

# Crowdfunding as a Financing Option for Small Contractors

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## Abstract

Difficulties in accessing financial support from banks and other financial institutions are the biggest challenge to small and medium enterprises (SMEs) including contractors. This paper aims to examine crowdfunding as a financing option for small contractors. A series of interviews have been carried out with nine participants including six founders and three funders. The results show that bureaucracy is one of the challenges for small contractors to obtain funding from financial institutions. The nature of their business involves various projects at the same time and needs to be completed in a short period. Therefore faster and easier financial assistance is necessary to ensure the smooth operation of the project through crowdfunding. However, trust is the main component of this method. Funders are more selective and therefore the founders should be able to offer a viable business plan or project that promises a good return. Besides various online crowdfunding platforms available in Malaysia like ECF and P2P, this conventional crowdfunding is still preferred and being practiced among small contractors. The results of this study provide insight to the funders to choose crowdfunding as an investment opportunity and help to improve the economy of the community.

**Keywords:** crowdfunding, trust, contractors, funders

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## 1. INTRODUCTION

Small and Medium Enterprises (SMEs) are a crucial component in the Malaysian economy that contributes a high portion of the gross domestic product (GDP) and also provide job opportunities to communities in the country. However, the sustainability of SMEs commonly encounters obstacles in obtaining sufficient funding. There are many options available for SMEs in terms of funding including from government agencies and banks. Some micro entrepreneurs use their own money and lending from family and friends (Prijadi Wulandari, Desiana, Pinagara & Novita, 2020; Baidoun, Luisser, Burbar & Awashra, 2018). However, there is a lack of studies regarding financing for SMEs in contracting enterprises (SMCE). There is a quite difference between SMEs nature of business with SMCE. A large number of SMCE comes from grade 1 (G1) which is categorized as small size contractor and mostly depend on government tender or become sub-contractors (Jaafar & Abdul-Aziz, 2005; Hasmori, Ismail & Said, 2012). Many SMCE face cases relating to delay payment and non-payment from the project owner and effect their turnover capital (Hasmori et al., 2012). Therefore SMCE needs an alternative option to finance its project and among them is the crowdfunding method.

Crowdfunding is a way of solution to addressing sustainability issues and is considered as their business model is less complementary to traditional financing, pooling a small amount of funding from interested funders (Short, Ketchen, McKenny, Allison, & Ireland, 2017). Many studies related to crowdfunding focus on digital platforms and crowdfunding models (Kraus, Ritcher, Brem, Cheng & Chang, 2017; Mollick, 2014). There is a lack of study on traditional crowdfunding that still exists particularly in small businesses like SMCE that need a regular or periodic financial injection to maintain their cash flow to continue with their work (Sabri & Mat Isa, 2020). Therefore, this present study emphasizes crowdfunding as a preferred financing option among small contractors.

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## 2. LITERATURE REVIEW

### 2.1 Construction industry in Malaysia

The construction sector in Malaysia plays a vital role in economic development. This sector experienced robust growth during the period from 1991 until 2020 with an average annual growth rate of 7.2 percent. However, because of the pandemic Covid 19, it contributed 3.9 percent to the gross domestic product index (GDP). Although this percentage is relatively small it provides a valuable multiplier effect to the economy and other industries. The industry provides work for a range of people from professionals such as architects, engineers, and surveyors to main contractors, subcontractors, suppliers, and laborers. In Malaysia, Construction Industry Development Board (CIDB) is responsible to regulate, develop and facilitate the construction industry. Contractors under CIDB are categorized into seven groups (refer to Table 1).

