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pitchIN

Equity Crowdfunding–the Malaysian Experience

Introduction

Malaysia is an equity crowdfunding (ECF) success story. Since its beginning in 2015, the industry has steadily grown and gone on to become an important fundraising option for Malaysian startups and small and medium-sized enterprises (SMEs).

Malaysia has become one of the region's leading countries for regulated ECF. As many regional and global research outfits group ECF and peer-to-peer (P2P) lending together when compiling crowdfunding statistics, it is hard to find ECF-specific numbers for the ASEAN, Asia, and Asia-Pacific (APAC) regions. Nevertheless, reviews of ECF operators' performance in countries where ECF is regulated reveal that Malaysia is one of the best performing countries.

ECF was introduced as part of the government's initiative to create greater, more cost-efficient and simpler access to funding for SMEs and startups. At an event in 2014, then Chairman of Securities Commission Malaysia (SC), Tan Sri Ranjit Ajit Singh, said, "The SC believes that leveraging on the power of crowdfunding will assist in the democratization of wealth, prosperity and ideas across the entire economy. . ."

This vision of the democratisation of fundraising has been realised. The ECF industry has recorded steady growth, firmly establishing itself in the SME funding landscape. Companies that previously had limited options to access capital have been able to successfully secure funding for growth and expansion. Thousands of investors have been able to invest in deals that otherwise would have been accessible only to venture capital (VC) companies and like investors.

In tandem with its growth, ECF has risen in importance over the years, with SMEs now seeing it as among their first choices when fundraising. At launch in 2015, ECF was positioned as an alternative fundraising option. Today, the alternative tag is no longer valid. ECF is today arguably the largest funding channel for startups and smaller SMEs. This is evidenced by the fact that in 2021, RM221.63 million was raised in 104 ECF campaigns.

The Road to Launch

The roots of ECF could be found in a conceptual framework for an unlisted market that was proposed by SC back in May 2013. The MyULM platform was envisaged by SC as an online trading platform for unlisted securities and alternative investment products under its Capital Markets Master Plan 2 (CMP2).

MyULM was aimed at addressing the capital market needs of SMEs. It would be a centralised platform that brought together over-the-counter (OTC) trading of unlisted securities as well as (importantly) emerging alternative investment products and asset classes. However, MyULM ended up never being built.

SC then began introducing standalone capital raising innovations, with ECF being the first. A public consultation paper was released in 2014. From there, a regulatory market framework to facilitate the establishment of alternative trading platforms including ECF platforms was readied by SC. It then invited applications from interested operators. A total of 27 applications were received, and in June 2015, 6 ECF platform operators were approved by the SC.

These 6 platforms began operation in late 2015 and early 2016. A seventh platform was approved to operate in 2018. In 2019, another 3 operators were registered, bringing the total number of ECF operators in Malaysia today to 10. These operators are a mix of local platforms and those with Singapore, Europe and Middle East connections.

Performance

ECF took 3 years to find its footing before taking off to become a major fundraising channel for startups and SMEs in Malaysia. Like most innovations, ECF went through a period when its value to the ecosystem was questioned and assessed. Some scepticism was expressed as to whether crowdfunding for capital would be embraced by companies and investors.

However, the success of some early ECF campaigns drew positive media attention. This helped spread information about ECF to the wider public. The first such campaign was run by Kakitangan, an SAAS-(software-as-a-service) based HR (human resource) startup on pitchIN, a local ECF platform. Kakitangan raised RM1.55 million from 63 investors in less than 24 hours in September 2016. The publicity generated by this campaign gave a boost to the wider ECF industry.

While it still took a few more years to truly unleash its potential, the success of the first few big name ECF campaigns was instrumental in convincing other companies that there was another way to raise funds than just making the VC rounds.

The number of campaigns and amount raised annually by the ECF industry are shown in Table 1.

In terms of number of ECF campaigns, 2018 was a challenging year for the industry. A hotly contested general election that took place in May 2018 dominated the minds and hearts of Malaysians in the first half of the year. Most companies held off their fundraising plans to the later part of the year, after the country had recovered from election fever.

The arrival of new ECF operators also added some steam to the industry and by the end of 2019, it was back on track. In 2020, the ECF industry took off with exponential growth that cemented its position as the de facto fundraising option for startups and SMEs in Malaysia.

The Malaysian ECF Landscape

Before we look at the factors that contributed to the success of ECF in Malaysia, it will be helpful to get a view of the participants and features of the industry. The industry data below are taken from the 2021 Annual Report of the SC.

