Exploring the 'Normal Investor' in Islamic Finance: A Behavioural Finance Approach to Mudharabah-Based Crowdfunding.

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DOI: https://dx.doi.org/10.47772/IJRISS.2025.910000687

Received: 28 October 2025; Accepted: 07 November 2025; Published: 21 November 2025

ABSTRACT

This paper aims to evaluate the expectations of potential investors in *Mudharabah*-based crowdfunding. It is a qualitative study involving semi-structured interviews with potential capital providers or *rabb al-mal* about the possibility of implementing *Mudharabah*-based crowdfunding in Malaysia. The data are analyzed using thematic analysis. The results show that potential capital providers in *Mudharabah*-based crowdfunding are willing to invest if the investment platform is regulated. Despite the higher risk of losing the invested capital due to conditions in the *Mudharabah* contract, as long as both parties, *mudharib* and *rabb al-mal*, agree, Mudharabah-based crowdfunding could become a reality. Additionally, as typical investors, capital providers are believed to know and are expected to make the best investment decisions. However, even a smart investor can make mistakes due to cognitive biases, like believing the future will be as easy as the past. The study is limited because it focuses only on Malaysia, especially since Equity Crowdfunding (ECF) is still a new industry. Also, the number of interviewees is small because of convenience sampling. Nonetheless, the findings may still be valuable as this study is exploratory. Positive feedback from respondents can encourage regulators to take more serious actions to develop regulations for Mudharabah-based crowdfunding. Moreover, this funding option could be an alternative way for small and medium enterprises (SMEs) to raise the capital needed for growth. *Mudharabah*-based crowdfunding could potentially benefit SMEs and promote the brotherhood concept as outlined in the Shariah objectives in finance. While many studies focus on regulators, Shariah experts, and business owners, this research gathers insights from capital providers. It also highlights the challenges faced by these providers in *Mudharabah*-based crowdfunding.

Keywords: Islamic crowdfunding, *Mudharabah*-based crowdfunding, Rabb al-mal, Behavioural Finance theory, Malaysia

INTRODUCTION

Malaysia and crowdfunding were still in infancy; however, about RM199 million has been raised in the last five years through equity crowdfunding (ECF) (Serendeko, 2021). It shows that ECF was developed and accepted as an alternative to the current financing facilities in Malaysia. Even though the numbers do not distinguish between Shariah-compliant and non-Shariah-compliant crowdfunding, the positive impact of crowdfunding appears to have been realised among investors.

Based on Business News Daily (2021), European Commission (2022), and several other websites, ECF can be referred to as crowdfunding campaigns that allow backers to own a portion of the supporting company. The investors are entitled to receive the return for the investments, like shares or venture capital investments. In contrast, Salizatul Aizah et al. (2018) stated that Islamic ECF might utilise *Mudharabah* or *Musharakah* contracts. For *Musharakah*, it is the same as conventional ECF and stock investment. On the other hand, with *Mudharabah* crowdfunding, the funder will provide 100% of the capital, and all the management and operational activities will be based on the company. For the profit, both ECF based on *Mudharabah* and *Musharakah* will be distributed according to the pre-agreed ratio. Regarding loss, *Musharakah* partners need to divide the loss based on their proportion of capital contribution. Meanwhile, for *Mudharabah*, the funder will bear the monetary loss, and the firm will lose its effort.

According to Forbes (2019), fledgling businesses have five different financing options. These enterprises could use angel financing, crowdfunding, small business credit cards, venture capital, and small business loans to fund their operations instead of relying on their owners' savings. Each strategy may have advantages and disadvantages. Furthermore, according to the Organisation for Economic Co-operation and Development (OECD) (2015), businesses can use traditional debt financings such as loans, asset-based financing, bond issuance, crowdfunding, and equity and hybrid instrument issuance. On the other hand, traditional funding would be problematic for the new business due to its high-risk-return profile. As a result, they will need to look for other funding sources. Metelka (2014) mentioned that the financing gap for start-up businesses could be bridged through crowdfunding. Thus, several studies have suggested that crowdfunding. Specifically, ECF is the most excellent answer for new start-up enterprises (Muhammad et al., 2021; Maryam et al., 2021; Maya et al., 2020; and Salizatul Aizah et al., 2018). However, these studies were conducted from the perspective of businesses.

