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EQUITY CROWDFUNDING IN MALAYSIA:
AN IMPLEMENTATION OF SETTING
VALUATIONS

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“I/ We hereby declare that I/We have read this thesis and
in my/our opinion, this thesis is adequate in terms of scope and quality, for
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DECLARATION

“I hereby declare that this thesis entitled “Equity Crowdfunding in Malaysia: An Implementation of Setting Valuations” is the result of my own research except as cited in the references.”

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DEDICATION

Special dedication to my beloved family members, beloved supervisor and panel who guided me throughout the research, friends who always been there for me, support and believe me all the way.

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ABSTRACT

Equity Crowdfunding is described as an alternative funding mechanism for young start-up businesses in Malaysia. Equity crowdfunding gains most attention as it is the newly funding mechanism through internet-based platforms, but it's subject to various valuation setting problems. The two main objectives of this research are: (1) examining the challenges of setting valuations towards equity crowdfunding and (2) identifying the valuation approaches for equity crowdfunding mechanism of Malaysia context. Meanwhile, this research study also would like to propose innovative suggestions in order to enhance the equity crowdfunding initiatives in Malaysia. In this research study, the researcher conducted the case study in qualitative research method by using semi-structured questionnaires interview to examine the related and importance of an implementation of setting valuations towards equity crowdfunding with selected expertise for a depth understanding. In short, an implementation of valuation setting towards equity crowdfunding able to guarantee both investors and entrepreneurs would gain fair value of their business and hence contributes to the rapid development of equity crowdfunding as an attractive paradigm to raise the business capital for the young start-up and SMEs businesses in Malaysia.

Keywords: (Equity) Crowdfunding, Valuation Setting, Business Funding, Malaysia

ABSTRAK

Ekuiti “Crowdfunding” digambarkan sebagai satu mekanisme pembiayaan alternatif bagi memulakan perniagaan kecil di Malaysia. Ekuiti crowdfunding menarik perhatian yang paling ketara kerana ia merupakan mekanisme pembiayaan yang terbaru melalui platform berasaskan internet tetapi tertakluk kepada pelbagai masalah penilaian. Objektif utama kajian ini terbahagi kepada dua bahagian iaitu: (1) mengkaji cabaran pelaksanaan penilaian terhadap ekuiti crowdfunding dan (2) mengenal pasti pendekatan penilaian bagi mekanisme ekuiti crowdfunding dalam konteks Malaysia. Sementara itu, kajian penyelidikan ini juga mencadangkan beberapa cadangan inovatif bagi meningkatkan inisiatif ekuiti crowdfunding di Malaysia. Dalam kajian penyelidikan ini, penyelidik akan menjalankan kajian kes melalui kaedah penyelidikan kualitatif dengan menggunakan temu bual separa struktur untuk mengkaji kaitan dan kepentingan pelaksanaan penilaian dalam ekuiti crowdfunding bersama dengan pakar- pakar yang tertentu demi pemahaman yang secara mendalam. Pendek kata, pelaksanaan penilaian dalam ekuiti crowdfunding dapat menjamin kedua-dua pelabur dan usahawan akan mendapat nilai saksama daripada perniagaan mereka dan dengan itu turut menyumbang kepada perkembangan ekuiti crowdfunding yang pesat dan seterusnya menjadikan ekuiti crowdfunding sebagai satu paradigma untuk memperolehi modal perniagaan bagi golongan perniagaan kecil dan perniagaan perusahaan kecil dan sederhana di Malaysia.

Kata Kunci: (Ekuiti) Crowdfunding, Pelaksanaan Penilaian, Modal Perniagaan, Malaysia

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LIST OF ABBREVIATIONS

ABBREVIATION	MEANING
SMEs	Small Medium Enterprises
SC	Securities Commission Malaysia
ECF	Equity Crowdfunding Frameworks
CMSA	Capital Markets and Services Act
DCF	Discounted Cash Flow Approaches
IPO	Initial Public Offering

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CHAPTER 1

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

In this economic downturn phenomenon, Drover and Zacharakis (2013) mention that “entrepreneurs turn to a number of sources to raise capital” as they tend to face the biggest challenges at the very beginning of their entrepreneurial initiative in raising of capital. It has become a critical issue in the entrepreneurial process, especially for those young startups and innovative organizations who have problems to access to business bank loans due to lack of credit history and facing difficulties in raising large amounts of capital for whole new product development cycle. Lam (2009) explains that there are several ways to raise funds for entrepreneurs who want to create or develop a business and it depends on the scale of the company and its level of development. First, entrepreneurs can use informal sources of funding (love money, bootstrapping and business angels). Second, the formal sources of funding are financial institutions (banks & venture capitalist) often less requested by young startups as it carries high risk. However, these traditional financial sources often slow down the process of getting promising innovations into the market.

