5 elaborates and presents a business plan for a Shariah compliant crowdfunding model based on the microfinance instruments, which aims to provide support for people in need, in particularly for refugees. The business plan includes a market analysis of the demand, industry and competitors, precise product description and evaluation of strengths, weaknesses, opportunities and threats.

Finally, Chapter 6 concludes the paper with a closing discussion and general overview of the conducted study, as well as includes further research recommendations.

Literature review

2 Islamic finance

Islam does not differentiate between religious and state rules. Namely, the Islamic religious law – the Shariah governs not only religious practices, but also affects political decisions, economic activities and other aspects of everyday life. Hence also financial institutions are obliged to act according to Shariah. However, Islamic banks have recently gained on popularity not only for Muslim customers but also in non-Muslim countries and global communities. In 2014, Islamic financial industry had total assets in worth of more than $2 trillion, which grew at compounded average rate at 17.3% over four years. (Ibrahim M. , 2015)

The growth of Islamic finance in the world is supported by different reasons. Ibrahim (2015, p. 185) claims that Islamic finance could offer a more “viable and resilient alternative financial system” due to its risk-free investments, prohibition of speculations with derivatives and as a result more stable capital markets. Trad et al. (2017) supposes that Islamic Banking has a higher capacity for shock absorption and is characterized by a better risk management than a traditional Western bank. In particularly during the financial crisis, Islamic banking got a special attention from the world financial experts, monetary authorities and academic researchers as it has remained strong while Western banking system were seriously doubted in their proper functioning (Beck et al., 2013).

In general, theory suggests that Islamic finance is quite different from modern conventional (or Western) banking. However, some academics (cf. (Chong & Liu, 2009; Hamza, 2016)) argue that modern practices of Islamic financial institutions and its benefits are not significantly dissimilar from conventional banking in reality. This chapter will first look at the theoretic concepts of Islamic banking and its proposed benefits, in particularly discussing the profit-and-loss sharing (PLS) principle and interest-free loan policy, which has a special importance in terms of initiatives against poverty reduction. Further, the theoretic Islamic banking laws will be compared to modern banking practices in Islamic financial institutions and to conventional banking loan issuing mechanisms in order to debate if the difference between both still exists.

2.1 Islamic banking in theory

There are three basic concepts in Islamic banking, which are different from conventional banking. First of all, some types of businesses are not allowed under that the Shariah. These include production, distribution and sale of non-*halal* or *haram* products such as alcoholic drinks and food, pork and other animals that were slaughtered not according to the Islamic law. Moreover the Shariah prohibits businesses related to gambling, prostitution and pornography. Gambling is not allowed because of a *gharar* rule, which refers to prohibition of risk and uncertainty and impels that business contracts should be precise containing no indistinctness. This means for example that only the commodity that exists, as well as belongs to the seller can be sold. Hence, financial instruments like derivates (e.g. options and futures) are not available in Islamic banking. The idea behind *gharar* is to protect poor, weak or unknowledgeable from being involved into situation in which one gains at the expense of other. (Chong & Liu, 2009)

The second basic law of Islamic finance refers to prohibition of *riba* (non-interest). There is no precise definition of *riba*, yet most of Islamic scholars define *riba* as pre-determined return on a loan, while others consider it as very high rate of interest. The initial idea of *riba* refers to the medieval Arabic practice of doubling the debt if this was not paid on time, which often led to bankruptcy and slavery of debtors. *Riba* was thus introduced into banking practices to improve the Islam's general morality. In modern societies the prohibition of interest as a counter-act to slavery is not anymore significant. (Kumru & Sarntisart, 2016)

The third concept of Islamic banking, however, still has a notable value for modern banking. The profit-and-loss sharing (PLS) paradigm is one of the major features that describe Islamic banking (Chong & Liu, 2009). PLS paradigm describes banking conditions under which borrower and lender share the risk of the project. The paradigm is based on an assumption that both parties are not in control of a successful outcome of the venture and thus it is impossible to set a certain rate of return before the event. Instead rate of return is set ex-post depending on a volume of initial investment of the parties. (Beck et al., 2013) PLS banking is mainly based on two types of contracts: *mudarabah* (profit-sharing) and *musyarakah* (joint venture). In *mudarabah* agreement banks provides full financial support for a project, whereas customer contributes with knowledge, management and executors. In case of success, profits are shared according to a pre-fixed ratio, yet in case of loss, bank bears full responsibility. In *musyarakah* contract, financial and managerial capital is provided by both parties. Profits and losses are then jointly shared based on pre-agreed ratio similarly like in a joint venture. (Chong & Liu, 2009)

PLS paradigm is considered to be beneficial for both parties because it leads to more productive projects, where both parties are interested in viability of a venture. From the perspective of the borrowers, Islamic banking requires lower starting capital (i.e. for paying the rate of return before profits) and allows initiation of longer-term projects with higher risks. Banks in turn benefit from shared financial losses in case of project's failure and lender's bankruptcy. Moreover, PLS concept fosters greater banking discipline and proposes higher efficiency of capital distribution due to banks' and borrowers' shared goal to receive higher returns on capital from successful projects. (Azmat et al., 2015)

The majority of Islamic banking contracts are based on *mudarabah* principle, both in theory and in practice (Chong & Liu, 2009). However, besides the above mentioned contracts, Islamic banking also allows other contracting types that refer less to PLS paradigm. These contracts include for example *murabaha* (cost plus) financing, which is typically used for trade and working capital financing. In *murabaha* bank purchases goods in the name of customer in order to resell them back to customer at agreed cost plus a pre-defined profit margin. Another contracting that is similar to leasing principle is called *ijarah* financing. In this agreement banks leases an asset to a borrower for a fixed time and rental fee, yet lenders bears the risks associated with the ownership of the asset. (Beck et al., 2013) Further possible under Shariah type of contract is *istisna*, which is used in the manufacturing, construction and infrastructure ventures. In this case a party sells an obligation to sell a good in the future that is not yet available at the time of the contract at a pre-determined price. Similarly, *bai'salam* contracts determine a sale process of specified goods at a pre-agreed price that has to be paid at the time of signing the contract, whereas goods will be delivered in the future. These last three agreement types are non-PLS based, neither fully match Shariah's concept due to the fact that buyer purchases goods that seller did not produce or delivered yet and thus refer to a forbidden short sale (Khan, 2010). On the opposite, these contracts resemble conventional banking with interest-based financing and are not hence Islamic in the traditional definition. (Chong & Liu, 2009)

2.2 Islamic banking in practice

As it may be extracted from the previous chapter Islamic banking in theory has major differences from the conventional finance. Nonetheless, a large number of researchers claim that Islamic financial institutions have developed products over recent time that are similar to conventional banks, where interest rates and discounting payments are replaced with fees and contingent payment structures (Beck et al., 2013). Two major researchers in the field of finding the resemblance of Islamic and conventional finance, Chong and Liu (2009) found out that in Malaysia only a small fraction of banks are based on Islamic PLS paradigm, as well as integrate interest fees. Namely, only 0.5% of banks in Malaysia offers financing based on *mudarabah* or *musyarakah* concepts on the asset side. Yet, on the liability side more than 70% of deposits are of *mudarabah* type. Moreover, although Shariah impels interest-free deposits, actual Islamic banks offer banking solutions that have similar conditions as conventional banking deposits, whereas Islamic deposit rates are influenced by fluctuations of current conventional deposit rates.

Similar findings were also supported by Khan (2010), who confirmed a study of a number of large Islamic banking in Pakistan, Dubai, Kuwait and Malaysia. He found out that although PLS based contracts like *mudarabah* or *musyarakah* should be theoretically dominant financing forms, *murabaha* (cost plus) and *ijara* (leasing) transactions are much more common on Islamic financial market. These contracts differ from conventional banking operations only in accounting standards, whereby the nature of the loan transaction remains basically the same. For instance, if a company needs to buy new machinery for $10 000 and is creditworthy, a conventional bank will lend those $10 000 today and require e.g. $12 500 in 60 months time at a 5% interest rate from the company. A typical Islamic bank will not offer 5% interest rate as Shariah prohibits this but will buy the machinery for the company paying $10 000 and agree to sell it back to company in 60 months time for $12 500. The ownership of the machinery is retained by the bank, whereas the company is allowed to possess and use the machinery for the whole repayment period. As such agreement is based on a real transaction (i.e. physical ownership of machinery) and the rate of mark-up is not a function of a time taken to cover the repayment, this *murabaha* contract is Shariah compliant, yet is not different from a conventional loan at 5% interest rate from a perspective of the company, the bank and the dealer.

The example provided above shows clearly that non-PLS Shariah compliant contracts are identical to conventional contracts, as they have defined time period, purchase price (i.e. present value) and sale price (i.e. future value) and thus implicitly also interest rate. It is no wonder why strictly conservative Islamic analysts argue that such contracts are very weakly Islamic. Despite this, non-PLS contracts constitute to the majority of the assets of Islamic banks (El Hawary et al., 2004).

In general, academics debate over all basic concepts of Islamic Banking as they are being applied today. El Hawary et al. (2004) propose following criticism of the four major characteristics:

1) Risk-sharing: non-PLS contract types are the most commonly used financing modes in Islamic Banking and thus those transactions are identical to conventional debt contracts. Moreover, current market interest rates were proven to be used as pricing benchmarks in modern Islamic Banks.
2) Materiality: short-sale and lease-back transactions often do not include any physical assets or the seller does not actually possess the stock on his/her portfolio at the time of transaction, which clearly contradicts Shariah's compliance.
3) No exploitation: as far as Islamic Banking convince dedicated Muslim customers that their products are riba-free, as well as demand higher fees for mortgages and investment funds for Shariah compliant contracts due to their higher degree of "religiosity", Islamic finance may be considered exploitative for its customers.
4) No financing of haram activities: some Islamic Banks do not inspect for which activities borrowers require financing and justify a transaction to be Shariah compliant, if they did not ask for which goals the money was borrowed.

