Islamic crowdfunding: A viable financing model for Omani SMEs?

In Oman, the creation of an entrepreneurial culture has been at the top of the government agenda for more than a decade as a means of stimulating the creation of jobs for nationals and driving private sector growth. Support for SMEs includes a host of initiatives to improve access to finance including soft loans and government loan guarantees. Omani banks have also launched a number of new finance products and facilities for SMEs, both conventional and Shariah compliant, following a Central Bank of Oman (CBO) directive in 2012 to allocate 5% of their outstanding credit to finance SMEs. MANSOOR JAMAL MALIK, senior partner with leading Omani law firm AL BUSAIDY, MANSOOR JAMAL & CO, offers us his insights.

Despite the recent measures, according to a survey of SMEs carried out for a recent Central Bank of Oman (CBO) report , access and time to and the costs of funding ranked as a key challenge. 84% of respondents stated that business loan approval took approximately six months and more than 50% respondents confirmed that they pay interest on such loans in excess of 5%. In addition, 86% of banks surveyed expressed a clear preference for financing existing established businesses or start-ups with government contracts in hand. They ranked early-stage start-ups last in terms of lending preference. According to the report, a staggering 75% of SMEs filled the resulting funding gap from their own savings and/or by borrowing from friends and family. This calls to mind the early roots of crowdfunding in the developed world which began as an online extension of traditional financing by friends and family to fund members with business ideas.

Recognition of this funding gap, especially for early stage start-ups, is generating interest in the development of an alternative SME finance market in Oman. So far discussion has focused on the benefits of developing a venture capital (VC) market to service manufacturing and technology hubs. The report recommends the setting up of VC forums and workshops under the CBO's remit to bring together VC investors and entrepreneurs for this purpose. VC firms typically invest large sums of money in companies with high growth potential operating in competitive sectors in return for an equity stake in the company. The disadvantage of VC for the entrepreneur is that, as well as forfeiting ownership of a part of the business, he/she is often required to grant control rights (seat on the board and voting privileges) and priority ranking on liquidation to the VC investor. For these reasons, VC as an alternative to conventional bank funding, is unlikely to appeal to the majority of Omani start-ups and small businesses.

These hurdles that Omani SMEs experience in accessing finance have much in common with those that hamper small businesses worldwide and that have fuelled the surge in popularity of crowdfunding in recent years. Today, crowdfund investing (CFI) for financial return based on debt and equity models has emerged as a viable alternative to conventional financing as well as donation and pledged-based crowdfunding. Web-based CFI harnesses the power of technology and social networks to tap into a wide investor pool across national boundaries as well as to streamline and centralise the entrepreneur's fund raising endeavours. It has developed into a global, multi-billion dollar industry with around 1250 platforms channelling billions of dollars to businesses, organisations or individuals for seed finance, product development and social causes around the world. Overall crowdfunding volumes have more than doubled annually since 2012 reaching an estimated US$34 billion in 2015 and are set to overtake VC in 2016. The World Bank forecasts the industry to reach $93 billion by 2020 . As it grows in size, CFI is also attracting the interest of and and VC investors since it provides proof of concept and efficiencies in evaluating the investment.

While the US continues to account for almost 50% of expected total industry funding and

82% of growth, Asian markets are predicted to have grown by a phenomenal 210%, eclipsing Europe and Africa markets to become the second largest region by volume at approximately US$10.5billion in 2015. Over the past two years, Islamic crowdfunding has recorded impressive growth in Muslim countries and western financial markets reaching an estimated value of US$25 million globally in 2015 . Crowdfunding platforms have sprung up in Jordan, Egypt, Lebanon and the UAE as well as Malaysia, Singapore, Indonesia, the UK and the US. The fastest-growing model has been equity-based crowdfunding (ECF) with the financial return coming in the form of dividends and/or capital growth for the crowd investor. In 2015, Malaysia alone licensed six ECF platforms for small businesses and entrepreneurs. Islamic scholars have stated that, with the exception of debt-based platforms, crowdfunding is compliant with Islamic finance principles provided that the project funded is itself Shariah compliant. As Islamic finance is by definition geared towards social enterprise and the creation of shared value within society it aligns perfectly with the socially responsible, shared-community ethos of crowdfunding. This synergy has boundless appeal for millions of young, tech-savvy Muslims worldwide and as well as cross-over appeal for non-Muslim investors seeking sustainable ethical investment opportunities.

The success of Islamic crowdfunding is also likely to resonate with a young, social-media engaged, population of Omani entrepreneurs and investors and the penetration. Despite Oman's comparatively late entry to the Islamic finance market in 2013, the public's appetite and enthusiasm for Shariah compliant products and services is evident from the high growth rate of the country's two Islamic banks and six Islamic window operations (65.9 per cent as at the end of September 2015, over the same period in 2014). However, the viability of CFI in Oman, as with any alternative finance model, would depend on the existence of enabling government policies, regulations and legislation. Many of the features of Shariah compliant ECF align with the Oman government's SME financing strategy; improved access for SMEs to financing and the capital markets; valuation of SME businesses; adoption by SMEs of best corporate governance practices. Oman's Capital Markets Authority (CMA) in particular has championed access to the capital markets for small investors and exposure for all market participants to potentially high-growth publically listed companies in terms.

Regulation of ECF in Oman where funding is intended to be raised through a form of public offering would fall mainly under the remit of the CMA. Despite the inevitable challenges involved in gaining acceptance

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and developing a regulatory framework for this innovative alternative financing method, precedents do exist. ECF regulatory regimes pioneered in Australia, Europe and the US, and more recently, Malaysia, provide precedents on ways to strike a balance between access to funds for entrepreneurs and protections for investors. Most amend existing capital market regulations to legalise crowdfunding and to reserve the running of equity crowd-funding portals to licensed financial intermediaries. As well as strict requirements imposed on portal operators, restrictions are included on the type of company, number and type of investor and maximum level of investment. They mandate full product and platform disclosure, due diligence and the monitoring of investments, record keeping and investor education materials. Potentially all of these matters would need to be encompassed by amendments to Oman's Capital Market Law (Royal Decree 80/1998 as amended) so as to facilitate the introduction of ECFs. Crowdfunding as a means of inviting investments from the public, whether in the form of equity or debt for onward funding purposes, would also need to comply with Oman's Banking Law and CBO regulations particularly if the activity could be construed either directly or indirectly as banking business as defined by the Oman Banking Law. Additionally, an amendment to Oman's Commercial Companies Law may also be required so as to permit private limited liability companies, as opposed to public joint stock companies, undertaking crowdfunding privately other than through a public offering or CMA-licensed crowdfunding platforms. Hand-hand with the development of a regulatory framework for CFI, the technical infrastructure for the operation of online portals and management of the investment process would need to be procured and developed in line with best international practices.

In conclusion, the emergence of Shariah compliant ECF as a new Islamic finance investment vehicle and its growing success globally, presents an opportunity for Oman to legislate for its introduction and share in a phenomenon that is re-shaping the entrepreneurial finance landscape around the world.

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