



Decide with Confidence



# D & B

BUSINESS INSIGHT SERIES  
*Industry Perspectives*

SME Lending in the UAE: 2008

# FOREWORD

Dear Reader,

Events in the financial world over the last few months have shaken the foundation of credit markets across the globe. Government authorities in UAE moved swiftly to ensure that the impact of tight liquidity conditions to local economy was minimized. As credit conditions remain relatively difficult, Small & Medium Enterprises are expected to face credit challenges.

However, it should be noted that problems faced by SMEs in accessing credit are not simply on account of the recent credit crunch. In the current article, D&B analysts have explored the theme of SME Finance in UAE with focus on structural issues that impact SME Lending.

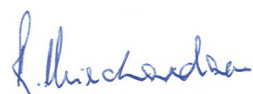
This article is part of the “D&B Business Insight Series,” a collection of research reports that focus on business subjects of current importance related to industry and the economy in the GCC region. The reports draw from the industry expertise developed by business consultants in D&B’s Research & Advisory Services division and from the economic research expertise of D&B Economic Analysis Group.

This article: “Industry Perspectives: UAE SME lending 2008” provides a detailed analysis of the SME lending activity in the UAE from the perspective of SMEs and banks.

This study is part of our ongoing commitment to the SME sector globally and to the business and banking communities here in the UAE. The study is based on extensive primary and secondary research done by D&B analysts and is being circulated to a select audience of industry leaders.

We hope that you will find the report useful and look forward to your feedback. If you need any further information about the report please write to us at [ras@dnbsame.com](mailto:ras@dnbsame.com).

Best Regards

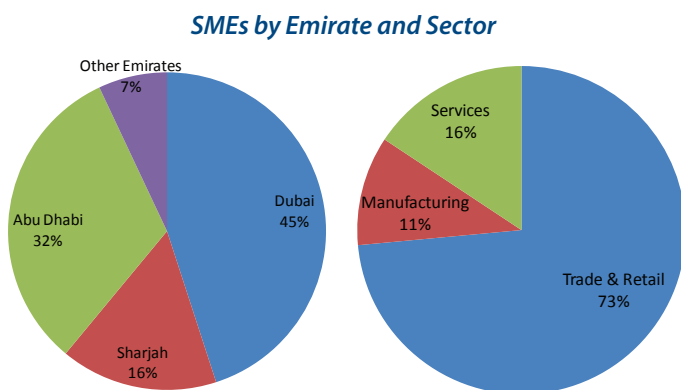


Rajesh Mirchandani  
Chief Executive Officer  
Dun & Bradstreet South Asia Middle East Ltd.

# INTRODUCTION

Large companies may grab headlines but it is the small businesses that form the foundation of the global economy. More than 99% of the world's businesses are Small and Medium Enterprises. They produce 50% of the world's GDP and employ 85% of the world's population.

To succeed, any business needs finance, but this is not always easy to obtain. SMEs in particular, are known to face difficulties in getting finance. The aim of this report is to examine the market for Small and Medium Enterprise (SME) finance in the United Arab Emirates. The report evaluates the financing needs of SMEs in the UAE and assesses whether those needs are being met by current bank offerings.



D&B Primary research suggests that Dubai and Abu Dhabi lead the charge in terms of sheer number of SME's and Trade & Retail constitute the highest proportion in terms of activity type across the emirates. In the UAE, Small and Medium Enterprises constitute greater than 85% of the total business universe.

According to the proceedings of the 1st Gulf SME Forum, "Survey after Survey reveals that the access to capital is what most SME managers and owners consider the biggest obstacle [to growth.]"

It is difficult to define precisely what constitutes an SME. Internationally, definitions based on employee size range from

under 250 (European Union) to under 500 (US small business administration). Based on turnover, figures below \$50 million are considered indicative of a medium sized enterprise, while below \$10 million is a small business.

Currently there is no widely accepted SME definition in the UAE. Since the focus of this report is on the availability of commercial credit in the UAE, the SME definitions employed by various banks were used as basis for this study. Accordingly, for the limited purpose of this study, businesses with less than 40 million dirham in annual turnover were considered as SMEs.