Hence, according to a number of researchers, Islamic Banking is an analog product of typical Western banking system and is rather a brand name, in which dutiful Muslim customers are eager to participate. (Khan, 2010) The growth of Islamic Banking around the world can thus be explained by the growing Muslim community and their religious demand to be engaged into the Shariah compliant transactions. (Chong & Liu, 2009)

Nonetheless, some 5% of IB transactions remain PLS based, which could lead to an initiation to increase the amount of those contracts to serve specific consumer segments. In particularly, poorer population could benefit from riba-free contracts and other tools of IB, intended for increasing the well-being of global Islamic societies. Indeed, the essence of IB is to have a real impact on society and economy by creating new jobs and motivate entrepreneurial development. Yet, both in academic and business application, the performance of "genuine" IB has been criticized for not contributing to either society or economic growth. The proportion of PLS contracts remains low due to inadequate legal frameworks, weak risk management measures, and high additional administrative and monitoring costs. However, academics (cf. (Alonso, 2015; Marzban & Asutay, 2012) suggest that non-financial institutions and NGOs could develop better equity-based models and new financial instruments based on PLS principles. (Alonso, 2015) Two of the most important financial alternatives in this sense are microfinance (Chapter 3) and crowdfunding platforms (Chapter 4), which can "help finding the equilibrium between social development, capacity-building, and profitability" (Marzban & Asutay, Standing out with the crowd, 2012, p. 28).

3 Microfinance

One of the fundamentals of any business is a decision how operations will be financed. The funds can be obtained internally, i.e. through retained earnings, or externally, i.e. by engaging into borrowing transaction such sale of shares, taking a loan from a bank or through equity finance (Ibrahim & Ghazali, 2014). While it may take tremendous time to save enough financial resources for initiating a business, credit institutions allow individuals immediate access to extra finance. However, not all individuals are granted loans at conventional financial institutions due to their bad creditworthiness. In particularly, populations living in poverty struggle to receive credit to run their businesses, build assets, ensure living costs and micro insurance (ibid.). To support those layers of society the concept of microfinance was developed.

Microfinance can be defined as “provision of financial services to people who have rather very low-income or are poor and self-employed” (Robinson, 2001, p. 4). These financial services usually include credits and savings but can as well contain other types of financial services such as payments and insurance services (Ledgerwood, 1998). Microfinance can be seen as “the trial to improve the access of poor households who were neglected by the banks to small loans and small deposits” (Awojobi & Bein, 2010, p. 160). Thus, microfinance involves provision of financial services such as savings, insurance, loans to poor individuals who live in rural and urban areas and are officially unable to get financial services from banks and financial institutions.

Microfinance Institutions (MFI) include non-governmental organizations, cooperative, rural banks, public and private funds and other institutions. MFIs represent thus separate physical entities with a main goal of providing financial support to small or micro businesses and entrepreneurs. (Khalifa, 2014)

Microfinance is a relatively new term in the history of financial development which became famous in 1970s (Seibel, 2005). Earlier in the 1950s until the 1970s, credit programs for rural areas were supported by government or donors and resulted usually in high default rates, high loses and also incapability to reach the rural poor households. Decade later microfinancing started to develop into more profitable concept as MF organizations started receiving funding and could reach to more clients. From the 1990s microfinance gained high significance as an instrument for reducing poverty, increasing entrepreneurship and improving economies of emerging poor countries by supporting small businesses. (Robinson, 2001) Along with growth of the microcredit institutions the attention was changed from the providence of the credit to poor people, to providence of other type of financial services as well, which include pensions and savings (Hermes & Niels, 2007).

Before discussing further the topic of microfinance, poverty needs to be defined. In general, poverty refers to the inadequate income or a shortage of resources, which are needed to cover basic needs. Poverty refers to limited or constrained everyday activities and often leads to poor physical and mental health, restricted social and economic mobility, social isolation and powerlessness. (Ibrahim & Ghazali, 2014) In developed Western countries poverty is often believed to be consequences of a personal failure, such as inability to manage financial resources, risky investments and business failures or asocial lifestyle. In developing countries, however, poverty may be triggered by natural disasters, economic crises, political instability, military intrusions or sicknesses. Moreover, lack of adequate education and employment possibilities increase the proportion of the poor population even further. (Chughtai et al., 2015)

South Asia has the greatest proportion of poor people and highest social inequality in the world. Alone in Pakistan, every third citizen was living beyond the poverty line in 2013 (Chughtai et al., 2015). Poverty is also strong in Indonesia, where almost one fifth of the population is living on less than $1.25 a day in 2011 (Riwajanti & Asutay, 2015). According to Chughtai et al. (2015), uneven access to public goods and services including education, employment, health care or financial support is the main cause of poverty in South Asia. Conventional banks usually decline issuing loans to individuals from poor populations, which further contributes to dissemination of poverty. Banks consider poor individuals not creditworthy, unable to save money and repay loans. Moreover, commercial banks do not grant access to any of common financial services to those individuals. At the same time, microenterprises in Indonesia, constituted to more than 98% of total enterprises in the country. This indicator is very high as microenterprise sector contributes to 32% of the total GDP and provides employment to 89.3% of the total labor force. (Riwajanti & Asutay, 2015) Hence, microenterprise sector has a high importance for Indonesian economy and requires significant financial support. Microfinancing could provide a good solution for reducing poverty and impel development in Indonesia, or other similar regions around the world.

Furthermore, Islamic countries could benefit from special form of microfinancing, which is based on the concepts of Islamic faith and developed in compliance with Shariah.

3.1 Islamic Microfinance

The goal of Islamic microfinance is similar to conventional microfinance in a way that it aims to support the demands of the lower strata of society, give an opportunity to the poor to gain an access to the capital and motivate higher participation in economic development of all social layers of society, which should ultimately lead to reduced poverty and unemployment (Obaidullah, 2008). The differentiating feature of Islamic microfinance is its foundation on “moral and Islamic values” that “fulfill the aspirations of Islamic economics (social justice)” (Riwajanti & Asutay, 2015, p. 56). Hence, Islamic microfinance aims to operate under Shariah principles and attract customers not only on an economic basis, but also on social and spiritual principles, as well as following the purpose of improving members’ awareness of social rights and responsibilities. Moreover, Islamic MF on average charges lower rates of return (around 10%) on non-PLS loans than non Islamic MF (16-22.5%), providing a further advantage to the poor (Obaidullah, 2008). Additionally, conventional microfinance is limited to external funds and savings of the clients only, whereas Islamic MF financial sources extend to charitable means in compliance with Shariah principles (Khalifa, 2014).

Islamic Microfinancing has been rapidly growing in the recent years. During past 30 years, its annual growth rate was at 15% with a total capitalization of US$1.3 trillion in 2014 (Khalifa, 2014). It showed good performance indicators against conventional MF banking, in terms of growth (12.5%), drop-out rate (5%) and operational efficiency (Obaidullah, 2008). Several studies have proved a positive impact of MF on poor households and general economic development. Rahman and Ahmad (2010) showed that improved household earnings increased output of harvest and cattle, and increased employment on a micro level in Bangladesh. Another study in Bangladesh by Ahmed (2002) demonstrated that Islamic MF had a positive growth influence on family incomes and family employment rates, as well as on health expenditures. A study in Indonesia by Riwajanti & Asutay (2015) confirmed similar findings by showing an increase in annual value of sales, net income, employment, business and household expenditures, as well as indicated a reduction of poverty that can be achieved through providing better access to financing. Another example of MF as a successful tool for reducing poverty, was proven by Littlefield (2003), who indicated a significant improvement of economic and social well-being of about three-quarters of the individuals who took microfinance loans and about half of the clients of this microfinance project progressed out from their poverty.

However, the number of financial service providers that participate in microfinancing remains small. The majority of Islamic MFI’s are concentrated in East Asia and Pacific (64%), followed by the Middle East and North Africa. Largest amount of clients are concentrated in three countries only: Bangladesh, Sudan and

Indonesia. Another fifth of all customers are distributed among 16 other OIC countries. (Iqbal & Roy, A market-based financing model for Islamic housing microfinance market, 2015) According to El-Zoghbi & Tarazi (2013), only 1.28 million people from the total poor population of 1.6 billion of the 57 OIC countries are active users of microfinancing. Besides, the average amount of microfinancing loan equals to US$ 768 only, which are most often borrowed for housing purposes. Most of the signed Islamic MF loans are based on murabaha or qard - hasan contract types.

One of the main issues for slow development of Islamic MF is the lack of systematic managerial approach. Khalifa (2014) argues that Islamic MF do not have enough talented managers who would be able to access the potential of beneficiaries, manage and recover funds efficiently, indicate the viability of a successful project and to evaluate ability of the borrower to develop his/her micro project into a profitable business. Moreover, in practice MF lack knowledge to which degree monetary *waqf* or similar financial instruments are Shariah compliant, although they were proven by academics to be in accordance with Islamic jurisprudence.

3.1.1 Instruments of Islamic Microfinancing models

The principles of Shariah compliant finance were discussed in the previous chapter (s. Chapter 2), whereby most important characteristics for Islamic banking in terms of microfinancing refer to riba-free (no interest) transactions and PLS contracts (profit-loss sharing). Islamic finance has four sources of funds for microfinance that can be offered to Muslims in need to improve their quality of life: 1) *zakah*, 2) *sadaqah*, 3) *qard-hasan* and 4) *awqaf* (*wqaf*) (Ibrahim & Ghazali, 2014)

Zakah refers to an obligatory religious charity of every Muslim, which is one of the Five Pillars of obligations listed in Quran. *Zakah* is thus a systematic religious obligation to support poor and needy by giving of 2.5% of one’s annual income to those in poverty (BBC, 2009). As a MF tool, i is used as “the distribution in a form of business capital to productive *zakah* recipients” (Ibrahim & Ghazali, 2014, p. 117). Loans from *zakah* funds serve two important purposes of Islamic teachings: first *zakah* loans are intended to help needy people in certain circumstances and second, on an interest-free basis (no *riba*). Hence, in relation to microfinance *zakah* is seen as a very effective tool to assist poor and ultimately reduce poverty in the particular region, and should be integrated in the overall economic policies (Khalifa, 2014).

If used properly, *zakah* as the instrument of MF can provide effective interest free non-financial services to the poor. Ibrahim & Ghazali (2014) suggest three factors for implementing *zakah* in practice:

1) Proper mechanism, such as contract between the *zakah* institutions and recipients to hinder any irresponsible usage.
2) Monitoring procedure implemented by the *zakah* institution to control the performance of *zakah* recipients, which should ensure feedback, corrective action and problem solving measures.
3) Impact assessment that should monitor the performance of *zakah* recipients and help making better decisions whether *zakah* support should be continued.

