# Islamic Crowd-funding as The Next Financial Innovation in Islamic Finance: Potential and Anticipated Regulation in Indonesia

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*Abstract*— **Crowd-funding is an innovative concept. The online nature and the usually small size of investments of crowd-funding makes it different from private placement or other similar activities. Crowd-funding is still infant industry but growing fast, including Islamic crowd-funding. Islamic crowd-funding is the platform designed to comply with the sharia. Considering as the most populous Muslim in the world, the third largest democracy, and the biggest Muslim nation in the world, with favorable demographics and transition to a middle-income country, Indonesia will mean eventually become the biggest market for Islamic finance. Hence, the coming era of Islamic crowd-funding in Indonesia is also underway. However, there is still lack of awareness and understanding about Islamic crowd-funding including its prospects and challenges. There is also no specific regulation on Islamic crowd-funding yet. In near future, regulation must also be put in place for crowd-funding. Regulator needs to create frameworks that provide sufficient structure and protections while allowing enough space for an orderly and robust market to grow. It is incumbent on Indonesia to ensure the groundwork in its place. Otoritas Jasa Keuangan (OJK) has shown resolve and determination to ensure the requisite infrastructure and regulations needed. Sharia and crowd-funding have similar goal and philosophical foundation. Our paper suggests that crowd-funding and Islamic finance are inherently compatible and mutually reinforcing. Islamic crowd-funding may also help Islamic finance to play more important roles with more significant market share in the Indonesian economy. Our paper also describes possible anticipated regulations for crowd-funding in Indonesia.**

***Keywords- Islamic finance; crowd-funding; financial innovation; Indonesia***

## I. INTRODUCTION

In the last few years, crowd-funding has been a global rising star phenomenon. At home, principles of crowd-funding are similar to Indonesian collective values called "*Gotong-Royong*" – or working together towards a common goal. For Indonesians, the values and tradition of ‘’*gotong royong”* is a legacy from their ancestors, a source of pride and an epitome of long standing traditions. The spirit of collective and mutual sharing and togetherness have been passed on from generations and should be kept alive.

Crowd-funding is an umbrella term describing the collective effort of individuals or organizations who network and pool their money to support a wide variety of activities, to fund the project, a business or personal loan, including startup-company funding, and other needs through an online web-based platform. The online nature and the usually small size of investments of crowd-funding makes this industry different from private placement or other similar activities.

Benefits from crowd funding can be reaped and reverberate when there is greater public understanding of what it stands for. Indonesia has the prerequisites to support crowd funding as the next successful financial innovation in Islamic finance. Building on industries (Islamic Finance, Internet and E-commerce Industry) at the background and with robust national economic growth, the overall growth potential is exponential.

Crowd-funding and Islamic finance are inherently compatible and mutually reinforcing. Considering that Indonesia is the most populous Muslim in the world: this will significantly support Indonesia’s aspiration to become the center of Islamic Finance in the world – when the right policies are developed and implemented.

The Indonesian Financial Services Authority or known as *Otoritas Jasa Keuangan* (OJK), therefore, as regulator, needs to create a framework which provides adequate structure and protection while allowing sufficient space for an orderly and robust market to grow. It is incumbent on Indonesia to ensure the groundwork is in its place. OJK should make use of the remaining time to anticipate the coming era of Islamic crowd-funding.

## II. TOWARDS DEFINING OF ISLAMIC CROWD-FUNDING

### A. *The Nature of Crowd-funding and Parties Involved*

In less than a decade, crowd-funding has spread across the developed world, and is now attracting considerable interest in the developing world as well.

Crowd-funding, or crowd-financing or crowd-capital, is a type of crowd-sourcing. As explained by Estellés-Arolas & González-Ladrón-De-Guevara (2012), crowd sourcing can be defined as:

*“…a type of participative online activity in which an individual, institution, non-profit organization, or company proposes to a group of individuals of varying knowledge, heterogeneity, and number, via a flexible open call, the*

*voluntary undertaking of a task which always entails mutual benefit. The crowd participates in bringing work, money, knowledge and/or experience."*

Therefore, crowd-funding is the application of this concept to the collection of funds through small to medium-size contributions from a crowd in order to finance a particular project or venture, offering small businesses and entrepreneurs a chance at success.

Other definition, according to Massolution (2012), "*Crowd-funding is the practice of developing an online group-based investment campaign to generate financing for a specific project*." This practice leverages dedicated Internet fundraising websites to spur community support and financing for an assortment of ventures, through numerous small dollar investors.

Kirbi and Worner (2014) in IOSCO Working Paper "*Crowd- funding: An Infant Industry Growing Fast"* defines crowd-funding as *"an umbrella term describing the use of small amounts of money, obtained from a large number of individuals or organisations, to fund a project, a business or personal loan, and other needs through an online web-based platform."*

Even though it is a small amount, crowd-funding should not be confused with micro-financing (for example, such as the Grameen Bank style of micro-lending). Micro financing is predominately a bank based exercise, whereby the bank is the sole provider of the loan, is the originator of the loan and bears the risk of the loan. As such, it does not draw on the principles of many investors funding small parts of a required capital need.