Table 1: Contractors' Grade in Malaysia

Grade (CIDB)	Project Price (RM)	Contractors category
G1	Not more than RM200,000	Building (B) Mechanical and Electrical (ME) Civil Engineering (CE)
G2	Not more RM500,000	B, ME, CE
G3	Not more RM1,000,000	B, ME, CE
G4	Not more RM3,000,000	B, ME, CE, and Facility
G5	Not more RM5,000,000	B, ME, CE, and Facility
G6	Not more RM10,000,000	B, ME, CE, and Facility
G7	No limit	

Source: cidb.gov.my

The government takes this sector seriously by also presenting National Construction Policy 2030. The policy focuses to improve quality in construction through technology, establishing a safe built environment, and improving the procurement system for government projects (NCP, 2022). Issue such as payment has been raised since Malaysia Construction Industry Master Plan (CIMP) 2005-2015, which recommend an Act be enacted to address non-payment, late payment, and other payment-related issues in the construction industry (CIMP, 2005). This act solved the issue of cash flow problems particularly payment from a government project.

The government encourages the participation of many Bumiputera to enter the construction sector with ease the registration specifically for grade G1 contractors. To the data in 2016, there are 35,555 contractors G1 registered and the number increased to 42173 contractors (CIDB, 2017;2020). Most of the contractors registered are small and medium-sized contracting enterprises (SMCE) that carried 80 percent of the population. The high number of SMCEs leads to intense competition and a high business failure rate (Jaafar & Abdul-Aziz, 2005). One of the issues is late and non-payment among contractors (Hasmori, Ismail & Said, 2012). Even though, payment issues between contractors and the government have been solved with the solution stated in CIMP 2005-2015. But, the problem of payment still exists between contractors (the project owner) and sub-contractors and this will affect their turnover capital/funding (Hasmori et al., 2012). Some cases showed the project owner failed to pay and most serious implication being declared bankrupt (Wah-Peng et al., 2020). Most of the small contracting companies' reputation is ruined as their trustworthiness with a bank is affected in such condition (Wah-Peng et al., 2020).

### 2.2 Small and medium-sized contracting enterprises

Most of the studies in the business area are more interested in SMEs but not many studies focus on SMCE, particularly G1. The number of G1 contractors is highest among other groups of contractors (G2-G7) because the entry cost as a G1 contractor is small which is RM5,000. During the early phase, financial assistance is often provided by personal funds and by friends or family. Financial aid is crucial for fostering the development of a business during the early phases of its development (Prijadi et al., 2020). According to Baidoun et al. (2018), the most important things for a small business's survival and success are having enough money, keeping good records with financial controls, making plans, and getting help from a professional management team.

The study by Jaafar and Abdul-Aziz (2005) stated SMCE has higher debt capital which a big portion of debt goes to suppliers. This situation affected them to complete the task and cause a delay in delivering the project. Knowing this situation, self-funding is not an option anymore. Government interference through the agency Tekun Nasional provides loans up to RM200,000 specifically for G1 contractors (Malay Mail, 2022). The government also urged the financial institution to provide loans for contractors. In addition, the nature of SMCEs' practice is to have or alliance with several companies registered under different grades and different categories at the same time. This common strategy is used to have many changes to compete in the project or government tenders. The problem of lack of capital happens if they have several projects at the same time. The funding alternatives are through crowdfunding.

### **2.3 Crowdfunding**

Crowdfunding is a form of a collective effort of many individuals to pool money with small contributions in providing financial support to an individual or organization. Mollick (2014) defines crowdfunding as the efforts by entrepreneurial individuals and groups, cultural, social, and for-profit to fund their ventures by drawing on relatively small contributions from a relatively large number of individuals using the internet, without standard financial intermediaries. Recently, the crowdfunding concept involves the use of the internet and the power of the crowd to raise capital openly and transparently (Beaulieu, Sarker & Sarker, 2015). By using a crowdfunding platform individuals could supply small extents of money to economic projects or innovative ideas (Hoque, Awang, Muda & Salleh, 2018).

There are four models in crowdfunding, named as donation-based crowdfunding, reward-based crowdfunding, crowd lending, and equity-based crowdfunding (Kraus, Richter, Brem, Cheng, & Chang, 2016). This paper focuses on crowd lending. Funders in the lending model provide funds over a small loan and earn an interest payment. This includes a private person called peer-to-peer (P2P) or private persons and companies.