Another Islamic microfinancing mechanism, *waqf* is also a charity based instrument, yet in comparison to zakah, payment of waqf is not compulsory and aims rather at improving non-economic factors of the needy such as health and education. The primary goal of waqf is thus to distribute the resources donated by philanthropic donors for increasing access of the poor to diverse physical facilities, employment, education or health institutions. (Khalifa, 2014)

Khalifa (2014) suggests two basic models of *waqf*. The basic model considers *waqf* resources as pure donations on which no returns are expected. Islamic MFIs are responsible for managing and controlling those funds. These resources are then meant to be utilized rightfully by people in urgent financial needs. The second model refers to monetary *waqf*, which is granted to the productive poor (i.e. entrepreneurs who are expected to succeed) in the form of interest-free loans for business development. In this model, receivers of *waqf* are expected to repay the loan from their future profits. Monetary *waqf* does not require any collateral from borrowers as well, making it within significantly different from conventional finance. Monetary *waqf* impels a number of beneficiaries to function: 1) donors of physical resources that grant access to wider public; 2) lenders of benevolent (interest-free) loans; 3) liquidity guarantors and 4) guarantors of losses in case of recipient's default. (Khalifa, 2014) Hence, *waqf* microfinancing schema ensures protection of the poor in case of the default and within increases their motivation in participation in such transactions. Moreover, in case of the default of one lender, the asset can be reused by other lenders.

Sadaqah is another type of donation based instruments in IB. In comparison to *zakah* and *waqf*, *sadaqah* does restrict neither the assets nor the purpose of the charity. While *zakah* is mandatory donation which aims at the poor and powerless recipients and *waqah* is endowment aiming at productive poor and impels that the assets should remain perpetual, *sadaqah* voluntary charity is flexible and supports any asset and its use. Regarding microfinancing, this donation type is more dynamic and hence can bring benefits to large number of recipients. (Lutfi & Ismail, 2016) Due to its flexibility, Lutfi & Ismail (2016) suggest that *sadaqah* instrument can be used for creating alternative solutions to funding problems for Islamic crowdfunding platforms (s. Chapter 4 for further discussion on crowdfunding).

The fourth and the last instrument of Islamic MF is *qard-hasan*, which is somewhat similar to monetary *waqf*, discussed above. Namely, *qard-hasan* (or qard-el-hasan) is a non-cost loan provided by more prosperous individuals to the ones in need. It is believed that individuals who are willing to offer benevolent loans will be spiritually rewarded. Apart from religious viewpoint, some researchers (cf. (Lutfi & Ismail, 2016; Rulindo & Pramanik, 2013) believe that *qard-hasan* contracts are the most appropriate for alleviating poverty. *Qard-al-hasan* loans do not oblige borrowers to pay the loan back; however expect that borrower will return the loan out of his/her moral considerations and financial capacities. If borrower faces a default, lender is not allowed to demand the payment back. Most benefits of *qard-hasan* refer to creating a more effective, collaborative and dutiful society. (Iqbal & Shafiq, 2015) However, Sadr and Torabi (2015) suggest that rational lenders can use *qard-hasan* investments for optimizing returns on their risky assets through better combination of monetary and non-monetary portfolios.

Donations in form of *zakah*, *waqf or sadaqah* are not only beneficial to borrowers in need but also to donors, lenders and society at the whole. From the macroeconomic perspective, charity serves as the consumption multiple, i.e. lending the money to the poor, increases their purchase parity and initiates higher financial injections into the economy and motivation to buy goods and services from the more prosperous individuals. Hence, donation today may lead to new consumers in the future. From the fiscal perspective, charity expenditures grant lenders tax benefits. For instance, in

USA all donations are tax deductible, whereas in most European countries, only donation to official organizations (e.g. NGOs) can be deducted from annual tax declarations. As MFIs are official institutions collecting voluntary and non-compulsory charities, lenders can potentially enjoy tax benefits. From the perspective of risk management, expenditure on *zakah/waqf* may provide better results than the risk model of the potential loss of any other investment. Moreover, if all interest rates and expected returns on any other security are more negative than the potential loss on capital, lending to the poor may be a beneficial option for a donor.

Besides all of the above, individuals make donations because of the religious reasons to improve own spiritual well-being or at least to create a positive social image of the self or the company in the society. So, in an extreme example one may profit from the sale of guns, yet donate generously to the poor to make oneself “clear” in spiritual sense and to become reputation of “righteous” person in the society.

As it may seem there are numerous reasons why people engage into microfinancing instruments of helping the poor. This could lead to a conclusion that microfinancing in Islamic Finance has a high potential of growth both in terms of compulsory collection of donations and voluntary financial contributions of prosperous individuals. However, lack of systematic approach and unity among MFIs in managing, controlling and motivating borrowers and lenders to use micro financial instruments represents a serious obstacle towards successful microfinancing model in terms of Shariah. In this sense, crowdfunding is believed to be a good alternative for developing an effective Shariah compliant microfinance instrument.

4 Crowdfunding

Although crowdfunding is relatively new financing instrument, it has quickly gained popularity worldwide. In 2018 crowdfunding is expected to raise US$ 9.37 billion (Statista, 2018), compared to US$ 2.7 billion in 2012 (Masssolution, 2012). The annual growth rate of crowdfunding platforms is expected to remain at approximately 29% for at least next 4 years. In 2012 North America and Western Europe had been the most successfully in raising capital. However, today China has become the leader in raising capital among all other countries in the world. Namely, in 2018 China is expected to collect US$ 7.5 million through crowdfunding transactions. (Statista, 2018)

Crowdfunding is a business tool that was originally developed to provide funding to the creative projects that are initially unprofitable such as band tours, films, music creators and similar. Over the last few years it has evolved beyond the creative products and businesses and includes financing of all the types of businesses, projects and entrepreneurs (Mollick, 2014). Crowdfunding (also known as crowdsourcing) can be defined as “a type of participative online activity in which an individual, non-profit organization, or company proposes to a group of individuals of varying knowledge, heterogeneity, and number, through a flexible open call, the voluntary undertaking of a task which always entails mutual benefit” (Alonso, 2015, p. 86). The participation of the crowd is usually measured in financial contribution, yet it can also be work, knowledge or experience. (Alonso, 2015) An average contribution of an individual is usually small or medium sized, thus the goal of crowdfunding is to attract larger crowds willing to sponsor small businesses and entrepreneurs (Lutfi & Ismail, 2016). According to Calveri & Esposito (2013) crowdfunding suits the concept of microfinance since it is funded through small contributions from a large number of individuals.

Despite sounding promising, receiving full coverage for the projects through the crowdfunding platforms is challenging task. Usually most successful projects get 25-40% coverage from their closest connections, such as friends or family. Further unrelated investors typically join with their contributions after the project has been launched and gained some attention (Prive, 2012). Moreover, crowdfunding platforms offer two funding options: entrepreneur can either receive money only then a certain funding goal has been achieved, or collect funds disregarding if the certain amount was raised (Alonso, 2015).

In general, contributors sponsor the project in exchange for a profit, or for gaining access to a product or service that is going to be produced. However, individuals can also sponsor the project based on charity incentives, and thus not expecting any returns. There are thus four basic crowdfunding modes mentioned in the literature: donation-based, reward-based, equity-based, and lending based. (Lutfi & Ismail, 2016) Additionally, the World Bank (World Bank, 2013) suggests adding a fifth type of crowdfunding – royalty based. Figure 1 below provides a brief overview of the characteristics of each type.

Figure 1: Types of crowdfunding models

Crowdfunding Model	Business Model	Features
Donation	Donation-based	Philanthropic funders donate without expecting any monetary compensation.
	Reward-based	Funders receive a token of appreciation or pre-purchase of a service or product. This model is evolving into a market place of its own, with firms raising considerable sums through pre-sales.
Investing	Equity-based	Funders receive equity instruments or profit sharing arrangements.
	Lending-based	Funders receive a debt instrument that pays a fixed rate of interest and returns on principal for a specified schedule.
	Royalty-based	Funders receive a share in term of unit trust, which acquires a royalty interest in the intellectual property of the fundraising company. A percentage of revenue is paid out over a period of time. The payout varies depending on the periodic revenue.

Source*: Lutfi & Ismail, 2016, p. 37*

According to the latest trend evaluated by Statista (2018), traditional venture capital investments, including equity-based and lending-based crowdfunding are the least popular among crowdfunders, whereas reward-based modes are currently appreciated the most. Furthermore, most current projects refer to support of new products, art, music and films, as well as tech innovations in scientific research or software. Kickstarter and Indiegogo are among the most popular crowdfunding platforms worldwide. The business interest of such platforms is to collect commissions on funds paid out to fundraisers, which is calculated either from the total sum of raised funds or in case the project's goal was met (Alonso, 2015). For instance, Kickstarter charges 5% of funds if the project was successful, whereas 3-5% are commissioned by Amazon Payments, which is responsible for management of commission. In comparison, Indiegogo charges 4% commission if the fundraising goal was met and 9% if it is not. Another 2.9% have to be charged by third-party agencies for managing the payments. (Zouhali-Worrall, 2011)

There are a number of benefits of crowdfunding money raising instrument. First of all, the success of a project on crowdfunding platforms may indicate the average viability of the project and its market potential (Lutfi & Ismail, 2016)l. In this sense, crowdfunding platform plays a role of a marketing instrument that encourages individuals developing an interest in a new product/service, as well as providing feedback to entrepreneur. Hence, through calling out for funds an initiator gets an opportunity to reach out to his/her future customers and test the market in advance. Grivenics et al. (2014) adds that successful projects are usually receiving attention already during the first couple of days after launching, and advices abandoning projects, which did not receive good funding in the first days.

Secondly, crowdfunding platforms allow entrepreneurs a funding alternative without interference of investors. Thus, investors remain independent in their business decisions and eliminate within the risk of conflict of interest. (Valanciene & Jegeleviciute, 2013)

Thirdly, funding through crowdfunding platforms can be significantly faster than through conventional financial instruments not only because of the rapid speed of online communication, but also due to absence of typical requirements of a bank, such as business and development plan, proof of credibility, availability of guarantors, collaterals and many other documents (Lutfi & Ismail, 2016).

Moreover, for many, crowdfunding platforms are the only available option to receive a funding. So for example, entrepreneurs in creative industry (e.g. music, arts) are very unlikely to receive a funding from a bank, yet can quickly raise money through crowd participation. Similarly, individuals with a weak credibility have significantly more chances to receive funding online than from a financial institution. In this sense, microfinancing and crowdfunding are closely linked together and can hence contribute to helping the poor with monetary and non-monetary resources for initiating their micro/small businesses. Besides, donation-based and equity-based crowdfunding models have many similarities with the principles of Islamic Shariah compliant microfinancing. Donation-based crowdfunding is hence comparable to *zakah*, *waqf* or *sadaqah* instruments of Islamic MF, whereas equity-based model is similar to PLS concept of Islamic Banking. The next chapter is going to discuss the standpoint of Islamic crowdfunding, as well as evaluate the opportunities of its growth in compliance with Shariah and microfinancing initiatives of poverty alleviation.