There are two main categories of crowd-funding, according to World Bank (2013) and IOSCO (2014): (1) Donation crowd-funding or Community crowd-funding, (2) Crowd-fund investing (CFI) or Financial Return (FR) crowd-funding. The main difference between these forms of crowd-funding based on its financial return where Community crowd-funding primary objective is to gain a non-financial reward, thus, do not provide any return in the form of a yield or return on investment. This Donation or Community are usually used for campaigns that appeal to funders' personal beliefs and passions.

Further, according to World Bank (2013), five business models currently are practiced within these two broad categories, and crowd-funding platforms typically are organized around one of the five models: (1) Donation-based, (2) Reward-based, (3) Equity-based, (4) Lending-based (peer to peer lending) and (5) Royalty-based.

The first two business models are under "Donation" or "Community" category, while the last three business models are within "CFI" or "FR" category. However, IOSCO (2014) and Massolution (2012) only define four models which do not include royalty-based model.

In donation-based crowd-funding, funders donate to causes that they want to support, with no expected compensation while in reward-based crowd-funding, the funders' primary objective for funding is to gain a non-financial reward. In equity-based crowd-funding, funders receive compensation in the form of fundraiser's equity-based or revenue, or profit-share arrangements. Whereas in lending-based or peer to peer lending crowd-funding, funders receive fixed periodic income and expect repayment of the original principal investment.

Ordanini, Miceli, Pizzetti, and Parasuraman, (2011) described that crowd-funding shares some characteristics with traditional resource-pooling and social-networking phenomena, but has a novel and defining characteristic: it involves consumers who act as investors, providing monetary support to others' proposals and expecting some payoffs, either monetary or non-monetary. Thus, instead of traditional investors, the general public funds crowd-funding campaigns.

Crowd Fund Investing (CFI) is the newest asset class in private capital markets. It fills a void left between microfinance and professional/institutional investors, in that it is capable of providing larger amounts of capital to start-ups and small businesses. It extends some of the social mechanics of microfinance to help fund high-growth start-ups, frequently in the technology sector, or to provide expansion capital to existing businesses.

Successful service businesses that organize crowd-funding and act as intermediaries are increasing worldwide, as banks have augmented interest rates or pulled back from lending to consumers and small businesses. Interestingly, lending supplied by a crowd has lower interest rates than those offered at large retail banks or by credit cards. For lenders, the platforms are viewed as investment opportunities, yielding them more than bank deposit accounts.

To sum up, crowd-funding is very much a collaborative endeavor linking investor, entrepreneur and platform as agents. It creates a social economy with a focus on building ideas.

Therefore, there are three primary parties in the crowd-funding model: (1) Creator, (2) Lender/Investor, and (3) Platforms. The first participant in the market is the "Creator" (entrepreneurs, artists, business owners and others who initiate projects). These individuals have an idea and are looking for financial and non-financial support to commercialize it. The second parties is the "Investors/lenders" – funders, pre-buyers, donors and contributors – representing the next participant. These individuals believe in the strategic value proposition being offered and lend their support to get the venture off the ground. The last is "Platforms" which are the online community that links investors with entrepreneurs. One may think of platforms as the matchmaker in the crowd-funding world.

### *B. Benefits and Risks of Crowd-Funding*

Crowd-funding has the potential to play several important roles in the developing world's entrepreneurial and venture finance ecosystem. Crowd-funding is perceived to contribute to economic growth through the creation of new and increasing flows of credit to SMEs and other users in the real economy.

Crowd-funding may offer many benefits including: (a) Crowds often spur diversity of thoughts and ideas, (b) Crowds materialize "collaboration" and "co-creation" , (c) Crowds have strong ties to innovation and breakthroughs, (d) Crowds provide cheaper access to capital, (e) It help fill the gap left by the banks, (f) It offers convenience, and (e) Geographical boundaries are removed.

On the other side, there are also a number of risks which are currently surrounds business model. As awareness of crowd-funding increases, questions pertaining viability and future of the business model will be under the spotlight. These risks include: (a) Platform risk, (b) Risk of default, (c) Risk of fraud, (d) Information asymmetry and quality, (e) Risk of investor experience, (f) Liquidity Risk, (g) Tax treatment in global e-commerce environment, and (h) Risk of cyber attack. The template is used to format your paper and style the text. All margins, column widths, line spaces, and text fonts are prescribed; please do not alter them. You may note peculiarities. For example, the head margin in this template measures proportionately more than is customary. This measurement and others are deliberate, using specifications that anticipate your paper as one part of the entire proceedings, and not as an independent document. Please do not revise any of the current designations.

### C. *Definition of Islamic Crowd-funding*

Islamic finance is perceived as value oriented, where it should meet *maqosid* (purposes or goals) of sharia. *Maqoshid* is to accomplish *maslahah* (benefit). These are the preservation of (1) religion, (2) life, (3) lineage, (4) intellect, and (5) property. Islamic finance is constructed through concept such as “equity”, “justice”, “human dignity”, “freedom of enterprise”, and “moderation”, with the ultimate objectives of utilizing economic and financial resources to satisfy the material and social needs of all members of the community.