Muhammad Sharul Ifwat and Md Habibur Rahman (2021) found that *Mudharabah* is still not an ideal instrument for ECF. They also listed several arguments to support their findings, such as the high risk for capital providers, insufficient regulations, the possibility of fraudulent projects, and the structure of *Mudharabah* itself as a profit-sharing contract. Furthermore, they proposed mitigation planning, such as using Fintech to monitor the project closely, improving the regulatory aspect, and creating awareness among all parties about the *Mudharabah* contract. Finally, they also suggested that Islamic ECF using *Mudharabah* is suitable for financing micro-enterprises, especially less risky ventures like the food and technology sectors. According to Dzuljastri, Syamsu, and Qosdan (2021), Islamic crowdfunding based on Shariah principles provides an alternative avenue apart from banking. From these studies, it can be concluded that *Mudharabah*-based crowdfunding can be implemented; however, potential investors must support it. Therefore, the present study focuses on assessing the expectations of potential investors (*rabb al-mal*) in *Mudharabah*-based crowdfunding.

Including the behavioural finance theory (BFT) in the study concerning investors and investment opportunities would be beneficial. According to Statman (2008), the main idea influencing the behavioural finance theory is that several behavioural factors influence market participants to spend, save, and invest their money. The theory assumes that market participants are rational and that their aim in finance is to increase utilitarian, expressive, and emotional benefits (Statman, 2014). Thus, how the potential *rabb al-mal* behaves when considering *Mudharabah*-based crowdfunding is essential to determining the success of a crowdfunding arrangement.

From the above two paragraphs, the problem statement for this study can be derived. *Mudharabah*-based crowdfunding has the potential to be an alternative financing facility for small ventures. However, the potential was marred by high risk, dishonest business owners, a lack of awareness among the investors, and a lack of regulations. As many previous studies were conducted from the perspective of business owners and regulators, this study will focus on investors. On top of that, the respondents' behavioural factors were expected to enhance the reported findings. Therefore, the research questions and research objectives for this study are as follows:

Research Questions

1) How do potential investors view *Mudharabah*-based crowdfunding opportunities in Malaysia?
2) What challenges do potential investors face in *Mudharabah*-based crowdfunding?
    a) How can the challenges be reduced for *Mudharabah*-based crowdfunding to be in place?
3) How do potential investors make investment decisions, especially in *Mudharabah*-based crowdfunding?

Research Objectives

1) To assess potential investors' views on *Mudharabah*-based crowdfunding opportunities in Malaysia.
2) To identify the challenges and solutions for *Mudharabah*-based crowdfunding.
3) To explore the behaviours of potential investors in choosing the investment instruments.

This study was expected to contribute practical implications and social implications. For practical implications, it could add one more innovation in financing alternatives to small ventures by focusing not on financial institutions but on public involvement. On top of that, feedback from respondents can be used as guidance for the regulator in developing the regulations for *Mudharabah*-based crowdfunding. In addition, for social implications, it could promote the concept of brotherhood as one of the value propositions of the Islamic financial system.

LITERATURE REVIEW

Mudharabah-Shariah contract

As cited from ISRA (2016), the word *Mudharabah* derives from the phrase *"al-darb fi al-ard,"* meaning to make a journey. It is a partnership-based contract that requires one partner to make a journey. Two terms represent this contract: *Mudharabah* by Hanafi and Hanbali scholars and *Murqaradah* by Maliki and Shafi'i scholars. *Muqaradah* comes from the word *qarada,* which means "to cut off". In this partnership, *qarada* refers to when the capital provider cuts off some of their money for business activities to be utilised by the business owner.

With reference to Mufti Mohammad Taqi Usmani and Mohammed Obaidullah, the Academy for International Modern Studies (n.d.) defines *Mudharabah* as a special kind of partnership where one partner *(rabb al-mal)* gives money to another *(mudharib)* for investing in a commercial enterprise. As *rabb al-mal* in the *Mudharabah* contract, one should understand that they should not interfere in any management decision of the *mudharib*. This feature will allow the *mudharib* to utilise the money contributed by the *rabb al-mal*. Thus, *rabb al-Mal* will be exposed to moral hazards and adverse selection (Noraina & Mohammad Rahmdzey, 2019).