4.1 Shariah compliant crowdfunding

It is believed that Islamic and Arab cultures have a high habitude towards entrepreneurship. Nonetheless, current circumstances in the most Arabic countries motivate entrepreneurship out of necessity instead of opportunity, whereby academic and business research lack examples of success stories compared to Western countries. Moreover, the entrepreneurial spirit in Islamic countries is weakly supported by the financial institutions and general economic structures. This reluctance of banks to provide support to younger and/or poorer populations initiated an evolvement of new financial actors on Arabic financial markets. (Marzban et al., 2014) Among those new actors microfinancing and crowdfunding play a crucial role.

Figure 2: Demand for Islamic Shariah compliant microfinancing instruments across MENA countries

Survey by	Surveyed Country	Respondents' preference (%)
CGAP 2008	Jordan, Algeria and Syria	20% - 40%
Planet Finance 2007	West Bank and Gaza	35% - 60%
IFC/FINCA 2006	Jordan	32%
The Ministry of Planning and International Cooperation 2012	Jordan	20.4%
Frankfurt School of Finance and Management 2006	Algeria	20.7%
SFD 2008	Egypt	13%
USAID 2011	Iraq	79.6%
IFC Sponsored Study	Yemen	40%
IFC 2007	Syria	43-46%

***Source**: Marzban, Asutay, & Boseli, 2014, p. 7*

With the help of crowdfunding models, which would enable an access to a large base of small investors, notably more capital funds can be attracted and collected in the Islamic global community. The importance of Islamic crowdfunding can be enhanced by the principle of charity giving and financial support of needy as promoted by Shariah. Indeed, the whole concept of Islamic finance is based on values of equity, justice, freedom of enterprise and moderation (Marzban et al., 2014). Study by Marzban et al. (2014) across MENA countries justified the preference of Muslim investors and entrepreneurs to participate in Islamic Shariah compliant microfinancing (Figure 2), underpinning the necessity of specially developed crowdfunding models rather than the use of conventional crowdfunding websites such as Kickstarter. Hence, in a well functioning crowdfunding model, investors from economically more developed countries (e.g. UAE, US or Europe) could easily and without interference of third-parties transfer small-to-medium financial aid to individuals in poorer regions, as well as should be able to fulfill their core ethical, moral and social duties.

Islamic based crowdfunding model is not significantly different from conventional platform, yet has a number of Shariah compliant characteristics, namely (Marzban et al., 2014):

- The crowdfunding platform must be certified and governed by a Shariah board or advisory.

Some researchers (cf. El-Gamal, 2006; Alonso, 2015) argue the religious supervisory is indeed the most distinguishing feature of Islamic finance. However, the role of the Shariah board is overrated in the modern banking, in particularly regarding their interpretation practices of religious laws. It is argued that current approaches to Islamic banking are rather based on imitation and adaptation of foreign banking practices than real imitation of the Shariah. Thus Shariah board may be seen as unnecessary entry barrier for less prosperous entrepreneurs who wish to launch an Islamic crowdfunding platform for microfinancing purposes, where the size of projects would not pay off a costly and ineffective committee of advisors. Moreover, it is argued that the role of the board can be notably reduced in case of standardization and systematization of Islamic financial products. (Alonso, 2015)

- All investments must be socially, morally and religiously responsible.
- The platform should be developed with financial resources originating from Shariah compliant sources, as well as supported start-ups must operate in Shariah compliant businesses and hence be interest-free and non-*haram*, neither at the time of application nor in the future.

Although nearly identical, conventional platforms cannot guarantee absence of forbidden activities. For instance, a pornography filming studio was requesting funds on Kickstarter in 2016 (Lutfi & Ismail, 2016). Microfinance providers in Malaysia, AIM and TEKUN do not eliminate the elements of *riba*, despite the majority of Muslim population in the country (Morsid & Abdullah, 2014).

- The shareholder structure and investor protection requirements must be Shariah compliant and thus differentiate from typical venture capital firms, where investors are granted superior rights of the project.

After discussing the main criteria for Islamic crowdfunding platforms, an adaptation of typical crowdfunding models to Islamic finance must be provided. Figure 3 summarizes the possible adaptation of conventional models to Islamic principles and Shariah-compliant instruments, including potential beneficiaries and different types of financing.

Figure 3: The adaptation of crowdfunding models to Shariah requirements and Shariah-compliant instruments

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

Source*: Marzban, Asutay, & Boseli, 2014, p. 10*

Among four main crowdfunding models, donation-based crowdfunding would represent an optimal model for Islamic market. Based on Islamic principles, donations in form of *zakah*, *waqf or sadaqah* would enable efficient poverty alleviation with a global outreach through internet crowdfunding platforms. The beneficiary in such model would be Islamic micro-entrepreneurs. The microfinancing instruments to use would be *hiba*[1], *qard-hasan* and *murabaha* (i.e. benevolent loan, in this case however the fund must be repaid by receivers). (Marzban et al., 2014)

One of the main differences to a conventional platform would be an appointment of Shariah advisory, who will constantly monitor that all activties are conducted in line with Islamic law. Additionally, Lutfi & Ismail (2016) suggest that conventional crowdfunding models practice only one-off donations, whereas e.g. *sadaqah* model would propose continuous benefits for numerous parties. In their study, Lutfi & Ismail (2016) develop a crowdfunding model for health care services based on *sadaqah* donations. Namely, the platform is intended to collect micro financing

[1] Transfer of possession rights of an asset without compensation from receiving party, i.e. gift

funds from a large group of ordinary people for entrepreneurs or charitable funds in health care. The platform works as intermediary or manager between entrepreneur and crowd funders and receives a portion of charity, which is paid as a fee. The goal of such platform is to ensure an access of the poor to health care and at the same time increase the participation of less fortunate in entrepreneurship. Hence, “the poor are not only given the opportunity to be an entrepreneur by receiving funds, but also they are given the opportunity to get good health care” (Lutfi & Ismail, 2016, p. 42).

Despite being compulsory from the religious perspective of Islamic finance, donation-based crowdfunding models are rather seldom in practice and often attract funders from the poor segments of population. Reward-based or equity-based crowdfunding could hence offer higher growth potential than microfinancing models based on Islamic charity. Potential beneficiaries for reward-based crowdfunding models could be also microfinancing receivers, but also small enterprises and startups, who would apply for financing a development of a product. (Marzban et al., 2014)

One of the existing reward-based crowdfunding platforms, Yomken, was developed in Egypt in 2012 as a first Shariah compliant product-based crowdfunding platform. The platform was launched as a startup after receiving a fund from the World Bank’s Youth Innovation Fund and since then has been quite successful in the Arab world. The goal of the platform is to increase funding of low-tech product developers, such as artisanal works or handicraft, which are underfunded on Egyptian market in comparison to high-tech products. Indeed, Yomken argues that high-tech innovations represent only 5% of Egypt’s exports, yet receive the highest funding, whereas 60% of less technologically intensive businesses of Egypt’s economy remain unnoticed. Thus, the mail goal of Yomken is to improve the productive sector of the Egyptian economy and promote development. In order to follow its mission, Yomken first links people looking for a solution with people able to provide or develop those solutions (e.g. researchers, students, startups). Both parties can post their ideas or requests on a platform for free. Moreover, Yomken partners with NGOs who work with supporting entrepreneurs, micro or SMEs to increase the participation of the crowd. Once the solution was provided, individuals receive a share of the benefits, lump sum compensation or an award from Yomken. Secondly, after linking interested parties together, a prototype of the product is developed and offered through the platform on a crowdfunding basis. If prototype received enough attention, the product will be developed and delivered to participating crowd funders. In other case, contributors retrieve their initial funding sum and the development is not progressed due to the lack of market potentiality. Hence, Yomken decreases the risk of innovation by funding temporarily challenges until the crowdfunding phase is completed. (Alonso, 2015)

Yomken however is not allowed to be officially considered as a Shariah-compliant platform, because it lacks a Shariah board. Nonetheless, other elements of Islamic finance are present: the platform supports only not-*haram* products, offers transparency of all its operations, promotes social justice and social participation in poverty reduction, as well as involves buying a product, which in this case is innovation. Yomken crowdfunding platform is an interesting case for a well-functioning "Shariah-friendly" model without costly Shariah board. (Alonso, 2015)

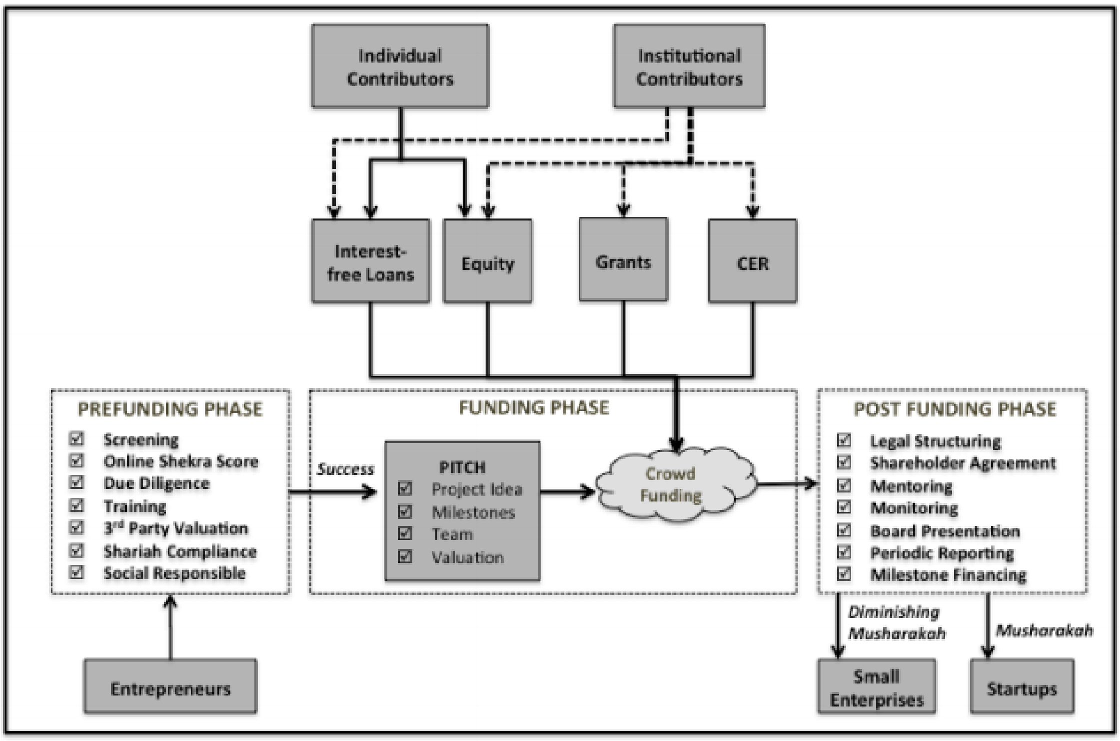
The third type of crowdfunding models in Islamic finance refer to equity-based models, which, according to Marzban et al. (2014), "represent a significant opportunity to deliver the essential expectations from Islamic finance by combining the benefits of social development and investment opportunities for a wide range of entrepreneurs and investors". Equity-based crowdfunding can be considered as the most Islamic because of its profit-and-loss sharing basis, which is the foundation of the Islamic finance. Moreover, it will provide access to capital to higher number of participants through minimizing risk by allowing multiple start-ups to split their limited capital. Therefore, it will not only enforce innovation but also support new businesses in the technology or health care services that are not represented on Muslim markets as public equity funds. (Marzban & Asutay, 2012)

The potential beneficiaries in equity-based crowdfunding are small enterprises and startups, whereby small enterprises usually try to redeem their shares after receiving financing and launching their businesses and thus a diminishing *musharakah*[2] instrument should be applied. (Marzban et al., 2014)

[2] Diminishing partnership, in which one party's share decreases while being transferred to another party until full transfer of the full sum.