Islamic finance and crowd-funding are inherently compatible and mutually reinforcing. Islamic Finance, ideally, is a way of financing based on sharia principles that are ethical and adheres to socially responsible standards, which should ensure fair distribution of benefits and obligations between all the parties in any financial transaction.

On the other side, crowd-funding also embodies these characteristics and provides ground for novel developments in the field. Islamic finance and crowd-funding both conceptualize costumers as investors and can potentially provide investment opportunities with higher returns. In addition, they both place a strong emphasis on transparency, mutual involvement, and trust. Sharia and crowd-funding have similar goal and philosophical foundation, which are aimed to build communities, encourage risk sharing, democratize wealth, and channel capital to real economic activity.

Consequently, we can define Islamic crowd-funding as the platform designed to comply with sharia principles. Islamic crowd-funding is further described as the use of small amounts of money, obtained from a large number of individuals or organizations, to fund a project, a business or personal loan, and other needs through an online web-based platform in accordance with sharia principles.

There seems to be some basic features distinguishing Islamic crowd-funding from conventional one, which relate to: (1) investing only in halal projects, (2) the absence of interest rate, prohibition of gambling and speculation (*riba*, *maysir*, and *gharar*), (3) existence of sharia supervisory boards. In Indonesia, sharia compliance can be in form of existence of a sharia supervisory board or a sharia opinion as formal certification process. Islamic financial institutions will have sharia board, while sukuk issuance will only require sharia opinion.

For Islamic crowd-funding, there is a formal certification process to ensure sharia compliance of platforms. Further, similar to Islamic banks, Sharia Supervisory Boards may also present as a part of its governance. Islamic banks employ scholars of Islamic law in a consultancy and advisory capacity to examine the Sharia-compliance of their contracts and transactions. According to El-Gamal (2006), this sharia certification is actually the most obvious distinguishing feature of Islamic finance. It is envisioned, however, that when Islamic financial products become standardized, the role of these boards is reduced substantially.

### D. *Islamic Crowd-funding as the Next Financial Innovation*

Islamic crowd-funding can potentially become the next financial innovation in Islamic finance industry. Islamic crowd-funding will manifest itself into five business models: (1) *Zakat*-based, (2) *Infaq-Shadaqah-Waqf*-based, (3) *Qard-al-hasan*-based, (4) *Syirkah*-based (*Mudharabah* and *Musyarakah*) and (5) Lending-based (*Murabaha*, *Ijarah*, *Istishna*, etc)

As Islamic financial services industry, especially the banking sector, has successfully designed interest-free alternatives to debt-based financing for Small and Medium Enterprises (SMEs) (typically based on Islamic trade instruments), Islamic equity financing for this SMEsremains elusive. Islamic crowd-funding offers a transparent, cooperative, and cost effective way for Sharia-compliant equity financing. As for lending based model, crowd funding essentially transforms what was previously “off-line” into “on-line” financing.

Equity-based crowd funding brings some advantages from Islamic finance perspective, which include: (a) it is based on profit and loss sharing, as characterized in original form of Islamic finance, (b) it provides access to capital to wide range of entrepreneurs, (c) it opens avenues for new asset classes for small and medium-sized investors, (d) it minimizes risk through the split of limited capital across multiple start-ups, (e) it promotes innovation, preserves local talents, generates job creation, and also (g) supports growth of ventures and possible future Initial Public Offerings (IPOs) in many sectors.

In many ways, crowd-funding resembles the economic relationships in pre-modern Islamic countries as trust becomes a precondition for longstanding business relationships. Merchants would often send their agents to sell their goods in distantly located markets, occasionally for little to no profits. Agents would venture out into markets and sell the products, returning with the profits earned, to be given to the merchants. To sustain and maintain this relationship trust was crucial.

Anyone who broke the trust would be excluded from the community.

Similarly, crowd-funding relies on trust. Nevertheless crowd-funding, where it is still mostly unregulated, is risky as the donors/investors may not have full information of the originators. But the Internet has created online communities that brings together people from around the world. Overseeing each member of a platform is a challenge and may not be possible, but platform operators are well aware that any desired impact will not be attained if the originator fails to bring the pitched idea to fruition. It is upon the platform to ensure that the originator is honest and hardworking. The originator in search for fund is also aware that in order to receive funding, the idea has to be original and well thought out.

Crowd-funding brings about the social aspects of finance as it draws individuals together to essentially evaluate the importance of an idea and its impact to society. Donors, by donating, are not buying a product they need or to enhance their lives, they are donating because they believe in its value. This is value maximization and not profit maximization. This is where the masses know what they want and are not swayed by the insinuations of advertising and excessive investments. This is a value driven, bottom up model. And we are only seeing the beginnings of its potential.

Based on Alonso (2013), there are over 450 crowd-funding platforms in the world, some of which are sharia compliant based. Shekra.com and Yomken.com, both based in Cairo, Egypt, were considered as first compliant online funding services in the world. Shekra is an example of equity-based crowd-funding, and Yomken, of micro finance product-based crowd-funding, which could be considered a type of reward-based crowdfunding.