There were 104 successful campaigns in 2021, up from 80 in 2020. It is certainly an active industry, with 8 to 9 campaigns completed on average every month in 2021. In tandem with the rise in successful campaigns, the total funds raised also increased to RM221.63 million from RM127.73 million in 2020.

Companies that carried out ECF campaigns in 2021 raised an average RM1.60 million. The campaigns came in all sizes. The smallest raised just RM42,460 while the largest campaign in 2021 raised RM18.89 million. It should be noted that In March 2022, Commerce.Asia became the first issuer to raise the maximum allowed amount of RM20 million.

The mix between nontechnology and technology issuers is fairly even in 2021, at 53% and 47% respectively. Historically, this was not so in the early years when mostly technology startups carried out ECF. As information about ECF filters to SMEs, more traditional and brick and mortar companies have started carrying out ECF campaigns.

There are practically no restrictions on the type, age and industry segments for companies that can apply for ECF. Any private limited company, non-listed public company or limited liability partnership with a clear business plan is free to explore ECF.

As for the age of the companies, 39% of the issuers have been in operation for less than 2 years. Another 37% are between 2 and 5 years old. Nearly a quarter of the issuers (24%) have been operating for more than 5 years.

It is not surprising to see, given the fact that ECF is positioned to cover the early-stage funding gap, that more than half the issuers raised funds for their Series A stage. Twenty-two percent of the issuers did Seed stage funding while another 23% were very early-stage at pre-seed. A mere 1% carried out post-Series A fundraising.

On the investor side of the equation, the total number of participating investors since ECF was first introduced in 2015 surpassed the 11,000 mark in 2021. More investors than ever have participated in 2021, as investor participation increased to more than 5,000 from more than 3,000 in 2020.

ECF is mostly locally driven and male dominated at this time. Ninety-six percent of investors are Malaysian and there are more men investing (62%) than women. One statistic that augurs well for the future is that a majority of the participants are young. Forty-seven percent of investors are below 35 years of age. Another 33% are aged between 35 and 45. Twenty percent of the investors are aged above 45, of which 13% are under 55 and 7% are above 55 years old.

Not surprisingly, retail investors make up the largest crowd in ECF campaigns. In 2021, 57% of the investors identified themselves as retail investors. Angel investors make up 24% of investors with the rest being sophisticated investors.

Angel investors are investors categorised as tax residents in Malaysia and whose total net personal assets exceed RM3 million or whose gross total annual income is not less than RM180,000 in the preceding twelve months or who jointly with a spouse have a gross total annual income exceeding RM250,000.

Sophisticated investors are defined in the Capital Markets and Services Act 2007. For individuals, they are those whose total net assets exceed three million ringgit, or with gross annual incomes exceeding three hundred thousand ringgit, or who jointly with a spouse have a gross annual income exceeding four hundred thousand

Table 1: Number of Campaigns and Amount Raised in the ECF Industry, 2016-2021

	2016	2017	2018	2019	2020	2021
No of campaigns	14	24	14	28	80	104
Amount raised (RM Million)	10.4	33.82	15.06	14.72	127.73	221.63

Note: Number of successful ECF campaigns and amount raised annually.
Source: SC Annual Reports

ringgit. Corporations with total net assets exceeding ten million ringgit based on the last audited accounts are also defined as sophisticated investors.

What Makes ECF Tick in Malaysia?

Now that we have an idea of the ECF industry landscape, let us examine what led to the vibrant ECF industry in Malaysia. There are quite a few factors, as examined below, that have helped make ECF in Malaysia such a success.

A responsive regulatory approach

The regulatory approach taken by SC has been instrumental in creating an environment that is conducive for growth. Perhaps the most important step taken by SC when it created the ECF framework was its decision to allow retail investors to participate in ECF deals. This enabled true crowdfunding to take place.

The participation of retail investors has enabled companies to market their funding deals widely. A large investor base has emerged with popular ECF deals ending up with hundreds of investors. While angel and sophisticated investors typically put in the most funds, retail investors add momentum to campaigns by bringing in the crowd. Figures collected by pitchIN over the years have shown a consistent pattern. Retail investors make up 75% of the investors in ECF deals, while angel and sophisticated investors put in 75% of the amount raised.

Allowing anyone to participate has a strong impact on the ECF industry. Its effect can perhaps be best appreciated by comparing industry growth in Malaysia to jurisdictions where ECF participation is limited to certain classes of investors. A good example of such an environment would be Singapore, which allows only accredited investors to participate. Consequently, ECF has not taken off there on the levels seen in Malaysia.

