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Finance

Raising finance as a small or medium enterprise in the Gulf can be a significant challenge. Faced with a restrictive regulatory environment, and with a lack of investors, businesses in the GCC can struggle to bring in the capital investments necessary to expand their operations.

"This is the biggest challenge in the market today," says Abbas Ali, vice president at TASC Outsourcing, a Dubai-based company with about 120 staff. "Say I have a fantastic idea, and I need a million dollars – but I have no means to get it, because I don't have three years of bank statements and audited reports. The bank won't even entertain me. If you look at the data, SMEs constitute only 2 per cent of the bank loans in the Gulf."

Paul Kenny, founder of e-commerce firms Cobone and Safarna, and now a venture capital partner at Emerge Ventures, has a similar view, based on his experience of starting a business: "My initial thoughts were to go to a bank and ask for a loan that would kick things off for me. Unfortunately, this was ruled out quite quickly, with the news that the interest rates they would charge on such a loan would be very high, and that the banks would not understand your business – such a loan was an impossible task."

Even for established firms, borrowing from banks is not easy, as loans are usually secured against personal assets of the business owner. As Ali explains: "If a business goes bust, you can't say the business is bankrupt but don't touch my personal assets, my kids' education".

A recent survey of UAE SMEs by Souqalmal.com revealed 28 per cent of respondents had gone to banks for finance, but 58 per cent of them found the process very difficult, saying there were too many formalities, or banks were not prepared to lend money to smaller businesses. In contrast, 31 per cent of SMEs were funded directly by the founders – this number rose to 42 per cent for companies with 10 employees or fewer.

Amir Ahmad, partner at law firm Pinsent Masons in the UAE, says the lack of bank lending to SMEs comes from a combination of commercial and legal factors. "In the UAE, how the conflict and interlink between commerciality and the regulatory framework plays out is that the regulations are such that commercial lending to SMEs cannot occur based on the restrictions or opaqueness of the legal framework. Hence, banks don't lend."

Faisal Aqil, deputy CEO for consumer wealth management at Emirates Islamic Bank, acknowledges that banks are not looking to lend to early-phase companies. “It is important to differentiate between start-ups and companies in mid-maturity,” he says. “Commercial banks are not in the business of venture capital or angel funding and this may create misconceptions for the public at large. Commercial banks actively participate in the financing of established and recently established companies. While funding is available from UAE banks, the quantum could be improved with the implementation of an improved securitisation regime.”

Governments in the region recognise the problems posed by insufficient lending. Last year, Oman Central Bank issued a regulation requiring 5 per cent of all commercial lending to go to SMEs, while Kuwait is in the process of launching a KD2bn ($7bn) fund to support SME development. Other GCC countries have made SME financing available through state-owned banks or dedicated SME agencies.

The Saudi government has been operating its Kafalah scheme, offering loan guarantees to banks that lend to SMEs. Earlier this year, it announced the programme had guaranteed loans totalling SR7.2bn ($1.9bn) since its creation in 2006, issuing 7,280 guarantees in total, and 2,515 in 2013 alone.

Ahmad says Kafalah is evidence the system is in need of significant reform: “The Kafalah government guarantee scheme is legal reform – it’s an interim measure, essentially saying there is a regulatory impediment presently in place. The government can’t overhaul that, given the timeframe, so it gives a guarantee to the banks. Based on that guarantee, banks should be in a better credit position to lend to SMEs. So looking at it from that angle, it is a regulatory change. But to be able to really solve the issue, governments need to do more changes than interim, ad-hoc measures such as Kafalah.”

Away from banks, SME owners can turn to sources such as venture capital funding. But regional companies also face challenges here, particularly with lack of knowledge, and unreasonable demands for equity and returns.

“There were very few investors in the region that understood technology, and to add to that there were even fewer that would write a cheque for more than $1m. With that in mind, as an entrepreneur, there really wasn’t enough supply to choose from, and there was a limit to those you could speak to. As such, securing initial funding at a valuation and funding amount that was fair was very tough,” says

Kenny of his experience of starting a company. He says many would-be investors wanted at least a 50 per cent stake in his firm.

"You might have to approach a private equity firm; one of the things with private equity is they put huge amounts of pressure on the returns," says Ali. In his view, a bank loan with a reasonable interest rate and repayment period might be a much better option for companies, as it allows greater "power of experimentation" – but with banks unwilling to lend, entrepreneurs are left with few choices.

"Most often, you end up arranging funding from your own sources, in other words, from family. If you can, put some friends who are willing to invest together – more of the non-professional sources," he says.

According to Kenny, now a venture capital investor himself, the regional environment is changing. "In the past five years, I have seen a dramatic shift whereby there is significantly more capital available to entrepreneurs and the investors are becoming much more educated on how to fund these companies. In comparison to global markets, it is still hard to raise funding here, and particularly hard to raise funding over the $10m mark."

Book-keeping: Investors will want to see reliable information on cash flows, revenues and other financial data