There was also a recently launched Peer to Peer (P2P) lending site based on sharia compliant principles, first introduced in the Middle East region, Liwwa.com. It was an Amman, Jordan based site, Liwwa gives a way to allow people in the region to invest in small businesses belonging to their friends and peers. Unlike other microfunding sites, however, Liwwa is not limited -nor branded- as a service catering to low-income populations exclusively. Other sharia-friendly crowd funding sites in western world are Halalfunder.com and UmmahHub.com. The first mentioned is United Kingdom (UK)-based site, while the second is the platform for Muslim projects and based in Canada.

The Islamic crowd-funding platforms are typically independent. However, we may well see the next generation of Islamic financial institutions introducing elements of crowd-fund investing to their own customers. Some Islamic financial institutions already had similar crowd-fund investment modalities, but without online or P2P platform.

As a final note, Islamic crowd-funding is not exclusive in offering benefits and immune to risks as those of conventional crowd-funding.

## III. Background of The Industry in Indonesia

### A. *Islamic Finance*

Define abbreviations and acronyms the first time they are used in the text, even after they have been defined in the abstract. Do not use abbreviations in the title or heads unless they are unavoidable. As the forth most populous country, the third largest democracy, and the biggest Muslim nation in the world, with favorable demographics and transition to a middle-income country, Indonesia will eventually become the biggest market for Islamic finance.

In the near future, Indonesia is expected to be a leading model of development for Islamic finance in the world. Indonesia is looking to Islamic finance as it is expected to play more significant role in the economy. Islamic finance increasingly stimulates economic growth to a higher level, reduces poverty, and enhances the stability of the financial system. Indonesia is also considered as a leading model of democracy for the Islamic world. Indonesia represents, because of its size and importance, a massive and even more relevant proof that democracy can work as well in Muslim societies as in others.

Indonesia’s Islamic finance sector is characterized by growing economy. Economic growth in Indonesia has averaged about 6% for the last five years. The growth of Islamic finance industry has been outpacing growth of conventional financing for over the last 10 years. With the unbanked accounting for more than half of the population, the potential for growth is still immense. The sector is expected to continue its growth at a double-digit level for the next five years.

However, due to a late start in establishing Islamic finance, which just began in Indonesia in early ‘90s, the industry remains in a nascent stage. The national share of Islamic finance sector is still around 5% or less. The share has only less than 2% of global Islamic finance asset. With such high expectation and potentials it is unfortunate that Islamic finance industry makes up less than 5 percent of the total asset of the industry. Something is not quite right.

The new administration sparks hopes for further development of Islamic finance industry. President Jokowi is known as a reform-minded leader, while Jusuf Kalla had demonstrated an experience to provide great opportunities to promote Islamic finance industry under his administration. As vice president from 2004-2009, Kalla succeeded in driving the enactment of Sovereign *Sukuk* Law Number 19 of 2008. For broader economic reform at that time, Kalla was also among prominent figures in converting the use of firewood and kerosene into gas.

The Financial Service Authorities (FSA) or *Otoritas Jasa Keuangan* (OJK) is now preparing a new blueprint to expand Islamic finance in the country. The new blueprint may include additional benefits to current fee and tax incentives to revive the domestic *sukuk* market. The document will also address issues in Islamic finance including lack of economies of scale, consolidation of opportunities, and the role of foreign ownership. Therefore, a combination of hope that new leadership and administration brings, together with OJK's new blueprint, it is envisioned that the sector will be empowered with much-needed catalyst.

The development of Islamic Finance industry in Indonesia until 2014 indicates that the new administration has no significant effect yet for the industry to transform. This analysis captures progresses of the industry up to 2014 and the outlook of the industry. Sharia banking continues to be the largest contributor to the sector. Strong growth in the past five years has been propelled by the Sharia Banking Law introduced in July 2008. Besides banking, the Islamic Finance sector in Indonesia is building insurance (*takaful*) and capital market (*sukuk* and managed funds), that continue to catch-up and develop.

### *B. Internet*

Those who might wonder about the future of the Internet need to look no further than Indonesia. Like many countries, Indonesia has swiftly entered into the universe of global digital communications. The Internet sector in Indonesia is now in a rapid growth phase. According to Ambardi K., et.al (2013), in Mapping Digital Media: Indonesia, reported that ownership of household personal computers (PCs) trebled between 2005 and 2010, which was recorded to be the highest increase in electronic device ownership (compared to TV-set and Radio-set). Mobile or cellular phone penetration has increased even more than 100 percent, to 115 mobile phone subscriptions per 100 inhabitants.