More recently, there started showing up a novel choice for entrepreneurs to rely on the Internet to directly seek for capital raising from the general public (the “crowd”) instead of approaching financial investors (Kleemann et al., 2008; Lambert and Schwienbacher, 2010) - crowdfunding. It has been defined as an alternative fundraising tool which able contributes to the evolution of entrepreneurship, the founding of new startups and the expansion of SMEs in terms of innovation,

competitiveness, employment and growth by creating additional revenue for organizations by giving cash flow to them. According to Rich (2014), “crowdfunding is a viable alternative to more traditional ways of raising capital through investors, bank loans, or by utilizing the credit.”

In general, crowdfunding refers to seeking capital via the internet with the development of specifically designed crowdfunding platforms such as Kickstarter, Indiegogo, RocketHub and etc. Besides, all crowdfunding transactions are facilitated through internet-based crowdfunding platforms which also provide a convenient means for all exchanges of funds by Burtch et al. (2012). Hence, this has definitely amplified the phenomenon whereby crowdfunding mechanism has totally opened up a completely new realm of possibilities and opportunities for the global businesses as it has broken down geographical limits for entrepreneurs who looking for financial resources to expand their business from worldwide investors. It is so called “such a huge industry evolves right now” by Feldman (in Goodman, 2014: 68) and even “an investment revolution” by Gilchrist (2014). Moreover, Mitra (2012) notes that there are basically four types of crowdfunding models including donation-based, rewards-based, debt-based and equity-based.

According to Crowdfunding Industry Report (2012), equity crowdfunding has been emerged as an increasingly dominant alternative financing mechanism for startups and volume has doubled every year since 2009 whereby startups worldwide has successfully raised U.S. \$88 million through equity crowdfunding platforms in the year 2011. In fact, equity crowdfunding refers to an innovative way for small to medium sized enterprises ranging from startups to growth stages to raise funds by giving up a portion of their equity in return. Hence, it gains most attention as it involves equity investment by investors who receiving an equity stake in a company. Usually, it involves a number of requirements that must be met under the particular company laws, especially issues regarding protection to the value of equity stakes and voting rights of the existing shareholders of the company from being diluted. This is due to the consequences of the company growth at the later stage of business development. Further, equity-based crowdfunding market is significantly affected by the regulatory environment due to it has involved the sale of securities by Bradford (2012) and subsequently subject to multiple of legislative issues.

In the year 2015, the Securities Commission Malaysia (SC) has announced the approval of six registered equity crowdfunding platforms, giving small businesses and entrepreneurs' greater access to capital (The Star, 2015). As per government Agency SME Corporation Malaysia (2015), there is a huge market potential in Malaysia which has more than 600,000 small and medium enterprises (SMEs) making up more than 90% of total businesses in the country. These SMEs are accountable for the large number of employment creation and consequently equity crowdfunding can play a vital role in it. Therefore, Malaysia has also become the first country in Asia-Pacific to legislate Equity Crowdfunding Frameworks (ECF) who opening an alternative funding platform for small businesses and entrepreneurs cited from <http://www.dealstreetasia.com>. In order to regulate ECF, the SC released the Guidelines on Regulation of Markets under Section 34 of the Capital Markets and Services Act 2007 (CMSA) (Guidelines) on 11 February 2015 cited from <http://www.mahwengkwai.com>. This legitimate framework gives an adequate lawful premise for equity crowdfunding operators in Malaysia to enforce rules and regulations that permit the equity crowdfunding platforms to operate in a practical regulatory framework in order to protect the benefits of investor and issuers (entrepreneurs).

1.2 PROBLEM STATEMENT

The Securities Commission of Malaysia described equity crowdfunding frameworks as a new form of fundraising that allows startups or small enterprises to raise capital through small equity investments from a large number of investors through online portals to facilitate such investments cited from <http://www.mahwengkwai.com.my>. Hence, an emergence of this new financing mechanism has raises setting valuations problem which associated with equity-based crowdfunding model. According to Buysere et al. (2012), "setting valuations in business will be a critical problem that might be faced by the fundraiser" since the equity crowdfunding is just started in Malaysia; equity-based crowdfunding model being the most complicated model and not yet working in the biggest part of the

world. It is further supported by Startup Juncture (2013) that valuation is a big problem within equity crowdfunding.

“Setting a valuation for business is one of the most important parts of the fundraising pitch” mentioned by Taylor (2014). This has led to many important questions emerged regarding an implementation of setting valuations towards equity crowdfunding initiatives in Malaysia such as a question of what is the right valuation so that entrepreneurs can operate their business on the fund being raised over the course of the time, a question of what value entrepreneurs can build with the business and a question of what entrepreneurs think the business could be worth. For instance, it is important to have an accurate value for the startup business ventures as it enables entrepreneurs to set a target at which they can forgo equity in turn for financing. With a sound valuation of the startup business venture, this attracts investors to invest in the business as they would see it a fair value for the financing they put forth. Hence, entrepreneurs are starting to focus on the setting valuations issue in which they can increase the firm value to achieve funding success.