Of course, SC ensured that there were adequate protective mechanisms for ECF retail investors. These measures include limiting retail investors to a maximum RM5,000 investment per deal, as well as an annual investment limit of RM50,000.

Companies seeking to raise funds must make extensive financial and business disclosures on their campaign pages. In addition, ECF operators are also mandated to carry out due diligence on companies raising funds on their platforms.

As the ECF operators gained experience, SC also began to widen the potential market size for ECF. This has been done by progressively increasing the amount companies could raise on ECF platforms. At the start of ECF in 2015, companies were limited to raising a maximum of RM3 million per campaign, with a lifetime limit of RM5 million. Also, only private limited companies with paid up capital less than RM10 million were eligible to raise funds.

As the market matured, SC first increased the funding limit to RM10 million and recently, in November 2021, SC announced that the paid-up capital limit was removed and that companies could now raise up to RM20 million on ECF platforms. It also opened up ECF to non-listed public companies. These measures have steadily brought new participants into the market.

The right timing

ECF arrived right when it was needed.

ECF helps to address the estimated RM90 billion financing gap among micro SMEs (MSMEs)[1], which is especially acute for earlier stage companies.

Prior to the introduction of ECF, the early-stage funding landscape in Malaysia was made up of government agencies that offered grants, private and public accelerator programmes, some VC companies that focussed on pre-Series A deals and traditional 'family & friends' investors.

Among the most visible government funding agencies is CRADLE, which focusses on technology startups. It provides pre-seed grants of around RM150K to startups to help them build minimum viable products. Companies that had validated business models and needed funds for expansion could apply for larger grants (RM500K) for marketing and business growth.

A few startup accelerator companies operated alongside these grant agencies. These accelerator programmes typically offered very early-stage capital as well as structured startup development programmes in exchange for equity in the startup. The VCs that fund pre-Series A and Series A deals were usually the next funding option when startups reached higher levels of growth. However, these agencies, accelerators and VCs understandably can only fund a limited number of startups and SMEs.

To compound the matter further, the number of startups seeking capital was growing. Around 2013-14, the government initiated lines of actions to spur the growth of startups in the country as well as encourage existing SMEs to digitise their operations. A new government agency, then known as MaGIC (Malaysian Global Innovation & Creativity Centre) was launched in April 2014, with U.S. President Obama present. It offered programmes and assistance to technology and social impact startups. The government also launched an accelerator programme called Global Accelerator Programme (GAP Accelerator).

The government initiatives had the desired impact by creating a wave of startups. Technology startups typically need to fundraise throughout their stages of growth. As a result, the number of companies that sought to raise funds grew sharply.

It must also be noted that in the wider context, Malaysia has always been an entrepreneurial nation. Even without the initiatives to grow the technology ecosystem in Malaysia in 2013/2014, SMEs have always dominated business sectors in Malaysia. Quite simply put, Malaysia has a large number of SMEs relative to its population. Malaysia, with an estimated population of 32.7 million in 2021, recorded a whopping 1,226,494 MSMEs.[2] Thus, there is no shortage of companies looking for capital.

The arrival of ECF opened up a new channel of fundraising that helped to address the funding gap.

Malaysia Co-investment Fund

The announcement by the government that it would co-invest alongside investors in ECF deals was another catalyst for the ECF industry. In November 2018, the Malaysian government announced in the 2019 Budget that it would allocate RM50 million to set up a co-investment fund. It is called the Malaysia Co-investment Fund (MyCIF) and it was set up specifically to co-invest in SMEs alongside private investors. The fund would co-invest exclusively on ECF and P2P Financing platforms. The initiative proved successful and additional amounts were allocated by the government in the 2020 and 2021 Budgets.

MyCIF was operationalised by SC. At launch, the co-investment criterion for ECF was set at a 1:4 ratio, where MyCIF would invest RM1 for every RM4 raised by the crowd, up to a maximum of RM1 million MyCIF investment per campaign.

MyCIF began disbursements in October 2019. Four months later, the world was hit by the COVID-19 pandemic. To sustain liquidity and investor confidence in the markets, MyCIF reacted quickly and made temporary adjustments by increasing the investment ratio to 1:2.

The MyCIF initiative had the desired impact. By the end of 2020, the ECF industry had grown by 458%. By 2021, the MyCIF fund reverted to the original 1:4 co-investment criterion.