TABLE I. PC OWNERSHIP, INTERNET AND MOBILE PENETRATION RATE (2009-2012)

| | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|
| PC | 10.2 | 10.8 | 12.0 | 15.0 |
| Internet | 1 | 19 | 22 | 32 |
| Mobile phone | 69 | 88 | 102 | 115 |

Source: Open Society Foundation, 2014

The Country Report further explained that the number of internet users reached 55 million in 2012, accounting for some 32 percent of the total population, which was still lower than the South-East Asian region (for example, Malaysia's Internet penetration rate was close to 66 percent in 2012, while in Singapore was 74 percent in the same year). This figure is lower than the actual subscription rate, which indicates that there are more connected devices than actual users. It is very likely that Internet users have their own choice of devices to access the Internet now that the communications industry has opened up this possibility. Internet-capable mobile phones are more frequently used by Indonesian users. As is so often the case today among newly-connected countries, the primary means of communicating online in Indonesia is mobile devices—many Indonesians carry two of them—making the country's citizens highly wired and fully engaged. The active mobile broadband subscription rate per 100 inhabitants stood at 32 in 2012, according to data from the International Telecommunications Union (ITU).

In 2011, Eric Schmidt, CEO of Google, commented about Indonesia tech boom, "You have 180 million cell phones, but did you know that you have only about 18 percent Internet penetration? You're going to have an Internet explosion." Indonesia is quickly becoming the "social media capital of the world." Furthermore, the nation's capital, Jakarta, is said to be the most active Twitter city in the world while Indonesia is the fifth largest twitter nation with around 29 million users. Indonesia now also has the fourth largest number of Facebook users with total users at around 49 million (or 20 percent of population). Indonesia is also the fourth largest Blackberry users with around 7 million users. Indonesia also has Kaskus as the largest community forum with over 4 million users.

Consensus forecasts that the number of Internet users will grow from 55 million in 2012 to 125 million in 2015. In sum, the growth rate in Indonesia will exceed 30% per annum for the next three years.

Both demand side and supply side drive the accelerating and sustaining growth. On the demand side, the fundamental element is the robust economic growth which is consistent at around 6% per year with personal spending levels which are currently rising by over 10% per year. Therefore, the middle class in Indonesia is growing rapidly, bringing with it strong demand for technology devices and online services. On the supply side, intense competition between the mobile companies is pushing prices down and also raising consumer awareness through mass market advertising campaigns. The government is also planning to increase Internet penetration to the country's easternmost islands.

According to the report from Citizen Lab (2014), The Ministry of Communication and Information Technology, recognizing the importance of high-speed Internet to economic and social development, launched the Indonesia Connected program to boost connectivity in border and remote areas. The fiber-optic Palapa Ring network is being implemented throughout Indonesia to accommodate this growth.

Not only is the user base growing rapidly, the profile of the typical Internet user is changing too. Within the user base, a big shift in the age of users is currently underway. Traditionally the Internet base in Indonesia has been dominated by the under-25s, leading to music, entertainment and social media being the most popular uses. Starting in 2011 the 25-50 age groups begin to play catch-up, and has grown so quickly over the past two years that the user base is now relatively evenly spread across all age groups. This has led to the rapid expansion of more lucrative online services such as e-commerce, travel services and online banking. The vast majority will access the Internet via their smartphone or tablet.

### *C. E-Commerce*

Based on Accenture Internet Business Framework, the Internet elements capture four categories: access, publish, interact, and transact categories. Publish, interact and transact are the phases in e-commerce that encompass a value chain of players from buyers to sellers.

Online business or as it is more known as electronic commerce (e-commerce) is one of many results which are produced from the massive growth of Internet usage. E-commerce is a type of transaction of goods or services that are conducted with the media of Internet. The growing of Internet usage itself directly influences people to use e-commerce websites as their media to perform transactions, to sell or buy anything they want. There are also several reasons of the increasing popularity of e-commerce, they are: Easiness/Simplicity, Unlimited Verities, Easy Comparing, and Competitive Price/Negotiable Price. It is open to any one, whether individual, groups, or organizations. The transaction of goods and services must be ordered through Internet, but the payment and delivery may be facilitated by internet (online) or not (offline).

According to Luthfihadi M. & Dhewanto, W. (2013), E-commerce can be categorized into 4 (four) types as shown in Table (2) below:

TABLE II. E-COMMERCE TYPES

| Type | Definition |
|---|---|
| Business to Consumer (B2C) | Enterprises provide the commodities or services in internet directly and offer sufficient information and convenient interface to attract consumers to buy online in order to eliminate channel intermediaries. |
| Consumer to Consumer (C2C) | Website's operator is not responsible for the logistics. They only help in gathering information and establishing credit-rating systems. The eBay is a good example of C2C platform. |
| Consumer to Business (C2B) | Consumers come as groups categorized by topics and needs. Facilitated by group negotiations bodies and demand aggregators, they can play a leading role for the products. |
| Business to Business (B2B) | By using EDI (Electronic Data Interchange), commerce among businesses can be conducted over the internet to integrate supply chain and logistics to reduce costs and promote efficiency in internet environment. |

E-commerce is developing in Indonesia, albeit slowly. Credit card use is increasing sharply, secure payment networks are being built, and stronger regulations are being put in place. In 2011, the Indonesian government enacted non-bank money transfer regulations, which stipulates that any online transaction should go through a licensed bank or company. Bank Central Asia (BCA) has launched an innovative online payments platform by leveraging its ATM network. This has popularized the notion of Klik-BCA –customers can use a disposable OTP (one time password) to buy goods or pay bills online with one easy click. At the same time, innovative Indonesian companies are finding clever ways to do e-commerce.