The bankers are *rabb al-mal* in the banking system, while business owners are *mudharib*. For bankers, it is highly risky to invest in *Mudharabah* contracts as they are exposed to the loss of return and capital. However, the risks can be reduced by imposing *mudharabah muqayyadah* (restricted *mudharabah*) (Muhammad et al. Rahman, 2021). Under this type, *the mudharib* must abide by the terms and conditions as stated by *Rabb al-mal,* such as the type of business, investment period, location, etc. The contract is valid if the *Rabb al-mal* does not intervene with the *mudharib* in his operation (ISRA, 2016).

Nevertheless, *Mudharabah* was widely used among the Arabs in Mecca before Islam. The Arabs brought goods from India and Yemen and sold them to the Roman Empire. The merchants will become the *mudharib* to finance the trading, and the communities will become *rabb al-mal*. This contract was later recognised in Islam. In addition, all Muslim scholars agreed with this Shariah contract in *fiqh muamalat* (ISRA, 2016).

Equity-based crowdfunding and *Mudharabah*-based crowdfunding

Equity-based crowdfunding is an alternative method for new businesses, especially Small and Medium Enterprises (SMEs), to raise funds from the public. However, these businesses typically have higher risks and give higher returns. Using a registered online platform with the Securities Commission Malaysia (SC), small businesses can offer equity in their companies to investors, and investors can diversify their investments beyond traditional asset classes. Ten ECFs have been registered in Malaysia. However, despite the advantages of ECF, Wilson and Testoni (2014) stated that ECF is the most complicated model to be implemented. This is because the investors require proper checks and balances. Otherwise, investors will suffer losses instead of getting a return.

ECF in Malaysia started in 2016 to respond to the government's call to use technology in the financial services sector. As of December 2020, RM199.23 million of funds had been raised through equity crowdfunding (capitalmarketmalaysia.com, 2022). In the same year, SC allowed ECF to operationalise secondary trading. This announcement encouraged businesses to offer more financial products to the growing online trading community in the country. To regulate the ECF activities, SC introduced the Guidelines on Regulations of Markets under section 34 of the Capital Markets and Services Act 2007 in 2015. The guideline stated the regulations on criteria for ECF platform providers, types of businesses, investors, and the limit of funds that can be raised through ECF, etc.

Like other segments of modern financial practices, Islamic crowdfunding has emerged as an alternative to conventional crowdfunding. Maya Puspa et al. (2020) found that entrepreneurs efficiently use Islamic ECF in

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS | Volume IX Issue X October 2025

raising capital, although they are quite reluctant to share their business ideas online; thus, the authors proposed a Shariah Equity Crowdfunding (SEC) framework to facilitate the processes. In addition, Syahida and Umar (2017) found that Shariah-compliant ECF is essential for the sustainability of the halal industry. Both studies suggested that Islamic ECF can be established in the modern Islamic finance sector to enhance the current financing facilities. Therefore, the conventional ECF can be replaced with profit and loss-sharing contracts such as *Mudharabah* and *Musharakah*, which are more Shariah-compliant (Muhammad et al., 2021) and Aishath, Nur Aishah, and Asma' (2018). In contrast, Khaliq, Rizal, and Aimadhuddin (2021) mentioned that even though *Mudharabah* and *Musharakah* are the most encouraged practices concerning investment behaviour, they seem impossible to implement due to less concern being given by governments, central banks, and industry players.

As for now, all the studies related to *Mudharabah*-based crowdfunding are in the proposal stage. For example, Aishath et al. (2018) proposed a framework for Blockchain-enabled *Mudharabah* Crowdfunding. According to them, through blockchain technology, the identity of individuals is protected, and the use of smart contracts for verifications and storage purposes can eliminate the third-party intermediary. In addition, Muhammad Shahrul Ifwat et al. (2021) proposed using *Mudharabah*-based crowdfunding as an alternative financing for book publications. They found that *Mudharabah*-based crowdfunding can solve the book publishing industry's financial problems. In other articles, it was proposed that *Mudharabah*-based crowdfunding can be used to support micro-enterprises with minor capital requirements (Muhammad et al. and Md Habibur, 2021) and to help single mother entrepreneurs start the business at home (Farah et al., 2022).