The importance of MyCIF cannot be overstated. On one level, it aided more issuers to achieve their fundraising targets by funding the 'last mile' of their campaigns. This was done by MyCIF taking up remaining amounts after investors had committed the initial 80% when the 4:1 criterion was applied or 50% when MyCIF temporarily changed it to 2:1. In addition, this initiative by the government to co-invest alongside the crowd was viewed positively as it encouraged more investors to put funds into ECF deals.

The pandemic

While the COVID-19 pandemic was bad news for many industries, the ECF industry was impacted positively. The number of deals and amounts raised rose sharply over 2020 and 2021.

The reason for this was simple. The lockdowns which disrupted everyone's lives resulted in a massive acceleration of digital transformation. Consumers made a huge leap into online services. New startups were launched and existing businesses pivoted towards online offerings. Digital and online focussed businesses sought capital on ECF platforms and investors were ready to back them.

ECF platforms also adjusted their operations swiftly when lockdowns were imposed. They pivoted from physical roadshows and events to online pitches. The online events found ready audiences among people who were locked in their homes and with time on their hands.

The quality of the issuers

And finally, a lot of credit for the vibrancy of the Malaysian ECF industry must go to the quality of the companies that raise funds on the platforms. Investors put money into these companies in the hope that their investments will generate good returns over time. If the companies do well, not only will the investors put more funds in, their success stories will draw more investors into the industry.

By and large, the companies that raised funds on pitchIN have performed creditably. The oft quoted saying that nine out of ten startups fail does not hold true for ECF issuers. There is no industry data available, but on pitchIN the percentage of companies that ceased business operations is very low, at less than 3 percent.

The success stories far outnumber those failures. Six years into ECF in Malaysia, it is clear that the wisdom of the crowd is effective with regards to making investment decisions. One issuer has gone on to a successful listing on the Leading Entrepreneur Accelerator Platform (LEAP) market, four years after raising funds through ECF. A few other companies are well on their way towards initial public offerings (IPOs). A significant number of companies have raised subsequent funding rounds with VCs and institutional investors at higher valuations, some at up to 5- to 6-times in 3 years. One issuer raised RM3 million through ECF in 2018 at RM20 million valuation. In 2022, this company raised another RM17 million at RM100 million valuation.

The industry has also seen some exits when companies have been acquired. Other investors have enjoyed steady dividends from their investors. A number of private secondary transactions of shares between individuals' shares at higher prices have also taken place.

The quality of the deals has not only brought new investors to the industry. It also encouraged existing investors to invest more regularly. Nearly 15% of investors at pitchIN have made 2 or more investments. Twenty-six investors have invested in more than 10 deals and close to 100 investors have invested between 5 and 9 times.

The Future of ECF in Malaysia

While ECF in Malaysia has been an unqualified success, there is still plenty of potential to unlock. As mentioned earlier, the over 1 million SMEs and startups in Malaysia translate to a huge market size. On the investor side, awareness about ECF has reached only tech savvy people living in large urban cities, primarily in the Klang Valley and places like Penang and Johor Baru.

Another boost will come soon for the ECF industry as SC is allowing operators to submit proposals to operate secondary trading platforms that will enable trading of shares in companies that had raised funds through ECF campaigns. As secondary market platforms will add liquidity and exit options for investors, the industry hopes that it will bring even more participants into the industry.

One operator (pitchIN) has already confirmed that it will be launching a secondary trading platform this year. Over 140 companies have successfully raised funds on its platform, and when trading in their shares starts, there is belief that the excitement generated will take the industry to new heights.

It is also expected that more operators will over time start offering Sharia-compliant ECF deals alongside their current deals. Again, such offerings will draw another group of investors. Finally, deal sizes are expected to grow as larger companies are now allowed to raise funds through ECF platforms.

ECF is and will continue to be a very important fundraising choice for the heavily SME-centric Malaysian business sector.

Notes

1 Capital Market Masterplan 3, quoting MSME Finance Gap: Assessment of the Shortfalls and Opportunities in Financing Micro, Small and Medium Enterprises in Emerging Markets, International Finance Corporation, 2017.

2 Malaysia Statistical Business Register (MSBR) published by the Department of Statistics, Malaysia.

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A life-long entrepreneur, he has built multiple successful businesses. Kash was previously the founder and Managing Editor of MOBILE WORLD, a leading technology publication that was launched in 2002 and ran for 11 years. He also co-created GoMobile, a groundbreaking event that incorporated a large consumer expo, conference and an awards night.