

تمويل المشاريع الصغيرة والمتوسطة في دولة الإمارات

### **Issues of Financing SMEs (Small and Medium Enterprises) in U.A.E.**

SMEs (small and medium size enterprises) in U.A.E.- There is no standard global definition of small or medium size enterprises. In U.A.E., SME companies are classified according to the number of employees and the level of investment. A company is considered large if it has more than 100 workers and investment worth more than AED 5 million. A firm with 10-100 employees and an investment of AED 2-5 million is considered medium-sized, and a firm with 3-10 workers with an investment ranging between AED 200,000 to 2 million is considered small. There are 260,000 companies in U.A.E. according to a private source (Ruwad Establishment), and 208,000 of them are SMEs, roughly accounting for 80% of the economy. Data on SMEs is largely available from private sources, is not official but adequate as an indicator.

Financing issues of SMEs – SMEs form the backbone of any economy, as also in U.A.E. They are thus critical for the process of development and growth. While there are several issues regarding fostering SMEs, their financing is foremost as SMEs usually do not have access to organized capital markets. Bank financing is usually their only option, and is the predominant source of external financing for most SMEs. However, banks consider SMEs to be relatively high risk, which on the one hand impedes their ability to obtain funding, and on the other leads to the charging of higher interest rates. There are several issues involved, relating to (1) banks' business policies which (2) the nature of SMEs approach to the banks and their banking relationship and (3) as well as banking regulatory policies on lending to SMEs which instructs commercial banks on the levels/amounts of lending to SMEs.

Situation in U.A.E. - A study by Dubai Chamber of Commerce and Industry concluded that in U.A.E. too, bank credit represented the major source of finance for SMEs. It also found that SME companies faced difficulties obtaining their needed liquidity as the country's commercial banks classify SMEs as high-risk categories because they view SMEs financial structures as weak. Banking source in U.A.E. admit that SMEs find it difficult to obtain finance in the country, and forward the reason that SMEs cannot meet the strict guarantees imposed by banks. In addition, banks maintain that some of these projects lack feasibility studies, which forces them to classify them as high-risk. At the same time, banking regulations instruct banks to finance SMEs to up to 10 % of the total banking portfolio.

Financing SMEs in U.A.E. – A study released earlier this year by a private consultancy firm, found that more than half of the SMEs in U.A.E. were unable to get the finance they required and the same proportion of SMEs surveyed were unhappy with the interest rates they were paying. This survey also showed that overdraft and letters of credit facility were the chief requirements of SMEs in the country.

Interest rates to SMEs higher - According to this same survey, more than half of SMEs in U.A.E. were facing difficulties in accessing credit. The report also mentions that interest rates for unsecured lending to SMEs (reportedly as high as 15%) are much higher in U.A.E. compared to those in Western markets. The high rate is the result of a risk premium, as the perceived risk of SME lending in the U.A.E. is high. Typical interest rates in U.A.E. for secured lending for overdrafts were 4% and 10% respectively which are close to international norms.

Cause of risk premium - The risk premium that drives up interest rates is primarily the result of an informational asymmetry between lender and borrower. This situation arises largely because the lending bank does not have adequate information about the borrower. It can be asserted that this is largely a procedural and standardization problem. It can be corrected by establishing standards of information revelation to which the borrowers must adhere with discipline with accompanying documented proof.

High loan rejection - The above survey also found the loan rejection rates for loans applied by SMEs to be rather high. If so, it suggests this is partly due to the potential borrowers' failure to comply with banks' requirements. Some banks are of the view that accurate financial statements were difficult to get from SMEs and in rare cases, recovering money/assets was a complex and time consuming process. This needs to be corrected and should not be difficult if the pre-conditions of funding are amply made clear to SME borrowers. A survey on the causes of rejection would provide valuable insights into the problem and lead to the appropriate remedy.