Among all the proposed models, in this study, the author would prefer to use the model by Muhammad Shahrul Ifwat and Md Habibur (2021). Cited from the article, the explanation of the model is as follows:

1) The project manager proposes his project in detail. He or she needs to provide clear information relating to the business regarding costs, strategies, and opportunities.

2) The platform acts as a wakil (agent) on behalf of the funders and will review the project in terms of its credibility and Shariah-compliant aspects. The platform may suggest a few aspects so the project manager can revise his or her idea. If the proposal is accepted, the platform will launch the campaign.

3) The funders channel their money to the project.

4) Fundraising is launched within a given period. If the amount meets the target successfully, it will be channelled to the project manager. Because of the *Wakalah* contract, the platform would obtain the fee based on the funders' ujrah (fee).

5) After the given period, if the project is successful, the profit must be divided according to the agreement. On the other hand, if it ends with a loss, funders must bear it, except if the failure resulted from the negligence of the project manager.

The respondents were asked a few questions based on this model in the semi-structured interview session. The respondents are potential capital providers, and their opinion on the proposed model was collected. This research methodology will be discussed further in the next section.

Shariah Analysis on *Mudharabah*-based crowdfunding

Syariyah Review Bureau (2020) reported that the ECF model is like raising capital through issuing shares. Therefore, the Shariah issue on ECF is related to compliance or non-compliance with Shariah principles. In addition, any ECF must satisfy the Shariah screening criteria, such as sector and financial screening. Thus, the SMEs must meet the requirements to be considered Shariah-compliant. SAC-SC Malaysia has a screening methodology that must be complied with by all publicly listed companies that want to be considered Shariah compliant. Two-tier quantitative approaches are adopted: business activity and financial ratio benchmarks (SC, 2022).

From the proposed model by Muhammad Shahrul Ifwat et al. (2021), it is understood that the model used

Mudharabah and *Wakalah bi al-ujrah* contracts. The *Mudharabah* is the essential contract connecting *rabb al-mal* and *mudharib*. At the same time, *Wakalah bi al-ujrah* is used as a supporting contract to clarify the role of the online platform. One of the Shariah issues in the *Mudharabah* contract is accepting capital from unlawful sources. Undeniable, *Mudharabah*-based crowdfunding may attract various capital providers. Thus, there is a possibility that *Rabb al-Mal uses funds from unlawful sources,* such as income received from conventional financial products or illegal or non-halal businesses. Therefore, the issue of permissibility will arise. According to BNM Shariah Resolution in the 58th meeting held on 27th April 2006, the Islamic banking institutions may accept any placement of deposit or investment funds from individual or corporate customers without the need to investigate the status of the sources of the fund, either shariah-compliant, non-shariah-compliant, or a mixture between the two. Since *Mudharabah*-based crowdfunding was proposed as an alternative financing product for SMEs, this issue may arise, too.

Based on BNM, *Wakalah bi al-ujrah* is a fee-based agency whereby the agent may charge a specific fee for the services provided to the principal. As cited by Muhammad Shahrul Ifwat et al. (2021) from Al-Qarahdahi (2011), the *Wakalah* fee must be clear, transparent, and mutually agreed upon by the contracting parties. For the paid agency, the fee becomes binding once the agent performs their act (ISRA, 2016), thus making it similar to the employment contract. Concerning the proposed model, the online platform provider will impose fees on the *mudharib* and *rabb al-mal*. On behalf of *Mudharib*, the online platform will provide services such as launching the campaign, facilitating funds transfer, and promoting the business. According to Rabb al-Mal, the online platform will ensure the invested business is transparent, reliable, and marketable to protect the investments.

The listed services provided to the *mudharib* and *rabb al-mal* could lead to a dual agency issue. According to the BNM Shariah Resolution on wakalah, if there is a dual agency, clear documentation is required and must be agreed upon by the contracting parties. In addition, the principals must agree to the appointment of the agent to act on their respective behalf. Thus, dual agency is permissible.