The success of crowdfunding projects is related to the amount of investment requested by the founder, the duration of the project as well as the contribution frequency by funders (Cordova, Dolci, & Gianfrate, 2015). A study by Mollick (2014) reveals that the geography factor also plays an important role in the success of crowdfunding. Local investors especially family and friends contribute earlier and are more responsive as compared to distant investors. Besides that, personal networking and underlying project quality are other factors related to the success of crowdfunding (Mollick, 2014). Forbes and Schaefer (2017) present the crowdfunding success tools like (1) choosing a smaller project with community-backing and consideration of social investment; (2) setting appropriate goals to ensure the expectations of the campaign are within their capability; (3) setting the reward option by reducing the profit margin, that is offering a lower price to the backers; and (4) presenting the key information that potential backers require such as the value of the product, how the money will be spent and the plan after the campaign. On the other hand, the information provided by the borrower in the form of updates and comments of other crowds and investment behavior is the other factor that influences the decision by the investor or funder (Hornuf & Schwiabacher, 2018). Moreover, according to Gerber et al. (2012), people are motivated to fund because to seek rewards, support creators and causes confirming value, and engage and contribute to a trusting and creative community.

## **3. METHODOLOGY**

### **3.1 Samples and data collection**

This study uses small contracting enterprises and microentrepreneurs to represent individuals who have encountered problems in financing their business activities. Judgmental sampling is applied to ensure that investigators choose people and sites for the sample that have a better understanding of the research problems and key phenomena in the study (Creswell & Poth, 2018). This study uses small and medium contracting enterprises definition according to their registration grade or class with the Malaysian Construction Industry Development Board (CIDB). Small contractors in this study refer to grades G1 with paid-up capital of RM50,000 or less with the tender limit for projects does not exceed RM200,000 (CIDB, 2017).

This study has conducted a series of interviews involving nine (9) respondents including six (6) founders and three (3) funders. The sample size of 9 interviews was determined to collect rich and thick data and found to be sufficient for achieving data saturation. When this research reached the data saturation threshold, it was determined that no new information was gained despite the collection of additional samples (Creswell & Creswell,

2018). The semi-structured interviews were conducted face-to-face and online based on the choice and comfort of the respondents, to gather rich and thick information from the participants.

### **3.2 Analysis of data**

The video and audio from the interviews were transcribed and analyzed with thematic analysis using ATLAS.ti software. This research applied the six-phase thematic analysis method (Braun, Clarke, Hayfield, & Terry (2018). This includes familiarization of the content, coding or categorizing data, and theme development by merging various codes to form a comprehensive theme. The themes were then reviewed and refined to find a consistent pattern. The next process was defining themes to recognize the stories behind each theme, and finally reporting the outcome of the analysis.

## **4. FINDINGS AND DISCUSSION**

### **4.1 Nature of business**

The construction industry has always been a keen competition arena due to the ease of entry. In Malaysia, most of the contractors belong to the smallest-scale, Class F category (Adnan, Heap-Yih, Idris, & Ahmad, 2011). Class F category is now known as the G1 grade mostly involved with supplying goods or services to the government through tender biddings.

*"I'm doing small contracting works, G1 grade, bidding government tender. I often go for sub-contracting works"*

Most of the contract works were carried out with a small number of workers depending on the nature of the contract works. Those employees were normally hired based on the terms or duration of the contract work and were paid wages based on the stages of work completed or daily basis depending on the type of the job.