1.3 RESEARCH QUESTIONS

In the year 2015, equity crowdfunding has just been approved and started in Malaysia. A critical problem that might be faced by the fundraiser in an equity crowdfunding effort is the subject related to setting valuations. Besides, some issues might raise up as well such as, what are the effects of setting high or low valuation of the firm’s business? Is that the setting valuations for equity crowdfunding is a must for both investors and entrepreneurs to have a fair value of the business? Thus, this proposed research is to investigate an implementation of setting valuations towards equity crowdfunding initiatives in Malaysia context. Hence, this thesis work addresses the following main research questions:

- i) What are the challenges of setting valuations towards equity crowdfunding mechanism in Malaysia?

- ii) What are the valuation approaches for equity crowdfunding mechanism in Malaysia?
- iii) How does equity crowdfunding initiatives can be enhanced in Malaysia?

1.4 RESEARCH OBJECTIVES

It is important for both entrepreneurs and investors when considering investing in a crowd funded project, attention to setting valuations is crucial. Usually, companies considering crowdfunding are in the early stages of growth and entrepreneurs might not have the appropriate knowledge of setting valuations in their business. Recognizing the importance of understanding of how the function of valuation approaches to value the firm and the need to examine the importance of setting valuations towards equity crowdfunding mechanism. The research objectives are:

- i) To examine the challenges of setting valuations towards equity crowdfunding mechanism in Malaysia.
- ii) To identify the valuation approaches for equity crowdfunding mechanism in Malaysia.
- iii) To recommend the innovative suggestions to enhance the equity crowdfunding initiatives in Malaysia.

1.5 SCOPE AND KEY ASSUMPTIONS OF THE STUDY

This research study is conducted to examine the importance of setting valuations towards equity crowdfunding initiatives in Malaysia context, whereas other criteria are not involved in this study. Besides, this research study aims to assess the equity crowdfunding models only; other models of crowdfunding in Malaysia are excluded. Moreover, this research study is only referring to equity crowdfunding platform operators whereas other crowdfunding platform operators are not included as well.

There are also few assumptions that made deliberately for this study. First, the researcher assumes all the respondents are answering with honestly. Second, this study only focuses on respondent's behavior and does not take into account environmental and economic factors.

1.6 SIGNIFICANCE OF THE STUDY

This study discusses about an implementation of setting valuations towards equity crowdfunding for new start up businesses in Malaysia as it is widely seen as a powerful enabler that helps startup prosper and further exploit their innovations.

Throughout this study, the researcher able to comprehend about the workable valuation approaches for an implementation of setting valuations towards equity crowdfunding of Malaysia context in order to attract the crowds towards new startup and SMEs businesses. In addition, the researcher able to recognize the current issue and find out the challenges of setting valuations and then recommend the innovative suggestions to enhance the equity crowdfunding mechanism in Malaysia.

In short, this study is significant to help our government to promote equity crowdfunding as an alternative funding channel that facilitates the development of young startups and SMEs businesses which devote significantly to the growth of national economy.

1.7 SUMMARY

Based on the research, the introduction is about the brief explanation of equity crowdfunding as an alternative funding channel that allows startups or small enterprises to raise the capital for their business in Malaysia. Besides, chapter 1 also highlighted the research objectives and research questions of the study. The data collection method used by the researcher is a qualitative interview for the purpose to understand subjective point of view of individuals as equity crowdfunding is a newly financing mechanism in Malaysia and lack of supporting information from academic literature.

In addition, the researcher intends to identify the valuation approaches for equity crowdfunding as a new way of learning for the entrepreneurs on how to value their business and examine the challenges of setting valuations towards equity crowdfunding which might bring significant effects on capital raising from the general public through internet-based platforms without seeking for traditional sources of funding. Last but not least, the researcher also comes out with innovative suggestions that able to promote the equity crowdfunding mechanism as a powerful sources to provide financing opportunities for SMEs, startups and innovative businesses who seeking liquidity in a more efficient and transparent manner in Malaysia.

CHAPTER 2

LITERATURE REVIEW

2.1 INTRODUCTION

This chapter extends an overview by providing a more detailed information and review of studies relevant to this research topic. For this research study, the literature review defines all related terms and concept of equity crowdfunding with the existing secondary data such as books and academic journals as the supporting information. In this chapter, the researcher explains the definition and origin of crowdfunding, concept from crowdfunding to equity crowdfunding, challenges and problems arise associated with an implementation of setting valuations as well as the valuation approaches that are suitable for the equity crowdfunding mechanism of Malaysia context. For instance, this chapter also provides the theoretical framework of this research study at the end of this chapter.

2.2 DEFINITION AND ORIGIN OF CROWDFUNDING

Cosh et al. (2009) state that entrepreneurs face an inherent problem at the early stage of business is to attract outside capital, given the lack of collateral and sufficient cash flows and the presence of significant information asymmetry with investors. Formerly, small companies only able to access traditional sources of funding such as business angels, venture capital, bank loans and love money at the beginning of businesses.