Current reported e-Commerce transaction values are growing fast but absolute values are still low.

According to survey by Veritrans and Daily Social (2012), the size of Indonesian e-Commerce market in 2011 was estimated at USD 0.9 billion, which stood at only 0.7% of total retail sales (USD 134 billion). E-commerce penetration was assumed at 8% while e-commerce buyers was estimated at 4.4 million users. Furthermore, majority of online shoppers spend up to Rp. 500,000 (US$ 55) per transaction and average annual e-Commerce spending per user is around USD 256.

On payment method, the survey found that Bank transfer is the most widely used method of payment for e-Commerce. Online payment solutions are fragmented and therefore still not widely used. e-Wallet solutions also account for very small portion.

More from the survey, fashion goods are the most popular things bought, followed by online travel bookings. Half of online shoppers uses Facebook or Kaskus to buy goods. This implies that Facebook and Twitter are heavily used and present great opportunities to reach potential e-Commerce customers. Many Indonesian entrepreneurs and businesses are connecting online through online advertising and social commerce to reap profit from these activities

The market size of Indonesian e-Commerce in 2015 is expected to increase exponentially to USD 10 billion in 2015 considering the support of robust economic growth, stronger purchasing power, and higher credit card usage. In addition, better infrastructure, better products and services, and better payment system at the same time will push explosive growth of e-Commerce in Indonesia.

Law No. 11 of 2008 on Electronic Information and Transactions (EIT) was adopted on 21 April 2008. It is the first cyber law in Indonesia and constitutes the main instrument regulating online content and transaction.

## IV. POTENTIAL, CHALLENGES, AND CASES

### A. *Potential*

Everything is in Indonesia. Many institutions made “bullish” forecasts on Indonesia. McKinsey and Citi Investment predicted that in 2030 Indonesia will be 7$^{th}$ largest economy in the world, while Standard Chartered forecasted more aggressively that Indonesia will be 5$^{th}$ largest. Robust economic growth, with so called demographic advantage”, for the next 15 years ahead, will place Indonesia to a very powerful economic force in the world.

This will push further the prospect for all related industries supporting sharia crowd-funding business. Islamic finance will continue to grow with bigger and more significant market share, at the same time with higher penetration rate of internet and bigger size of e-commerce industry.

We also should not leave behind the fact that Indonesia is the most populous Muslim in the world. Indonesia is even bigger than total 5 counties in North Africa and also slightly bigger than total 16 countries of Middle East. This will support, if policy is rightly taken and developed, Indonesia to become the center of Islamic Finance in the world.

### B. *Challanges*

There are at least three major issues that need to be addressed: (1) trust, (2) quality of projects presentation, and (3) improper project campaign.

First and foremost is trust. A lot of Indonesians still have yet to trust the Internet for e-commerce or to facilitate financial transactions. Even for those who are comfortable with online transaction, trusting a total stranger with executing a project is another problem compounding the issue. The presentation of projects in Indonesia's crowd-funding platforms is also another hurdle faced by the industry.

We believe that many project owners have not tried their best to present how interesting their projects are. A lot of projects are still presented with minimal effort. Project owners often just post a description and a cover image for their projects. Lastly, campaigning on projects have not always been conducted properly by many project owners. Many project owners seem to think that tweeting once or twice about their project will set things rolling. A crowd-funding platform, to get funded, of course need to gather the crowd first.

Other challenges that also seem to be solved include: (1) payment method, and (2) regulation support to develop ecosystem.

We believe that more education to the market about crowd-funding will solve above mentioned challenges and issues.

The crowd-funding industry can catch up with the whole startup industry in Indonesia soon. It has been a proven working alternative to fund projects in some developed countries. Many believe, when crowd-funding has gained its foothold, it can provide Indonesia with a more vibrant startup.

### C. *Cases in Indonesia*

There are some crowd-funding portals in Indonesia that mostly donation-based. Wujudkan.com, Patungan.net, and also kitabisa.co.id. Until this paper is written, Islamic crowd-funding has not been launched.

There have been a number of phenomenal cases in Indonesia. These cases have attracted the interest of regulators in anticipating future development and regulation of crowd funding in Indonesia. At the same time, the size of crowd-funding is relatively still very small in Indonesia.

*1) Crowd-funding for movie-making :* There was some major headlines at Indonesia's crowd-funding scene. At the top of the list is the successful funding for "Atambua 39º Celcius", a movie directed by renowned Indonesian writer and director Mira Lesmana. Posted in Indonesian crowd-funding site Wujudkan.com, the project collected more than the Rp 300 million (approximately $31,071) that it needed. Another movie that was successfully funded by the public in 2012 was "Demi Ucok". The movie, which screened in Indonesian cinemas in January 2013, gathered about Rp 250 million also after seven months of self-organized crowd-funding.