One of the best examples of an equity-based platform in Arabic world is Shekra. Shekra was established in 2012 in Egypt and aims to link a closed network of investors with potential entrepreneurs and already established companies. The size of these companies has to be too big for receiving microfinancing but yet too small for receiving conventional financing from banks. Figure 4 shows the detailed organization of Shekra crowdfunding instrument.

Figure 4: The mechanism of Shekra crowdfunding model



Source*: Marzban, Asutay, & Boseli, 2014, p. 11*

In order to become an investor, a recommendation from existing member has to be received. Once a network of investors is build, Shekra allows distributing the capital among multiple startups to minimize the high risk exposure typical for innovative businesses. At the same time, in order to be considered as a potential fund receiver, entrepreneurs have to become Shekra-eligible by proving essential skills and requirements. (Alonso, 2015)

In a funding phase, potentially successful entrepreneurial ideas are when posted on Shekra platform and promoted through social media networks. Public is able to see only a short summary of the project and its current funding status, whereas only internal investors can access full details of the project. If the target fund was achieved, post funding phase is initiated in which Shekra organizes the transfer of shares between investors, a meeting of startupers and investors for signing a shareholder agreement, as well as takes the responsibility for online monitoring of progress. The platform also helps with development of business plan, for which it requests minimum fees from entrepreneurs. The platform also acts as a partner and takes an equity stakes in venture, hence the success of the funding project has a direct influence on the success of Shekra itself. (Alonso, 2015)

Shekra shares the ideas of social responsibility and Shariah-compliance, as well as aim at promoting entrepreneurship in the MENA region to reach global standards. However, similarly to Yomken, Shekra does not promote itself as a Shariah compliant crowdfunding platform but as Shariah-friendly model. Indeed, all rules of Islamic finance are obeyed by Shekra: 1) no interest-based capital raising; 2) only *halal* innovations and businesses; 3) funding based on PLS principle. Yet, the lack of Shariah board, as well as a number of legal issues of crowdfunding, including shareholder structure with preferential rights for certain investors, exclude Shekra from "pure" Islamic platforms. (Alonso, 2015)

Shekra and Yomken show examples of well functioning crowdfunding platforms without the Shariah board. Yet in order to gain higher attention among potential investors on a global level and to attract more startups, both platforms still need to overcome significant challenges. Regarding to Alonso (2015) the main challenges of Islamic crowdfunding is the lack of regulatory structure for crowdfunding, which would protect both investors and entrepreneurs, difficulties with online payment, in particularly when crowdfunding platform plays an intermediary role in financial transfers, and low internet penetration. Moreover, many potential entrepreneurs lack knowledge regarding funding opportunities through microfinancing and crowdfunding platforms, and hence significant effort should be put into promoting Islamic crowdfunding to local and international Arabic community. This is in turn complicated as neither governments nor conventional financial institutions are interested in supporting officially non Shariah-compliant crowdfunding, which in reality obeys all rules of Islamic finance except for hiring Shariah board. Therefore, the future of Islamic crowdfunding platforms is bright, yet very debatable in terms of their "Islamic" component and legal approval.

Empirical part

The literature review of this paper dealt with introducing the concepts of Islamic Banking, as well as microfinancing and crowdfunding in general and particularly from the viewpoint of Islamic finance. It was shown that Islamic microfinance instrument can be very beneficial for poverty alleviation and for increasing entrepreneurship among poorer populations of the world. At the same time, it was found out that microfinance instruments are not quite popular in MENA and other developing countries where Islam is practiced. Moreover, many Muslims are unaware of the principles of Islamic finance and hence cannot fully comprehend the benefits of micro-lending, crowdfunding, or profit-and-loss contracts for their well-being.

The empirical part of this thesis aims to develop and introduce an Islamic financial product for reduction of poverty and improvement of life standards of the poor in the politically instable regions. Namely, the author of this paper proposes a crowdfunding model, which intends to raise funds for refugees foremost of Syrian, Iraqi or Afghani origin seeking protection in Turkey, Lebanon or Jordan or remaining in conflicting home regions. The crowdfunding platform will collect funds mostly from Muslim and non – Muslim individuals living in the Western world or in richer Arabic countries, willing to help refugees by providing tangible or non-tangible assets for initiating micro-entrepreneurship and hence contribute to sustainable development of the region rather than offering simple monetary donations. The main characteristics of the crowdfunding model is high degree of transparency, which is going to ensure that funds are raised for a particular business goal and are implicitly transferred to an individual or group of individuals without intervention of third-parties (excluding, money transfer fee and minimal fee for the platform usage) in accordance to Islamic finance principles of benevolent loans or PLS contracts.

Hence, on the one hand, the mission of the Islamic crowdfunding platform is to raise awareness of the Western or/and more prosperous world to the refugee problem by motivating capital inflow in form of micro-loans without interest rate. On the other hand, the platform aims to raise micro-entrepreneurship of the poor in accordance to their religious values and cultural beliefs, which in a long term may improve the overall economic situation of the conflicting regions by decreasing poverty, as well as contribute to a well-being of displaced persons by stabilizing their economic, social and psychological condition.

The concept of the crowdfunding model can be summarized as follows:

> "To develop a Shariah compliant financial instrument capable of designing and providing interest-free crowdfunded microfinancing to the people of the MENA regions for facilitation of equitable economic growth without the violation of Islamic financial rules."

In the following, the business plan of the proposed crowdfunding model will be described. The business plan in this paper will focus mainly on the analysis of external environment, including market analysis with trends, competitors, potential customers and investors; internal market, including SWOT analysis, as well as on the description of the product and its mechanism. The analysis of the external market aims to evaluate the demand for the proposed product, which is then described in detail and assessed by its strengths and weaknesses, and further opportunities and threats.

5 Business plan and strategy

5.1 External environment analysis

This section of the business plan describes the conditions of the external environment that evaluate the demand for the Shariah compliant crowdfunding model in MENA countries by analyzing the market, the refugee situation and poverty levels in the regions of concern, as well as the main players in similar industry of micro-financing (e.g. NGO's, conventional banks)

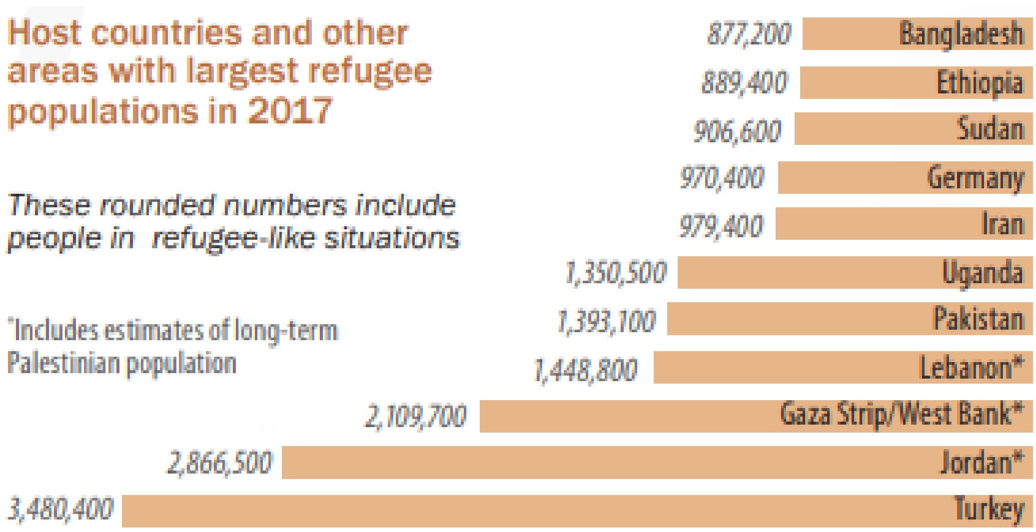
5.1.1 Refugees' statistics and displacement trends

Due to the fact that the crowdfunding platform elaborated in this thesis aims to raise funds for Muslim refugees of the Middle East countries, an analysis of the current refugee situation is essential. For this analysis, three countries were chosen and namely, Turkey, Jordan and Lebanon, where at the current point (in 2018) the majority of the world's refugees are temporarily hosted. Most of these refugees flee from Syria, Afghanistan or Iraq due to war crises or hostile political environment (e.g. ISIL attacks). Syrians, Afghani and Iraqi people are almost exclusively Muslims, following strictly the religious laws of Shariah.

Since 2011 more than 5.6 million people have fled from Syria, whereby another 6.1 million are displaced within the country (World Vision, 2018). The on-going crisis in Afghanistan since 1970's has led to a chronic poverty and unemployment, as well as economically and politically instable country, which is being left by millions of its citizens every year. In 2017, one million people were nationally displaced, whereas another 3 million searched safety from ISIS and the Taliban in the other countries (RESCUE, 2017). Less than a million people fled from Iraq, however the country has 4.5 million people of concern according to UNHCR, among those are about 250 000 Syrian refugees and more than 3 million displaced people within the country that are seeking protection from tribal and religions armed conflicts. (UNHCR, 2018)

As it is seen from Figure 5, Turkey hosts most of the refugees at the end of 2017, followed by Jordan and Lebanon. It is subjective to measure the number of refugees in the West Bank from this Figure, as the number includes Palestinian population, which is not considered as refugees by some of the sources.