Another issue that can arise is the combination of two contracts in one agreement. Muhammad Burhan (2007) stated that as long as the combined contracts pass the legal test by legal principles, the combined contracts can proceed to the next stage. According to him, any transactions that could coexist with well-established Islamic law principles and serve a valid purpose by lifting hardship from people are considered permissible. The combination of *Mudharabah* and *Wakalah bi al-ujrah* is permissible in this case.

Behavioural Finance Theory (BFT) and Islamic Instruments.

It is not easy to find trading strategies that reliably make money (Ritter, 2003). The difficulty is that there are many factors that investors must consider, such as whether the market is efficient or not and whether investors are rational or normal. According to Ritter (2003), behavioural finance relates to traditional assumptions of expected utility maximisation with rational investors in an efficient market. However, investors will make the wrong decisions due to cognitive psychology and the limits to arbitrage when the market is inefficient. Earlier than Ritter (2003), Barberis and Thaler (2002) found that the models captured something about investors' beliefs, preferences, and limits of arbitrage in investment decision-making. Thus, both studies argued that behavioural finance has two building blocks: cognitive biases and the limit of arbitrage.

Hirshleifer (2015) found that there is a need for more testing of the effects of feelings on financial decisions and aggregate outcomes, especially for social finance. Social finance offers equally fundamental insight and is a worthy descendant of behavioural finance. On top of that, Statman (2019) mentioned that the second generation of behavioural finance could guide individuals to know what they want. It guides individuals to balance their wants with correct cognitive and emotional errors when satisfying their wants.

RESEARCH METHODOLOGY

This study applies a qualitative method whereby the data are obtained from semi-structured interviews. DeJonckhree and Vaughn (2019) stated that a semi-structured interview is an effective method for data collection when the researcher wants to collect qualitative, open-ended data and explore the participants' thoughts, feelings,

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS | Volume IX Issue X October 2025

and beliefs about a particular topic. Since the purpose of this study is to assess the views of potential investors towards *Mudharabah*-based crowdfunding, it is suitable for use. In short, this method enables the researcher to understand the subject matter's issue deeply.

Another important element in research methodology is the sampling technique. Ilker, Sulaiman, and Rukayya (2016) stated that a suitable sampling technique is nonprobability sampling when the researcher has limited resources, time, and workforce. This sampling can be divided into convenience sampling and purposive sampling. The present study applies convenience sampling. This sampling technique refers to where the target population members meet specific criteria, such as easy accessibility, geographical proximity, and the willingness to participate in the study.

However, to reduce the limitations of convenience sampling, such as biases and lack of generalizability, the selected interviewees were chosen from different levels of educational backgrounds, occupations, ages, and locations of stay. Furthermore, even though all interviewees consented to disclose their names and organisations, this study prefers to safeguard their information, as this represents their personal views, not their organisations. Generally, all the respondents understand ECF basics and the *Mudharabah* contract.

The interview sessions were conducted using Zoom meetings and were recorded for reference. Each session took about 30 minutes, and interviewees were asked four questions, and their answers were handwritten in the book. Later, the information was transcribed and analysed using content analysis methods. The content analysis aims to organise and elicit meaning from the data collected and draw conclusions (Bengtsson, 2015). The information was coded and themed into meaningful categories. To ensure the data is valid and reliable, all facts mentioned by interviewees were confirmed to avoid accidental errors. All interviewees are listed as follows (Table 1).

Table 1: List of Interviewees

Respondents	Age	Level of educational background	Occupation	States and federal territories of Malaysia
IV 1	37	PhD	Academician	Kelantan
IV 2	48	PhD	Academician	Pahang
IV 3	37	Master	Academician	Kedah
IV 4	33	Master	Academician	Selangor
IV 5	43	Master	Business Owner	Pahang
IV 6	29	Master	Student	Selangor
IV 7	37	Degree	Medical Officer	Terengganu
IV 8	36	Degree	Assistant Manager	Terengganu
IV 9	36	Degree	Executive	Selangor

FINDINGS AND DISCUSSIONS

Theme 1: The possibility of Mudharabah-based crowdfunding being implemented in Malaysia.