Many of the small businesses in the UAE are family owned/operated and these businesses often lack the financial sophistication of larger businesses. Ownership structures in the UAE are an outcome of the law which stipulates that the majority of any business is owned by UAE nationals. In the free zones, 100% foreign ownership is permitted.

For businesses outside the free zones, equity ownership does not necessarily amount to management control. While 51% of these businesses must be owned by a UAE national, these "silent partners" often do not engage in running the business themselves. The expatriate partners own only 49% of the business, hence they find it beneficial to keep the balance sheet relatively light. They do this by releasing the bulk of the profits as dividends or management fees.

According to the UAE Central Bank, there are 24 national banks and 28 foreign banks licensed to operate in the UAE. Some banks focus on SMEs as a matter of strategy and there appears to be a competitive market for SME financing.

*Growth in the SME sector has been rapid: between 2003 and 2008; there was a 200% increase in lending to individuals for business purposes .*

To obtain the data for this paper, D&B carried out in depth interviews with the banking sector in the UAE and with a select sample of SME owners and employees. This was supplemented by secondary research. The data thus

obtained is intended to paint a general picture of the situation, and the report is qualitative in nature.

# APPROACHES TO SME LENDING

## *Secured lending*

Secured lending is the dominant form of SME finance in the UAE today. Loans are secured on assets such as property (mortgages) or intangibles like accounts receivable. Banks in the UAE are risk averse with regards to SMEs and therefore prefer this form of lending. As the loan is secured on an asset, the need for evaluating creditworthiness is reduced.

## *Unsecured and partially secured lending*

When a bank extends an unsecured loan to a business client, the bank assumes direct risk on such business. The bank is relying on the ability and willingness of the business to pay back the loan. The bank does not have any collateral / security from the business and hence no protection in case of default. Hence, the bank is constrained to rely mainly on creditworthiness of the business while making an unsecured lending decision.

Broadly speaking, there are three traditional approaches to determine creditworthiness,

1. Relationship based lending (business owner's character and informal information dominate)
2. Financial statements (focused on detailed evaluation of firm's financial position)
3. Credit score based lending (A numerical credit score is calculated based on a set of rules and transaction history)

### *1. Relationship based lending*

The relationship based approach has historically dominated the SME lending market in much of the world, but it is problematic in the context of modern risk management and can depend heavily on the loan officer involved. In any case, the transient nature of many UAE residents makes this difficult.

### *2. Financial statement based lending*

Lending based on the financial statements of a business is the dominant form of lending for larger business clients. Most smaller businesses do not have proper financial statements, and only a very small minority among SMEs have audited statements.

Further, detailed financial analysis requires skilled analysts and banks may find it unprofitable to take this approach for SMEs.

Also, given the nature of SMEs in Dubai, banks prefer to see several years of bank statements rather than P&L accounts and balance sheets since cash flows are more likely to give an accurate picture of the health of the business.

### *3. Credit score based lending*

Credit score based lending is a method in which the bank relies on mathematical models that determine the credit and loan-pricing decisions. The calculation of credit scores is a complex subject and various approaches have been developed for the same. However, most credit scoring models take into account appropriate combinations of the

following parameters: past payment / credit behavior, current liabilities, net worth, cash flows, assets, and income / income volatility. Several firms worldwide specialize in the calculation of credit scores, including Dun and Bradstreet.

A major component of credit scores is the historic records of repayment by the business and possibly by the directors/ owner. Credit scores issued by credit bureaus and credit reports can also cover information about the other loans that a business has taken out.

D&B Commercial Credit Scores (CCS) indicate the chance of delinquent payment by a business, a small business with a good CCS can often get credit on similar or better terms compared to a larger company with a worse CCS. This makes on-time payment a competitive advantage for accessing credit.

*“My Dun and Bradstreet credit rating is actually more important than my banking facilities. With a good rating, suppliers will give me attractive credit terms, unlike a bank loan, this is interest free” – Owner of a computer trading business in Dubai*

# SME BANKING IN THE UAE

All banks aim to target profitable market segments and adopt a range of strategies to be competitive in these segments. For some banks, SMEs may be an important target segment, whereas others may not have such focus. Of course, virtually all banks lend to SMEs to some extent as part of their retail banking or corporate banking portfolios.