*2) Yusuf Mansur case:* Yusuf Mansur, the well-known Islamic religious public figure, with its famous campaign of "power of giving", recently pulled on a string of attention after making an investment worth of Rp 500 billion (around US$49,77 million). However, the investment scheme is yet to be approved. Yusuf Mansur did not collect the crowd-money through the web platform – worth noting. On his official website, Yusuf promised that the investment will manifest in various business outlets like hotels at Soekarno-Hatta airport. Investors will have 8 percent profit and cashback in a 10-year period. His investments include hotel and apartment, Kazahkstan's oilrig, private TV station, 4.7 hectares of land, paddy fields in Sukabumi, and also 2 banks.

## V. Anticipated Regulation and Policy Recommendation

### A. *Current Regulation Implication*

The regulatory implications arise under Indonesian law in relation to the development of an online platform for peer to peer (P2P) crowd-funding in Indonesia. The relevant and prevailing laws on Islamic crowd-funding in Indonesia are as follows:

1) *The Indonesian Civil Code, Kitab Undang Undang Hukum Perdata Law*
2) *No. 7 of 1992 on Banking, as amended by Law No. 10 of 1998*
3) *Law No. 23 of 1999 on Bank of Indonesia, as amended by Law No. 3 of 2004 and Government Regulation in Lieu of Law No. 2 of 2008, as ratified into law by Law No. 6 of 2009*
4) *Law No. 21 of 2008 on Sharia Banking*
5) *Law No. 8 of 1995 on the Capital Markets*
6) *Law No. 8 of 2010 on the Prevention and Eradication of Money Laundering*
7) *Law No. 23 of 2006 on Population Administration as amended by Law No. 24 of 2013*
8) *Law No. 25 of 2007 on Investment*
9) *Law No. 40 of 2007 on Limited Liability Company*
10) *Law No. 11 of 2008 on Electronic Information and Transactions*
11) *Law No. 25 of 2009 on Public Services*
12) *Law No. 7 of 2011 on Currency*
13) *Law No. 21 of 2011 on Financial Services Authority*
14) *Law No. 7 of 2012 on Cooperatives*
15) *Law No. 9 of 2013 on Prevention of Financing of Terrorism Criminal Action*
16) *Law No.20 of 2008 on Micro, Small, and Medium Enterprises*
17) *Law. No. 3 of 2006 on Religious Court*

The related regulations on Islamic crowd-funding in Indonesia are as follows:

1) *Government Regulation No. 82 of 2012 on Electronic System and Transaction Providers*

2) *Bapepam-LK Regulation No. IX.A.13 Kep-181/BL/2009, on General Guidance on Issuance of Sharia Instruments*
3) *Bank Indonesia Regulation No. 7/6/PBI/2005 on Transparency in Bank Product Information and Use of Customer Personal Data*
4) *Bank of Indonesia Regulation No. 14/21/PBI/2012 on Reporting of Foreign Exchange Activities*
5) *Bank of Indonesia Regulation No. 14/27/PBI/2012 on Implementation of Anti-Money Laundering and Countering Financial of Terrorism for Commercial Banks*
6) *Bank of Indonesia Regulation No. 9/19/PBI/2007 on Fund Mobilization and Financing Agreements for Banks Conducting Business Based on Sharia Principles*
7) *Bank of Indonesia Circular No. 15/7/DInt 2013 on the Reporting of Foreign Exchange Activities for Offshore Loan Plans, Changes in Offshore Loan Plans, and Financial Information;*
8) *Bank of Indonesia Circular No. 15/6/DInt 2013 on the Reporting of Foreign Exchange Activities for the Realization and Position of Offshore Loans;*
9) *Presidential Regulation No. 39 of 2014 on Business Sectors that are Closed or Partially Open to Foreign Investment*
10) *Ministry of Finance Decree No. 279/KMK.01/1991 on Implementing Regulations for Offshore Loans and Bank Guarantee Issuance for Offshore Loans by Foreign Exchange Banks*
11) *Ministry of Finance Decree No. 84/PMK.012/2006 on Finance Companies*
12) *Presidential Regulation No. 9 of 2009 on Consumer Finance Institutions;*
13) *Minister of Cooperatives Regulation No. 19/Per/M.KUKM/XI/2008 on Implementing Regulations for Savings and Loan Businesses; and*
14) *Transaction Reports and Analysis Centre Regulation No. PER09/1.02.2/PPATK/09/12 on Suspicious and Cash Transaction Report Procedure; and*
15) *OJK Regulation No.31 of 2014 on Agreements in Sharia Financing*
16) *OJK Regulation No.37 of 2014 on Collective Investment Contracts*

### B. *Scope of Legal Analysis*

Based on above mentioned relevant laws and regulations, the analysis therefore classifies 2 major subjects i.e (1) Lending Business in Indonesia, and (2) Platform Business in Indonesia.

Islamic crowd funding is created to allow small and medium enterprises and individuals to access funding which may not be available otherwise through other channels.