Sub-theme 1: *Mudharabah*-based crowdfunding is not possible to be implemented in Malaysia.

Among the nine respondents, two interviewees (IV 1 and IV 6) believe that *Mudharabah*-based crowdfunding is impossible to implement. IV 1 argued that she is not confident in the business owner or *Mudharib*. According to her, the business owner may not be honest in doing the business, and the *rabb al-mal* has no access to the business operation due to *Mudharabah* contract conditions. Competition from other types of investments could also slow the acceptance of this alternative investment opportunity. For example, investment in Islamic mutual funds offers a stable return to investors. Meanwhile, IV 9 doubted whether there is a demand for Mudharabah-based crowdfunding since capital providers imposed greater risk. Both respondents mentioned that using the online platform to facilitate the transactions would not cause a problem implementing the crowdfunding, except for using the Mudharabah contract.

Sub-theme 2: *Mudharabah*-based crowdfunding can be implemented; however, it needs to meet certain conditions.

Most respondents (IV 3, IV 4, IV 5, IV 7, and IV 8) believed that *Mudharabah*-based crowdfunding could be realised in Malaysia. There are expected benefits from having *Mudharabah*-based crowdfunding in the modern financial system, such as an alternative source of capital for SMEs and promoting wealth circulation among the public (Muhammad et al. Rahman, 2021). However, the respondents provided several conditions to ensure the success of the transactions. For example, both parties (business owners and capital providers) must understand the concept of *Mudharabah* and agree with the contract's terms and conditions, establish proper monitoring and administration from the regulators, and implement appropriate mitigation methods to reduce the risk.

Sub-theme 3: *Mudharabah*-based crowdfunding is possible to implement without any conditions.

Knowing Malaysia is a country at peace and the people are helping each other, IV 9 believed that Mudharabh crowdfunding could be implemented in Malaysia. Many capital providers would willingly assist SMEs in raising capital for their businesses. The respondent is aware of the risk of the *Mudharabah* contract and can absorb the risk by converting the intention from doing a partnership to donating. Even though the study does not focus on *Mudharabah*-based crowdfunding per se, Dzuljastri et al. (2021) found that the concepts of Islamic ECF, justice, and fairness significantly influenced the respondents' acceptance of Islamic crowdfunding. The concept refers to the methods employed, such as profit-sharing, halal investment, and avoidance of riba. On the other hand, justice and fairness cover elements such as being reasonable, serving society, and equal distribution of wealth.

Sub-theme 4: Mixed opinion of the implementation of *Mudharabah*-based crowdfunding.

Interestingly, IV 2 has mixed opinions on the issue. She believed that there was a chance for *Mudharabah*-based crowdfunding to be established in Malaysia. It is due to considering the needs of SMEs, showing infrastructure like reliable online platforms, and innovation in Islamic financial products. However, simultaneously, she claimed that the *Mudharabah* type of financial product is not as popular as *Murabahah* and *Musharakah*. Therefore, it is impossible to have *Mudharabah*-based crowdfunding in the near future.

Theme 2: Possible challenges faced in Mudharabah-based Crowdfunding

Sub-theme 1: Lack of regulations for *Mudharabah*-based crowdfunding.

Most respondents (IV 1, IV 5, and IV 6) commented that the lack of regulation for *Mudharabah*-based crowdfunding is the biggest challenge for capital providers or *rabb al-mal* to invest their money in the business. Malaysia's Securities Commission (SC) has introduced guidelines to facilitate the ECF, which came into effect on 10th February 2015 (SC, 2022). The new guideline is for registering the ECF platform and provides governance arrangements for the platform's operators. However, the regulators in Malaysia have yet to impose specific regulations on *Mudharabah*-based crowdfunding (Muhammad et al. Rahman, 2021). IV 5 commented that capital providers would face double risks as *Mudharabah* contract conditions and no regulations if no rules had been set, regardless of whether Islamic crowdfunding or non-Islamic (Abdulmajeed et al., 2021). Lack of regulation is one of the problems identified in crowdfunding.