Figure 5: The number of hosted refugees by country



Source: *HIU (2018). Retrieved from: https://reliefweb.int/sites/reliefweb.int/files/resources/Global_WorldRefugeeDay_2018Jun20_HIU_U1820.pdf*

By the standpoint of May, 2018 most of the 3 570 352 refugees in Turkey originate from Syria (3.5 million), Afghanistan (169.000) and Iraq (142.000). Among those numbers only 7256 individuals managed to resettle in more stable and secure countries, such as USA, Germany and Netherlands. Others remain in refugee camps or predominantly outside of camps in urban Turkish areas. 70% of refugees in Turkey are women and children, which escalates poverty due to lower chances of finding employment. (UNHCR, 2018) Similar situation exists also in Jordan, where most of the refugees come from Syria, followed by Iraq and Yemen. 83.2% of registered refuges are living in urban areas and 16.8% in the camps (UNHCR, 2018).

One of the most active agencies working with the Turkish Government with the goal of supporting refugees is UNHCR, which coordinates the UN efforts of refugee assistances, provides direct operational support, technical advice, develops diverse educational and health programs, as well as raises funds. The UNHCR is also one of the most active organization in relieving refugee situation in Lebanon and Jordan. The UNHCR collects funds from voluntary contributions, whereby 87% of funds come from governments and 10% from private donors. (UNHCR, 2018) Despite its active efforts in fund raising, the actual funding capital is notably below the needed level. For instance, as of May, 24th of 2018 only 19% of funds equal to USD 81million were funded in Turkey, yet another 355 million are still needed to provide assistance to refugee crisis in the country (UNHCR, 2018).

The lack of funding was also register in Lebanon with only 21% of funds received (UNHCR, 2018) and in Jordan with 81% funding gap equal to US$ 25 million (Shelter Sector, 2018) of funding for refugee problem alleviation.

75% of Syrian refugee households in Turkey, Lebanon and Jordan are living in extreme poverty, meaning that they cannot meet basic needs of food, health, shelter and education. Among them only one quarter was supported by cash assistance, whereas another 1.2 million individuals eligible as cash beneficiaries in 2018 (standpoint: April, 2018) remained without minimal funding. The lack of funding reflects the limited access to water, protection and health services, educational services, inability to develop minimum requirements for social stability or initiate micro-entrepreneurship. (UNHCR, 2018) Moreover, there are not enough funds to ensure food and shelter security to all of the refugees. For instance, in Lebanon 53% of refugees' households are shelters that do not meet the minimum humanitarian standards and 77% of households do not have enough sources to buy food (UNHCR, 2018).

Summing up the statistics provided above, the funding of refugees' problem in the Middle East is complicated and lacks approximately 80% of funds required to normalize the situation or at least provide minimal living requirements for suffering populations. Hence, refugees in Turkey, Lebanon and Jordan are in urgent need of additional funding options. Even if minimal, any additional funding option would contribute to the overall alleviation of the problem. The potential demand for the Islamic crowdfunding platform is thus estimated as enormous, both from the receivers' and investors' sides.

5.1.2 Demand: customer profile

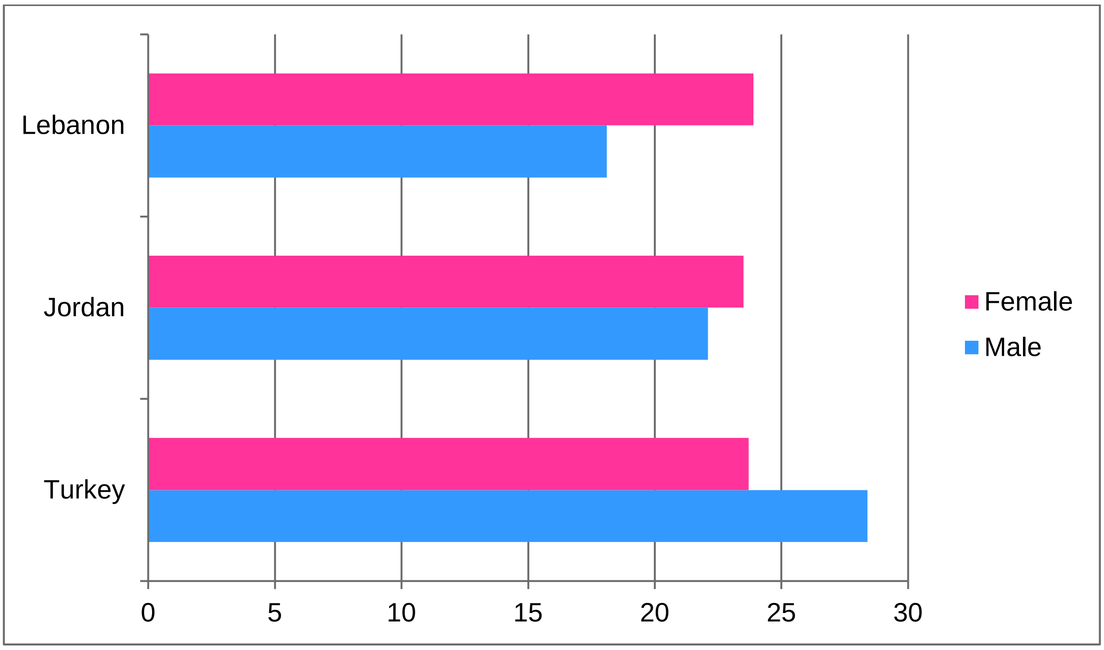
The analysis of the refugees' situation in the previous chapter has identified the need for additional funding instruments in the affected countries, i.e. Turkey, Jordan, Lebanon and Syria. The customers of such financial instruments are hence the poor population permanently or temporarily (such as refugees) living in their home countries or in forced displaced locations. The analysis of the market showed that only in three described countries a potential multimillion demand for microfinancing exists, disregarding other geographic locations where Islamic crowdfunding could possess an attractive niche on the financial market (e.g. Malaysia, India).

The need of poor in the Islamic countries is similar to the poor populace of other regions and communities around the world. However, Islam puts rules and influences the financial system by the Islamic culture and Islamic faith in a significant way. The mechanisms of the Shariah and its importance for the customer were thoughtfully discussed in the literature review (see Chapter 2.1). The analysis of the literature also showed that Arabic culture is characterized by a high degree of entrepreneurship and dignity. The concept of the Islamic crowdfunding model developed in this thesis is build upon these two main components:

- Dignity of individuals
- Entrepreneurial spirit

Therefore, the product presented is this thesis is targeting men and women in the productive age (18-59), willing to launch a micro-business with the help of funds gathered from crowdfunding platform for a particular business idea. In order to be able to receive funds, an idea must be first presented and shortly described, whereas the funds receivable will be not measured in cash but in the assets needed for launching the business (see Chapter 5.2 for full product description). The goal is to address individuals' dignity by giving them the opportunity to develop microenterprise rather than simply donating money. Investments into a business not only enhance entrepreneurial spirit and drive for action in challenging times, but also improve the overall social and economic conditions in the micro-community in a long term. Moreover, such investments based on PLS contracts conform religious views of Muslims and thus allow them to receive funds from strangers that are going to be returned without interest rate in terms of Shariah laws.

Figure 6: The gender distribution of refugees in the age of 18-59 in hosting countries (Turkey, Lebanon, Jordan)



***Source**: Based on UNCHR (2018). Retrieved from: https://data2.unhcr.org/en/situations*

As it is seen from the Figure 6, women represent a slightly higher proportion of refugees in the analyzed countries (except Turkey). However, typically women in the developing MENA countries have less decision-making power in households than men and are hence considered as less productive, are excluded from employment opportunities, as well as are not seen as potential entrepreneurs in the community, although women could contribute significantly in terms of micro-businesses (e.g. cooking, handicraft, agriculture branches) (Armendariz & Morduch, 2010). Therefore, microfinancing might empower women to enjoy higher control over the household or even take the whole responsibility of the own family, in case of split families because of forced immigration.

Another important consideration for raise awareness of women in microfinancing opportunities is the fact that commercial banks tend to consider men as more creditworthy than women, because men usually run larger businesses and are able to provide better collaterals to the bank. However, in microfinance sector women represent higher proportion of borrowers as the businesses in this sector are rather small and informal. As women have fewer alternative sources of capital, the demand for microcredit is especially high among them. Moreover, women are believed to have stronger incentives in repaying the loans, particularly in regions where they lack access to labor markets, commercial loans and hence view and value self-employment as the only opportunity to earn money. (Armendariz & Morduch, 2010)

Armendariz and Morduch (2010) name three reasons why lending to women could be beneficial for a microfinance institution:

1. Women are poorer than men and hence aim for more support in form of microfinancing. Due to their limited access to capital, their returns to capital should be higher than for men under the neoclassical assumption of production function. However, in reality women often lend money for all family members and re-direct it to male household heads. Hence, higher control of actual investment projects is necessary.
2. Women are less mobile than men and hence work in a near proximity from the home, which enables cheaper and more convenient monitoring by microfinance institutions or by members of group (peer) borrowers.
3. Women are more risk-averse, more conservative and fearful about social sanctions than men and hence are highly concerned about their reputation in the community and are more reliable about their debt repayments.

Based on the above mentioned arguments it may be justified that the crowdfunding platform should specifically (but not exclusively) target women. For this goal, female friendly assets (e.g. kitchenware, handicraft tools, agricultural tools, and seeds) should be purchased and available for lending in terms of PLS contracts. Moreover, the institution will consider employing local female employees for monitoring the success of the borrower. These employees will be responsible for empowering their community for launching their micro businesses, promoting new products and services and raising general awareness of new opportunity to receive funds for investment. In cultures where males still represent the dominant decision makers, employing women to speak to other women may represent an additional motivation sources in order to eliminate fear and insecurities that money will be lent to men only (Armendariz & Morduch, 2010).

Last but not least, customers of the Islamic crowdfunding platform are not only the receivers of funds but also the providers of funds. The group of providers is considered as crowd (s. Chapter 4) of any origin and geographical location. Predominantly the platform will target Muslim individual living in more prosperous regions than the receivers. Muslim funders are expected to be more interested in the crowdfunding instrument because of their higher religious identification with Shariah principles of helping the poor and better understanding of non-interest lending for the global well-being of Muslim community. Nonetheless, Islamic crowdfunding platform might be interesting also for non-Muslim investors due to numerous reasons (e.g. described in Chapter 3.1.1) such as reputation, concern about global community, taxation benefits, or even fear of refugees' migration to the Western countries.