Dedicated banks for SMEs - Commercial banks are keen on business which meets the working capital needs of businesses, but less on business to finance SME start-ups. Thus, there is a need for dedicated banks, working on commercial principles but dedicated to financing of the setting up of SMEs. Currently, not only U.A.E. but the entire AGCC region lack institutions which specialize in funding SMEs. Such institutions however, exist in Western countries and even China. However, the larger demand for SME funds can be expected not from setting up new SMEs, but existing ones.

Dedicated/specialized banks and the concept of "house bank" - This is where the concept of a "house bank" as popular in Germany for SMEs can come very handy. Here, bank lending is exercised through close, long-term relationships between an SME and one particular bank – and not deal with several banks, unlike large enterprises which could be dealing with upwards of ten banks at any time. This puts the "house bank" in a position to reduce risk and charge a lower interest rate, at least compared to another (new) bank which does not have the same amount and quality of information on the SME and will therefore charge the debtor a risk premium to make up for this lack of information. The "house bank" is entirely a commercial entity and run on market principles without any subsidy element.

Not all SMEs, but only those relevant to the economy's needs and growth projection - While broadly speaking, the SMEs certainly need to be fostered and encouraged, a blanket policy to encourage them is not appropriate either. In some economies, they have been seen as “too many, too small”, and focused on small-scale trade, and this could also be the case in some sectors in U.A.E. For example, SMEs are globally known to be more labour intensive and given the shortage of labour in U.A.E., capital intensive SMEs employing less labour need to be fostered. Some benchmarks need to be established, not for the entire population of SMEs, but SMEs by each individual business sector.

“SME Index” - The starting point has to be the current situation in each business/economic sector. There is a need to establish a sector-wise “SME index” to establish the role of SME enterprises. This index could even be based on different definitions. Currently, there are several definitions of SMEs used worldwide which vary considerably, not only by threshold but also by the criterion. The SME index can be simply calculated as the number of SMEs in proportion to total enterprises. Against this, there is a need to establish the ideal size of establishments within a range and their characteristics, viz. labour and capital intensity etc.

SME policy - This should enable the establishment, discussion and analysis of whether too many or too few SMEs in each sector, and develop an appropriate support policy or policies. Further criteria need to be developed regarding the kind of SMEs are suitable to the country's economy. These criteria could relate to employment (nationals and expatriate), technology, location, environment and growth potential. The theme of SME lending in U.A.E. needs to be analyzed and explored further with focus on structural issues that impede SME credit access.

Policy criteria - Clearly, there are certain sectors ideally suited to SMEs. Agriculture, Manufacturing (some, though not all), trading (both retail and wholesale) and service in general, are very well suited to SMEs. Meanwhile, Construction, Transport, IT and Finance sectors have medium potential for SMEs. Utilities, Oil and Minerals have virtually no room for SMEs. The SME policy has to be sector-wise and keeping in mind the needs of the sector and that of the economy. In this regard, U.A.E. banks need to be advised which sectors are best suited for SME loans, what amounts, at what interest rates and what information SMEs need to provide to the banks.

Non-financial support needs of SMEs - Meanwhile, SMEs also have non-financial needs as well, which they find difficult to meet on their own. Besides financing, particularly because of their smaller size, SMEs need support on market research, technological choices, logistics options etc. Larger companies can commission dedicated studies for such information which are too expensive for SMEs. Instead, SMEs rely on their trade/industrial associations for such support. However, in a small country like U.A.E. the industry associations are rather small, a good option is to provide this from a central source dedicated to SME and market related information, particularly, for those sectors which are deemed of importance to the economy.

Outlook - Nevertheless, despite all difficulties, bank lending to SMEs as a market segment reportedly grew last year (2007-08) by more than 20% according to the survey mentioned above. Despite the global financial crisis, banks remain cautiously optimistic regarding lending to the SMEs during the coming years. If cost of funds for SMEs could be reduced by dedicated/specialized banks, it would give a huge boost to SMEs and the U.A.E economy.