Sub-theme 2: Uncertainty of business performance in the current economic condition.

IV 2 and IV 3 mentioned that challenges in *Mudharabah*-based crowdfunding are more related to business uncertainty. As a capital provider, return on investment would be one of the essential criteria for selecting investment opportunities (Kallapur & Trombley, 2001). Therefore, both respondents believed the invested business might not perform at its best due to the current economic conditions. Furthermore, as COVID-19 attacked the economies of countries globally, it seemed that it would be difficult for new businesses to sustain. Thus, capital providers will lose the invested capital and must bear it wholly since the funding is based on the *Mudharabah* contract.

Besides, IV 4, IV 8, and IV 9 believed that the success of the businesses depends on the type of business, i.e., food and beverage or technology company, which is less risky than the real property sector. Furthermore, IV 4 added that if she wants to invest in *Mudharabah*-based crowdfunding, she will consider how the business owners prepared a plan to reduce the risks faced by the business. Capital providers may be reluctant to invest without proper planning, especially using the *Mudharabah* contract, since *rabb al-mal* needs to bear all the losses. IV 8 also mentioned that the online platform might not be reliable, and the fraudsters can take advantage by getting easy money from ECF.

Apart from business risks and economic risks, as discussed above, respondents (IV 7 and IV 9) stated that the risk in the *Mudharabah* contract would hinder them from trading in *Mudharabah*-based crowdfunding. Moreover, even though both parties agreed on *Mudharabah* conditions, they were still required to cover 100% of the losses.

Theme 3: Mitigation solutions to challenges faced by the capital providers.

Sub-theme 1: The need for a regulatory framework for *Mudharabah*-based crowdfunding.

Most respondents believed that the issue of reliability and higher risk in investing using *Mudharabah*-based crowdfunding could be reduced by having a proper regulatory framework. In Malaysia, BNM and SAC-SC are responsible for issuing guidelines and resolutions for Islamic finance matters. Thus, they must be considered to issue new and specific rules and regulations for *Mudharabah*-based crowdfunding. As stated by respondents, the expected benefits of the regulatory framework are ensuring the business's governance, boosting the investors' confidence, and promoting better business performance. On top of that, IV 2 mentioned that the government authority bodies could also play some roles to ensure a specific performance, such as providing an entrepreneurship module for the *mudharib* to join and prepare himself with equipped knowledge. Interestingly, IV 5 and IV 8 suggested regular feedback from the *mudharib* to *rabb al-mal* will ensure the business owner is on track. Therefore, the risk of uncertainty and unreliability can be mitigated.

Sub-theme 2: Practice of due diligence by the *mudharib* and *rabb al-mal*.

According to IV 3, the challenges for investment in *Mudharabah*-based crowdfunding can be reduced if both parties exercise due diligence. For example, the *mudharib* must prepare a good business proposal covering expected and unexpected outcomes. FindLaw (2016) mentioned that a business plan is a foundation for the success of a business. Preparing the business plan requires the business owner to do market research to determine the profitable type of business, estimated start-up costs, and other relevant information. In addition, IV 4 mentioned that when the business owner chooses the right products to be produced or sold, it can attract buyers to buy the products, and the income for the business will increase. Capital providers may do market research too, but they should focus on different perspectives, such as expected returns from the proposed business.

IV 7 and IV 8 suggested that business owners may have a backup plan if the business is not running as expected. This backup plan should be presented during the business campaign. The suggestion is good for the business and can increase confidence among the capital providers. Both respondents believed this backup plan is essential, especially for *Mudharabah*-based crowdfunding.

Sub-theme 3: Prefer to have restricted *mudharabah*.

Muhammad Shahrul Ifwat and Md Habibur Rahman (2021) stated that some aspects of *mudharabah* practice should be enhanced. It refers to the use of restricted *mudharabah* in *Mudharabah*-based crowdfunding. This contract allows the *Rabb al-Mal to impose restrictions with specific prerequisites for Mudharib*. The restrictions include the location of the business, manner, and type of investment (ISRA 2016). Noraina (2016) stated that breaching these conditions means the *mudharib* is held accountable if the project is unsuccessful.