Therefore, the initial Islamic microfinancing crowdfunding platform identifies two main groups of its customers:

1. Funders (or the Crowd, givers, investors): Muslim and non-Muslim individuals from any geographic location
2. Receivers: the poor and refugees living in Turkey, Jordan or Lebanon, or displaced individuals in Syria, Afghanistan or Iraq

5.1.3 Industry participants: competitors, potential partners and benchmarking examples

There is a number of different industry participants, which on the one side represent the potential partners for out crowdfunding model and on the other side direct and indirect competitors of microfinancing instruments.

First of all, the direct competitors are comprised of the conventional banks, which provide financial services based on the Islamic financing rules such as Islamic banks (e.g. Dubai Islamic bank) and other financial institutions offering Shariah compliant financial loans, investment schemes, funds and deposit offers on the profit and loss sharing accounts. Nonetheless, as discussed in Chapter 2.2 there are not many financial institutions in practice, which indeed fully implement Shariah compliant mechanisms. For instance, in Turkey in 2008 only 4 from 48 banks could had been classified as Islamic, whereas in Egypt only 2 Islamic banks operated in 2010, despite that Egypt has been promoting the principles of Shariah compliant finance already in 1970s (Mirimadi, 2012).

In addition to conventional banks, various not for profit organizations and nongovernmental organization are providing schemes and projects based on microfinancing to eradicate poverty in MENA region. Nevertheless, NGOs usually provide support in form of cash donations or humanitarian aid (i.e. building of shelters, provision of food supplies and water, health care and educational services) and hence can rather be seen as partners than competitors. In effective cooperation between NGOs and the Islamic crowdfunding platform, NGOs can provide refugees with the basic living requirements, whereby crowdfunding platform will enhance entrepreneurship, slightly above the basic survival level. Moreover, having enormous experience in the region and monitoring ability, NGOs are important source of market knowledge for our crowdfunding platform.

As mentioned before (Ch. 5.1.1) UNHCR is one of the biggest NGOs managing the refugees' crises in MENA. Its main goal is to collect funds from global governments and private donors to improve living conditions of refugees. Other world known NGOs concerned with alleviating the poverty in general and the poor living standards of refuges in particular with slightly less funds and influence than UNHCR are following (Raptim, 2016):

- World Vision
- Doctors without Borders (focus on medical aid)
- Zakat Foundation of America (focus on Islamic donation of zakat and sadaqah)
- Care (focus on poverty alleviation)
- IRC or International Rescue Committee
- Islamic Relief (faith based humanitarian aid)

Further industry players are pure microfinancing institutions and Shariah friendly crowdfunding platforms. Despite the enormous demand for microfinancing services, there are only a small number of institutions operating in this sector. Figure 7 proves that there was only limited number of microfinance institutions in 2013 in a number of MENA countries with 1.6 million active borrowers.

Figure 7: Number of microfinance institutions in MENA region in 2013

Countries reporting data in 2013	Number of Microfinance Institutions	1.6 million Active Borrowers
Egypt	6	350,049
Iraq	1	13,355
Jordan	4	134,855
Lebanon	3	47,405
Morocco	6	701,221
Palestine	4	48,538
Sudan	1	7,476
Syria	2	22,630
Tunisia	1	231,520
Yemen	2	44,409

***Source**: Ernst & Young (2014)*

Among Shariah-friendly, or in other words crowdfunding platforms built upon Islamic principles but operating without the Shariah board, two Egyptian crowdfunding platforms, Shekra and Yomken did well in providing the microfinancing based on the Islamic principles (s. Chapter 4.1). However, these and some other platforms collapsed after experiencing the sudden growth due to the many underlying factors, such as the lack of regulatory structure for crowdfunding. One platform, which still provides crowdfunding in the Middle Eastern countries, is Zomaal. It could be considered as the biggest competitor in the field of microfinancing, yet, the values and objectives of Zomaal are quite different and focus rather on the business profits instead of poverty eradication. Hence, we can assume that there are no significantly big competitors at the current moment operating in the market of MENA.

Finally, there are a number of indirect competitors, operating on other than Islamic markets and consequently not in Shariah compliant terms. However, these crowdfunding platforms could be used as benchmarking examples of successful companies. Among such examples, Kiva[3] (*riba* free benevolent loans) and Eureeca[4] (PLS financing) are going to be presented.

Kiva is the American nonprofit company founded in 2005 and aiming to alleviate poverty through connecting funders with potential micro-entrepreneurs, who cannot access other sources of credit and are financially excluded in their communities. Kiva works on a crowd lending principle, whereas single loan starts at as less as $25. The operational costs are covered by optional donations and grants and sponsors, and thus 100% of the lending goes to funding of the loans. Kiva does not promise lenders full repayment of loans by borrowers, yet claims that historically only 3% of loans were not repaid in the past. Kiva operates in 80 countries, predominantly in South America but also in MENA countries, and mainly focusing on farmers, artisans, students, shopkeepers, builders or restaurant owners. However, Kiva does not put constraints on borrower's industry selection. (kiva, 2018)

The mechanism of lending that Kiva provides is similar to the Islamic finance in terms that most loans are interest-free. However, whereas Kiva lenders are not eligible for any interest payments on loans, Kiva field partners do receive interest from borrowers, which is explained by many expenses associated with providing micro loans in developing regions. Moreover, field partners participate in many additional services for borrowers, such as training, financial literacy classes or health services. For those borrowers unwilling to pay interest on loans, Kiva offers a possibility to apply for a direct loan without intermediacy of the field partner. In this case money is transferred to the borrower via PayPal and not through the distribution of the field partner. Similarly the funds in form of monthly repayments are transferred back via PayPal or through repaying the field partner. (kiva, 2018)

Kiva is thus more than a simple donation platform for supporting the poor as lenders receive in the majority of cases their money back and may reinvest or withdraw their funds after successful lending. With this mechanism, Kiva encourages higher participation of global society in the matters of alleviation of the world poverty and

[3] https://www.kiva.org/about
[4] https://eureeca.com/Default.aspx

hence serves as one of the best examples of the crowdfunding platform built on microfinance instruments.

Another example of equity-based crowdfunding platform, Eureeca is smaller and has slightly different mission than Kiva. Namely, Eureeca considers itself as the first global equity crowdfunding platform, which connects crowd investors willing to provide access to capital for borrowers, who sell their business shares in return. Hence, Eureeca build its operations on the terms of PLS contracts, where investors become the co-owners of the business and bear the responsibility for profit and/or losses. Such form of crowdfunding is believed to increase the participation and motivation of the crowd in the business operations of the borrowers. (eureeca, 2018)

Eureeca has a strong focus on the Middle East and Southeast Asia, thus operating in the same markets where our crowdfunding platform will be developed. However, Eureeca's requirements include existing operational SME raising at least $ 250 000 and aiming for product or market growth. (eureeca, 2018) Hence, the platform is not appropriate for micro lenders or for supporting the poor, yet provides a working example of PLS crowdfunding in Islamic region.

5.2 Product description

Based on the analysis of the external market conducted in the previous chapter, it may be concluded that there is a strong demand for additional alternative financing products for the poor populations, including refugees, in the politically and/or economically unstable regions of the Middle East. With the goal to increase the access to the capital, enhance entrepreneurship in the region and within contribute to the alleviation of the poverty in the long term, we propose to develop Shariah compliant equity-based crowdfunding platform. In its structure the platform refers to the best cases of existing crowdfunding models but differentiates from them in a way that:

- it is based on the Islamic financial mechanisms and is thus Shariah compliant;
- it supports the ideas of microfinancing with a starting investment sum equal to as less as US$ 10;
- it promotes entrepreneurship among the poor and suffering populations, such as refugees;

- it encourages the participation of the whole local community and smart integration of global concerns into business action rather than simple donation;
- it guarantees 100% transparency of the processes and handling of funds.

Table 1 below describes each element of the proposed product, providing brief explanation and additional notes where needed.

Table 1: The overview of the main elements of the Shariah compliant crowdfunding model

Element	Explanation	Notes
Crowd model	Equity – based financing for investing into asset acquisition	No pure money transfer Tangible assets preferred
Beneficiaries	Micro and small enterprises, startups	Including individuals, groups, communities, already operating companies
Lenders	Muslim and non-Muslim crowdfunders, online global community	
Islamic finance mechanism	*Musharakah* Diminishing *musharakah*	PLS contracts similar to joint ventures, with shared responsibility for profits and losses in accordance to ones share proportion
Minimum loan	US$ 10	Minimal profit return rate
Funding areas	Agriculture, handicraft, food and beverages, construction, reparation services, arts and similar.	Examples of eligible assets: kitchen appliances, carts, delivery bicycles, seeds, sewing instruments, mechanical kits
Partners	Field Managers (employed by the Company) Local universities (voluntary contribution for the benefits of knowledge-experience exchange) Local communities (social volunteering and peer-monitoring for the benefits of the community) Money transferring companies (i.e. PayPal, Transferwise)	Optional: NGOs for additional knowledge about the market structure and access to the persons of the concern

Source: *Self-created*

As it may be extracted from Table 1, we propose a crowdfunding model based on the equity principle of shared profits and losses between investors and borrowers. According to the Islamic finance terminology such type of contract is called *musharakah* (s. Chapter 2 and 4.1) or diminishing *musharakah.* In the latter, initial shares of investors are redeemed over time until full repayment of the loan, when the enterprise becomes an independent entity. As discussed in the literature review of this paper, equity-based crowdfunding can be considered as the most Islamic because of its profit-and-loss sharing basis, which is the foundation of the Islamic finance. In terms of crowdfunding mechanisms, equity-based financing provides an access to the capital to higher number of participants because of the minimization of the risk through allowing multiple start-ups to split their limited capital.

Further on, in order to comply with the Shariah laws, main principles of the Islamic finance (for detailed explanation s. Chapter 2) will be respected and namely:

1. Absolutely no *riba* (no interest on any of the loans)
2. Only non-*haram* investments and assets
3. All investments will be socially, morally and religiously responsible
4. Certification and supervision of the local (and simplified) Shariah board

5.2.1 The mechanism of the platform

This chapter explains more precisely how the product will work and which parties participate in the process. The proposed *musharakah* - based crowdfunding model is illustrated in the Figure 8.

The explanation to Figure 8 is following:

Flow of cash and assets:

In the initiation phase we will offer loans to borrowers in the following countries Turkey, Jordan, Lebanon and Syria, with a possible geographical expansion in the future. Predominantly the model will focus on providing capital to refugees, living in camps or urban areas of the above mentioned countries. In order to receive funding, receiver should propose a short and very simplified business plan about his/her idea and identify, for which asset the funding is required. It is important to mention that pure money transfer without business idea will not be supported by the platform.