*"I have about ten workers on a contract basis, only two management staff"*

*"For cleaning services contract normally takes about thirty to thirty-five workers and their employees come to an end when the contract ended"*

*"We sometimes sub-contract the works and pay wages in lump-sum, however, we supply the material. We make the claim later when the job is completed"*

Among the natures of this small contract business is the number of employees and duration that changes according to the tender obtained. Most of the contract works were on a short-term basis and the payment or claims are based on the stage of completion. Therefore, the contractor needs to keep sufficient and fast cash to start their contract works. Further, sub-contracting works depend on the job offered by the main contractor, and claims on the completed job will be made to the main contractor. The 'pay-when-paid' method applied in sub-contracting agreements results in a delay in payment received by the sub-contractors (Sabri & Mat Isa, 2020).

### **4.2 Funding management**

The nature of the contracting works discussed above requires small contract operators to ensure sufficient funds are available before starting the contract works. A rising number of small contractors are facing delays in payments, insufficient financing, shrinking contracts as well as difficulty in getting loans due to tougher operating environments in the construction industry (Adnan et al. 2011). Delay in payments from the main contractor or the agency and having multiple job contracts are among the challenges facing small contract enterprises. Thus, the fast and readily available financing is preferred.

*"We sometimes got more than one job at a time, got to start a new job while the other one is still in progress, therefore we need fast cash, we go for crowdfunding"*

*"... from then until now, I've been looking for funds from sources other than the bank"*

Respondents chose funding other than banks, mostly from family and friends, a traditional way of lending. Crowdfunding represents a unique way for founders to raise funds for various projects. Apart from the online platform or internet-based peer-to-peer lending that gathers interesting funders with small amounts of money, respondents would rather be traditionally using fundraising.

*“I got funds from seven to eight people at a time”*

*“...they lend me money for five years”*

*“I occasionally take a loan from the bank, but only when I found no other places”*

Requesting money from the crowd stands in contrast to traditional fundraising efforts such as securing funds from banks, venture capitalists, and foundations (Gerber, Hui & Kuo, 2012). A mutual understanding and relationship between the founder and funders are most crucial during the process of exchanging resources to realize the hopes and goals of both parties. The reward-based crowdfunding and crowdlending are the most appropriate models related to this kind of business activity. Both parties have their motives, founders seeking funding and funders funding the small ventures. Motivations for giving among funders are related to interpersonal connections between the giver and the requester and communication styles (Gerber et al. 2012). On the other hand, the founder can raise similar sums of money through a large number of supporters contributing small sums (Gerber & Hui, 2013), instead of obtaining funds from banks or venture capitalists.

#### 4.2.1 Trust

The process of crowdfunding begins with giving information to entrepreneurs who wish to obtain funds from potential funders. Trust enables crowdfunders to overcome perceptions of risk and uncertainty, and thus influences their intentions to support a project financially (Moysidou & Hausberg, 2020). The founders should be able to provide complete information about the projects and convince the funders about the viability and expected return on the projects. The traditional way of fundraising from the public that they closely related.

*“ .... just based on trust ....we have an agreement, based on trust”*

*“ We make sure that we have a win-win situation, so we trust each other”*

*“ .... most of my funders, believed in my projects”*

On the other hand, the funders rely on the proof of documentation or the details of the project. A piece of complete information regarding the contract work will lead to the crowdfunders' trust in the project.

*“They have the evidence, like tender agreement and payment schedule, I decided to contribute, can be trusted”*

Another measure of confidence is that the trustee or the founder will behave expectedly and will refrain from opportunistic behavior. The willingness among crowdfunders to be vulnerable is also a critical component in building trust.

*“I did not involve with the job, they are the ones who handle it, they will pay according to the terms in the agreement, that's it...”*

*“A loss in business is normal, so if the project is at loss, and they just pay me how much they can afford...”*

*“Some did not pay as agreed, they need the money for another job... understood”*

*“I never put any conditions, if there is a problem, he will take a few years to pay back, so we agree on that.”*

Further, trust also can be built in the funders' strong desire to help the founders with whom they have a personal or extended interest or connection.