Regulatory framework therefore have to ensure that a minimum extent of due diligence is performed to protect both lenders/investors and borrowers while allowing the platform to remain flexible and easily accessible. The purpose of the analysis is therefore to provide overview of how existing regulatory framework may apply under schemes proposed.

TABLE III. SUBJECTS OF LEGAL ANALYSIS

| Type | Definition |
|---|---|
| (1) Lending & Investment Business in Indonesia | a. Licensing Requirements for a Lending & Investment Business<br>b. Loans, Lending, and Investment Business Under Indonesian Capital Market Laws and Regulation<br>c. Reporting Obligations (Offshore and KWC)<br>d. Restriction on Rupiah Conversion, and Associated Reporting Obligations<br>e. Agreement (Aqad) and Shariah Compliance<br>f. Dispute Settlement |
| (2) Platform Business in Indonesia | a. Electronic Transaction Provider for Public Services<br>b. Electronic Loan/Investment Agreements: Implications Under EIT Law<br>c. Know Your Customer (KWC) Exercise<br>d. Data Protection<br>e. Foreign Ownership<br>f. Language Law Compliance<br>g. Currency Law Compliance |

Source: Digi, 2014

### C. *Policy Recommendations*

According to Kirbi and Worner (2014), in general there are five regulatory regimes for peer-to-peer lending:

1) *Exempt or unregulated through lack of definition :* Some countries have not regulated this sector due to a lack of definition regarding the service provided to the investors and consider the market too small for regulation (Tunisia and the UK).

2) *Regulated as an intermediary:* This classification usually requires the registration of the platform as an intermediary. The obligations and requirements for intermediaries vary according to the jurisdiction.

3) *Regulated as banking:* Due to their credit intermediation function, platforms are therefore regulated as banks. As such, the platforms must obtain a banking licence; fulfil disclosure requirements and other such regulations. In jurisdictions that require bank-like regulation, the industry is comparatively small (e.g. Germany and France).

4) *The US model:* The US regulatory regime, in summary, is structured as follows. At the Federal level, each platform is required to be registered with the SEC. One level below the federal requirements is state regulation. Some states outright ban the practice of peer-to-peer lending and equity crowd-funding (e.g. Texas).

5) *Prohibited:* Some jurisdictions ban the practice of peer-to-peer lending.

There is other form of regulation anyway. Another possible form of regulation that could be implemented is the regulation of peer-to- peer lending as a collective investment contracts (CIC) or *Kontrak Investasi Kolektif* (KIK) in Indonesia. KIK is managed under fund manager. Though this regulation does not seem to exist, some peer-to-peer lending business models do seem to act as a CIS. This can potentially qualify as a collective investment scheme for the purpose of regulation.

Other possible form in Indonesia is to put P2P crowd-funding as part of sharia banking service. It is already well-regulated. However, Financial Services Authority or *Otoritas Jasa Keuangan (OJK)* needs to make use of remaining time available to perform more comprehensive analysis, as crowd-funding is still at its infancy and its sharia-based scheme is still awaiting to be launched.

## VI. CONCLUSION

The definition of Islamic crowd-funding is outlined in this paper as the platform designed to comply with the sharia principles. Islamic crowd-funding will describe the use of small amounts of money, obtained from a large number of individuals or organizations, to fund a project, a business or personal loan, and other needs through an online web-based platform in accordance with sharia principles.

Islamic crowd-funding, are still in the beginning of its development. There are not more than 10 platforms of Islamic crowd-funding in the world. Even more, Indonesia still awaits for the first launch of this Islamic crowd-funding.

There is growing anticipation in Indonesia as the conventional crowd-funding have experienced exceptional growth since 2010. Although crowd-funding in Muslim markets is relatively still new, but the rate at which new platforms are being launched suggests that a fundamental shift is underway. Indonesia also has witnessed examples and cases which can be considered as initial crowd-funding and with similarities to Islamic crowd-funding.

Policymakers and regulators should focus on the growth of this segment which has the potential to develop into a credible investment option for sophisticated and retail investors alike.

There are a number of benefits as well as risk associated with crowd-funding. Benefits need to be balanced with the risks posed by these innovative industries. There are still some questions on the future of the industry, both in terms of how the benefits of this type of market-based finance can be best directed to the real economy, and how the risks of this infant industry can be controlled.

Although regulatory regimes vary across jurisdictions, broadly speaking they can be classified into four regimes for regulating crowd-funding: exempt market/unregulated due to lack of definition; regulated as an intermediary; regulated as a bank; and the US model, with a possibility of a fifth regime: regulating as a collective investment scheme.

Other possible form in Indonesia is to place P2P crowd-funding as part of sharia banking service. It is already well-regulated.

Financial Services Authority (*Otoritas Jasa Keuangan*), as regulator, can continue to maintain research focus on this topic. This would aid regulator in monitoring the development of the industry. Much of the impact factor assessment is qualitative in nature and further research towards developing indicators for those areas lacking hard data; as such the development of quantitative indicators, can also help with this assessment, as crowd-funding is still infant and sharia crowd-funding remains un-launched.

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