In order to increase product awareness and consequently enhance participation, a field manager for every location will be employed, whose activities will include

- promotion of the platform as Islamic financial instrument accessible for micro loans and poor populations,
- support by creating, editing, translating, uploading and managing loan application,
- collection, management and transfer of funds between the platform and receivers;
- regulating and guaranteeing the compliance with the rights on the asset;
- ensuring correct investments and responsible treatment of funds.

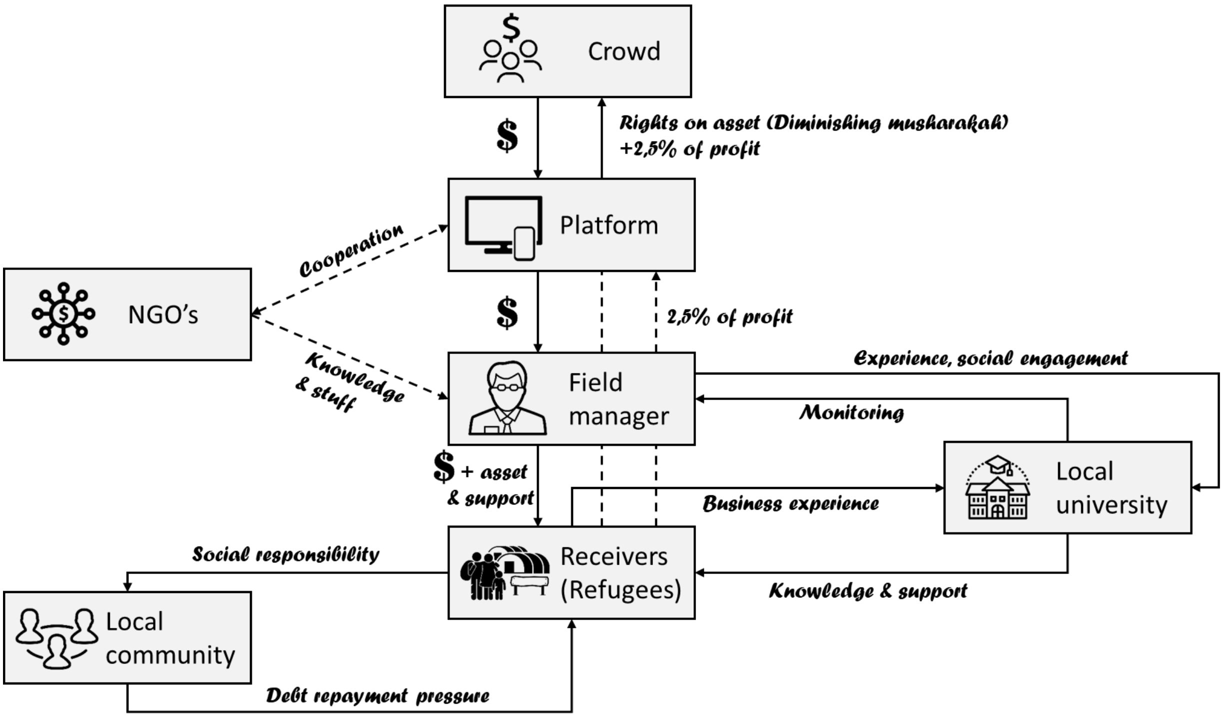
The role of the field manager is very important because this person is an intermediary between the platform and crowd and hardly reachable receivers in the remote places. Moreover, as the majority of the receivers is expected to be financially excluded from the market and thus will neither possess a bank account nor eligible for PayPal transfers, field managers will solve the operational problem of cash transfer by distributing the funds or collecting repayments on spot.

Once the loan request is created and posted on the platform, potential crowd funders may start transferring cash to the platform through a third-party money transfer program PayPal or similar. The platform will incorporate the “all or nothing” crowdfunding option, meaning that entrepreneur can only receive money then a certain funding goal has been achieved. If the funding goal was reached, money will be transferred to the field manager, who will forward it to the receiver either in form of the asset or cash. In the latter case, the receiver should provide a receipt or any other proof of purchase.

After the purchase of the asset, receiver signs an equity-sharing contract, which is transferred through platform to the funder as a business share according to his/her proportion to the total funding. If the business proved to be successful, funders will receive a minimal profit rate of 2.5% from the total profit in the particular period (in case of simple *musharakah*) or once (in case of diminishing *musharakah*). In case of default, funders will not receive any repayment of their investments.

Finally, in order to cover some of the operational expenses, the platform will charge borrowers with another 2.5% profit rate from the total profit, yet also only in case of profitable venture. Therefore, mutual benefits motivate all parties to be more engaged into the process.

Figure 8: Illustration of musharakah - based crowdfunding model



Source: *Self-created*

Knowledge and experience flow:

Apart from cash flow, the model also considers extensive flow of knowledge and experience. One of the important players in this terms, are local universities, which will voluntary share theoretic knowledge and provide support to the receivers. This support is measured in terms of help in editing and creating business plan, elaborating on idea for a micro-enterprise or developing common financial literacy. In return university students will get practical business experience and an opportunity to lead real-world business projects. Moreover, the whole concept of supporting the poor and working together towards the goal of poverty alleviation is one of the basic principles of Islamic faith. Hence, exchange of knowledge and experience not only enhances social engagement but also serves the common religious goal. University students will also work closely with field managers to support him/her in monitoring activities.

Another important player in the proposed model is the local community or peer-group. In the concerned micro communities, the reputation of the individual is very important and hence borrowers feel more responsible to repay the bills if supported/monitored by the own community.

Optional support:

We consider local NGOs as optional partners because the crowdfunding platform does not expect to receive funds from NGOs or raise charity donations. However, usually global NGOs have enormous knowledge of the affected regions and hence may provide an access to people in need, help in promoting our platform as the new financial alternative or by offering services such as entrepreneurial training and literacy skills. The platform in turn will cooperate in providing relief to the regions in crisis by introducing a new funding instrument.

5.3 Internal market analysis: SWOT

After detailed description of the product (i.e. *musharakah*-based crowdfunding platform), as well as complete analysis of the external forces of the microfinancing market, this chapter concludes the business plan with an internal market analysis of strengths, weaknesses, opportunities and threats (SWOT) of the proposed product.

Strengths

- Expected high repayment rates.
- Crowdfunding as a microfinance instrument has greater ability to attract innovation-seeking and socially responsible investors, whereas Islamic component enhances the importance of social and religious engagement of Muslim funders.
- Continuously growing demand (evaluated at > 6 million people) for micro loans because of the unemployment and massive poverty.
- Large demand for Islamic microfinancing products, which are purely interest free and/or based on PLS concept.
- Equity-based crowdfunding addresses entrepreneurial spirit of Arabic culture and enhances dignity in challenging times

Weaknesses

- Lack of regulatory structure for crowdfunding, which would protect both investors and entrepreneurs
- Difficulties with online money transfer

- Low internet penetration
- Problems in dealing and handling the non-performing loans
- Many potential entrepreneurs lack knowledge regarding such funding opportunities and hence significant effort is required for promoting Islamic crowdfunding to local and international Arabic community
- Shortage of trained staff, experts, financial advisors to present and promote the Islamic microfinance
- Expensive services of Shariah board's certification and monitoring
- Failure to meet the regulations and governmental frameworks
- Illiteracy of customers

Opportunities

- Microfinance initiatives are highly supported by the political elites having an access to the governmental budgets who may become interested in a cooperation
- Funding from larger international organizations for bigger projects
- There is growing demand for small loans or interest free financial products by the general public
- Growing market share for crowdfunding as an alternative financial instrument for microfinancing needs with a very large potential demand from millions of individuals excluded from the conventional financial services.

Threats

- Regulatory changes, legal issues and turbulent business environment
- Frequent economic and political changes, including war conflicts
- Corruption despite the 100% transparency guaranteed by a platform
- Robbery of assets or illegal transfer of funds between members of the local community
- Ineffective or corrupted field managers
- Lack of interest from universities to support and participate on a voluntary basis in the crowdfunding initiative
- High peer-pressure from the community regarding debt repayment, which may eventually lead to business default or even suicides of borrowers. .

6 Conclusion

Growing concerns for the global poverty escalation call for development of alternative financial instrument that would provide access to the capital also for the poorest population of the world. One of the possible alternative ways for enhancing the entrepreneurship among the poor could be built upon principles of Islamic finance.

The precise literature overview of this thesis has shown that main Islamic banking principles include prohibition of interest rates on loans, participation in non-*haram* businesses and highlighted the importance of profit-and-loss sharing contracts. Further analysis of Islamic microfinance and crowdfunding mechanisms justified that PLS contracts could provide an effective base for an equity-based crowdfunding model that would also consider Islamic religious principles. It was also shown that such Islamic microfinance instrument can be very beneficial for poverty alleviation and for increasing entrepreneurship among poorer populations of the world. At the same time, microfinance instruments remain notably underrepresented in MENA and other developing countries where Islam is practiced. Moreover, many Muslims are unaware of the principles of Islamic finance and hence cannot fully comprehend the benefits of micro-lending, crowdfunding, or profit-and-loss contracts for their personal development and general well-being of societies.

The goal of this thesis was to develop and describe a framework of a crowdfunding mechanism built upon the instruments of Islamic microfinance and general Islamic finance principles. According to the literature analysis, the most appropriate instrument for the Islamic crowdfunding platform that supports the poor with micro-loans is *musharakah* contracts, in which lenders and borrowers share the responsibility for the potential profits and losses of the venture.

The empirical elaboration of the model was done in the form of business plan, which first evaluated the potential demand for crowdfunding micro-lending by analyzing refugees' statistics and development trends in Turkey, Lebanon and Jordan. Secondly, an analysis of external environment was conducted, which identified potential competitors and partners. The market analysis together with academic findings have enabled a development of the product – the Shariah compliant crowdfunding model based on *musharakah* contract, which was then precisely described. If implemented and promoted properly, the proposed model will increase the entrepreneurship among refugees and hence in the long term contribute to the alleviation of poverty.

6.1 Future prospects

In scope of the future research an empirical testing of the model proposed in this thesis is required. It will test the potential effectiveness of the model in practice, as well as highlight its weaknesses that will then require further adjustments. Before the launch of the product, a statistical survey testing the demand for crowdfunding models among receivers, as well as interest of funders to invest in such products can be conducted for gathering more information. After the successful testing period and adjustments to the market, the crowdfunding platform can be launched and actively promoted.

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