*“I just want to help and like to help and encourage people in doing business”*

Trust is about reliance based on the expected trustworthiness of the other party. The quality and completeness of the information on the related projects indicates trustworthiness and therefore helps to build trust in the project. The funders need to trust the indicators and the best intention of the entrepreneur or the founder of the projects. A ready-built relationship between the founder and funders also contributes to the development of trust. Further, trust is also related to the openness of negative outcomes to be experienced when the project or the other party proves to be untrustworthy.

#### 4.2.2 Bureaucracy

Crowdfunding can be a fast way to obtain finance with no upfront fees. The crowdfunding process does not associate with credit rating compared to bank financing involves risk of credit and demand risk where a higher interest rate will be charged or even reject the loan application if the related project is too risky (Xu, Guo, Xiao, & Zhang, 2019). To lower the risk, detailed documentation and a stringent review of the trustworthiness of the project will be carried out by the bank. Such beurocracy and proper documentation seem to be a problem to most of the fund seekers.

*"I did not apply for a bank loan, too much bureaucracy and documentation".*

*"...the easiest is crowdfunding because you don't want to be bothered with documentation. If the funder asks for documentation, it seems he is looking for someone else"*

Banks take a longer period for loan processing and approval. The bank officer needs to perform extensive analysis considering all attributes related to the applicants and the business (Ottavia1, Chuluunbaatar, Kung & Luh, 2011). This situation causes small contract operators to be discouraged from making any loan application with the bank.

*"Applying for a bank loan takes time, we need fast cash, need to complete the job in a very short period"*

*"I've experienced once, the bank only approves the loan while my contract works about to complete..."*

The need for the fast available fund among small contractors especially when dealing with multiple jobs at a time seems to be a valid reason for not applying for a bank loan. On the other hand, loan approval by the bank is based on the belief that the borrower can be trusted to repay the debt and this should be done extensively to screen out potential bad loans. Thus, crowdfunding appears to be a better solution to the problem facing small contractors who seek a quick funding platform and are unable to provide proper documentation.

#### 4.2.3 Rewards and return

Funders are the utmost important subject in crowdfunding. There are various motives for contributing to the crowd. Among them are the desire to collect external rewards, help others, and feel part of the communities (Moysidou & Hausberg, 2020). The reward crowdfunding model offers material and immaterial social rewards such as acknowledgment. Material rewards include the exchange of the product which is commercialized by the entrepreneur when the project is successful.

*"As for me, I will always look for opportunities to invest anywhere and would like to contribute to a project with a reward, for example funding a new model of bicycle with solar energy, and I will finally be rewarded with a bicycle and not a profit"*

Further, the helping behavior among funders represents a strong desire to help founders with whom they have a personal or extended connection. On other hand, the so-called lending-based crowdfunding reflects the lending of money to the founders in exchange for rewards like interest or profit sharing and repayment of capital over some time.

*"I was first helping, when everything succeeds then we talk about profit sharing."*

*"My goal is profit so that I can use that profit to help others."*

*"The company I invested in has a proper record and he presented it, so we know he has financial health rights"*

The reward crowdfunding model offers a lower cost in terms of communication as well as transaction cost. Whereas the lending-based crowdfunding model benefits the founders in terms of ease to get funded compared to the loan in a traditional way such as through bank and other channels. These models finally offer benefits to both parties in terms of personal relationships, shared interest, and helping the community as a whole.

## 5. CONCLUSIONS

To conclude, crowdfunding is among the best solution for small contract enterprises due to the nature of the business. The ease of getting financing with less bureaucracy; the trust built among founders and funders; and the returns and rewards offered by the crowdfunding activities contribute to the success of the founder and funder relationship as well as the projects or business. This study represents traditional per-to-peer crowdfunding, thus future studies should deal with crowdfunding by small and medium contract enterprises using internet platforms. The larger participants involving larger grade contractors from G1 to G7 would be more meaningful. The results of this research contribute to the literature on crowdfunding knowledge. It also provides insight to the funders to make crowdfunding an investment opportunity and help to improve the economy of the community.

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