Theme 4: Behaviour of respondents towards Mudharabah-based crowdfunding

Statman (2014) stated that behavioural finance is finance with normal people. It assumes that normal people are more intelligent, but sometimes can get swayed by cognitive errors such as overconfidence and misleading emotions. The misleading emotions can be referred to as exaggerated fear or unrealistic hope. The same concept

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS | Volume IX Issue X October 2025

can be examined in *Mudharabah*-based crowdfunding. The respondents were asked one open-ended question: "What factors will you consider for investment decision in *Mudharabah*-based crowdfunding?". The responses from respondents were filled under the characteristic of normal investors: investment decisions based on acquired knowledge, emotional benefits, expressive, and maximising utilitarianism. For example, IV 3 mentioned that he is willing to explore *Mudharabah*-based crowdfunding as he perceived benefits as a capital provider from the investment opportunities. In addition, IV 6 stated that she is concerned about the financial return and other types of returns, such as whether the invested business's activities violate the environment.

A normal investor should not separate their roles as investors and consumers. A response was observed from IV 2, where she stated that she would look at the invested business's objectives before proceeding with the investment decision. IV 1 and IV 9 believed that *Mudharabah*-based crowdfunding could help SMEs start their business. The emotions of helping the person in need are greater than other factors. Based on the responses, cognitive biases, emotions, and heuristic factors influence financial decision-making. Arran (2023) mentioned that cognitive biases, which refer to systematic patterns of deviation from norm or rationality in judgment, will significantly impact investors' financial decisions. While heuristics or simplified thinking can lead to sound decisions, they can also lead to otherwise.

LIMITATIONS AND RECOMMENDATIONS

One limitation was identified in the present study. It is the number of respondents used in the study. Nine respondents may not be able to represent the whole population in Malaysia. Nevertheless, this study could be considered valid since the respondents were selected based on different occupations, geographical locations, education, and age. Feedback from respondents must be obtained to ensure that *Mudharabah*-based crowdfunding becomes a reality. Future researchers may consider extending this study by adding many respondents. Hence, the semi-structured interview method may not be realisable since it is time-consuming and expensive. It is recommended that future researchers apply quantitative methods, such as questionnaires, when involving many respondents.

CONCLUSION

This study provides critical insights by assessing the expectations and identifying the challenges of potential capital providers (*rabb al-mal*) regarding *Mudharabah*-based crowdfunding in Malaysia. The findings explicitly demonstrate a strong willingness among investors to participate in the *Mudharabah*-based crowdfunding, depending upon the establishment of a robust regulatory framework. This indicates that the inherent risks associated with the *Mudharaba*h profit-sharing contract—specifically the higher risk of capital loss—do not present a barrier, provided there is mutual, informed consent between the *mudharib* (entrepreneur) and the capital provider.

The results carry significant practical implications for the development of Islamic finance. First, the finding that the lack of specific regulation is the primary hindrance is a clear mandate for the regulators. Prioritizing the design and implementation of clear, Shariah-compliant *Mudharabah*-based crowdfunding rules will immediately unlock a new pool of capital, transforming *Mudharabah*-based crowdfunding from a concept into a market reality. Second, operationalizing *Mudharabah*-based crowdfunding provides a promising, much-needed alternative source of funding for Small and Medium Enterprises (SMEs), especially those seeking ethical, interest-free capital. This directly supports economic growth and promotes the Shariah objectives (Maqasid al-Shariah) related to wealth circulation and brotherhood (*ta'awun*) in the financial ecosystem. Lastly, the analysis, informed by BFT, categorized the respondents as rational or normal investors who possess investment knowledge. However, the study serves as a crucial caution: regulatory bodies and platform operators must implement investor education initiatives that specifically address cognitive biases and heuristics. This is essential to help even 'smart' investors avoid common errors (e.g., overconfidence or herd mentality) and ensure long-term market stability and investor protection.

In summary, *Mudharabah*-based crowdfunding holds substantial promise for advancing the Islamic capital market. By directly addressing the regulatory and behavioural challenges identified, stakeholders can effectively harness investor confidence, thereby establishing an ethical and sustainable funding mechanism for the broader economy.

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