Banks that have a strategic focus on the SME market try to tailor their credit and other banking products to meet the needs of this segment. They do this by offering less complex versions of the financial products offered to larger companies, by relaxing documentation requirements, and training staff specifically to deal with small businesses.

Financial services aimed at small businesses should be designed to grow with the business, providing scalable solutions and a smooth upgrade path to larger lines of credit. Smaller businesses often have fewer cash reserves and volatile cash flows and they often depend on access to finance not just for growth but for their survival.

The UAE banking market has grown at a rapid pace over the last few years, and banks compete aggressively for market share.

The smaller sizes of the loans and simpler businesses in the SME market mean that it is logical to reduce turnaround times on credit decisions for banks. The value at risk on a loan decreases, thus it makes sense for the bank to reduce the cost of making a loan decision. Not only that, but in the highly competitive UAE market a customer kept waiting too long may well go elsewhere.

In the course of researching this document, the heads of SME banking at many of the leading banks in the UAE were interviewed to get their perspectives.

## *Key banks focussing on SMEs*

HSBC	One of the world's largest banks, worldwide SME strategy
Standard Chartered Bank	Large International bank, in SME business for a long time
RAK Bank	Rapidly growing, widely regarded as a leading innovator, aggressive in marketing to SMEs
Mashreq Bank	Especially popular with retailers
National Bank of Fujairah	Especially popular in the Northern Emirates
ADCB	One of UAE's largest banks
Union National Bank	Popular especially with smaller businesses
Citibank	Small SME division, but regarded as innovative by other bankers

Other banks also lend to SMEs in various capacities, but these are the key banks as found by surveys of bankers and SMEs.

## *Credit products*

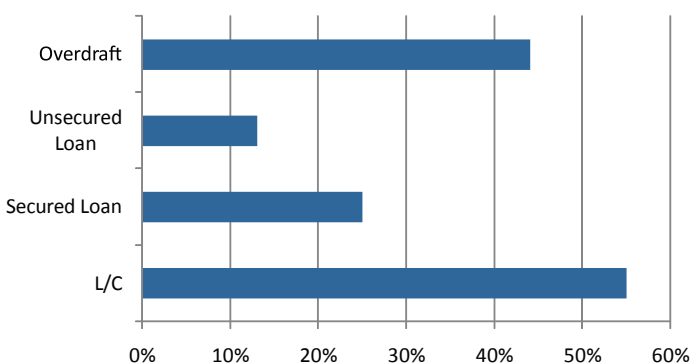
The four categories of credit products most commonly used by SME borrowers in the UAE are:

- Letters of credit – A letter of credit guarantees payment by the issuing bank if certain conditions are met, for instance a shipment is delivered
- Equipment loans (secured)
- Working capital loans (unsecured)
- Overdrafts – Used by account holder for working capital
- Performance bonds and guarantees are commonly used only in the construction sector.

# SME BANKING IN THE UAE

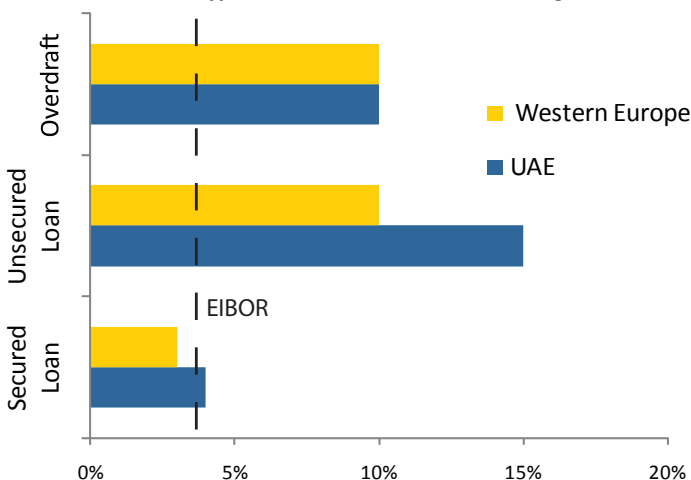
Banks also offer non-credit products such as foreign exchange services that are tailored for SMEs and these may be bundled with overdrafts or other credit facilities.

Credit products used by SMEs



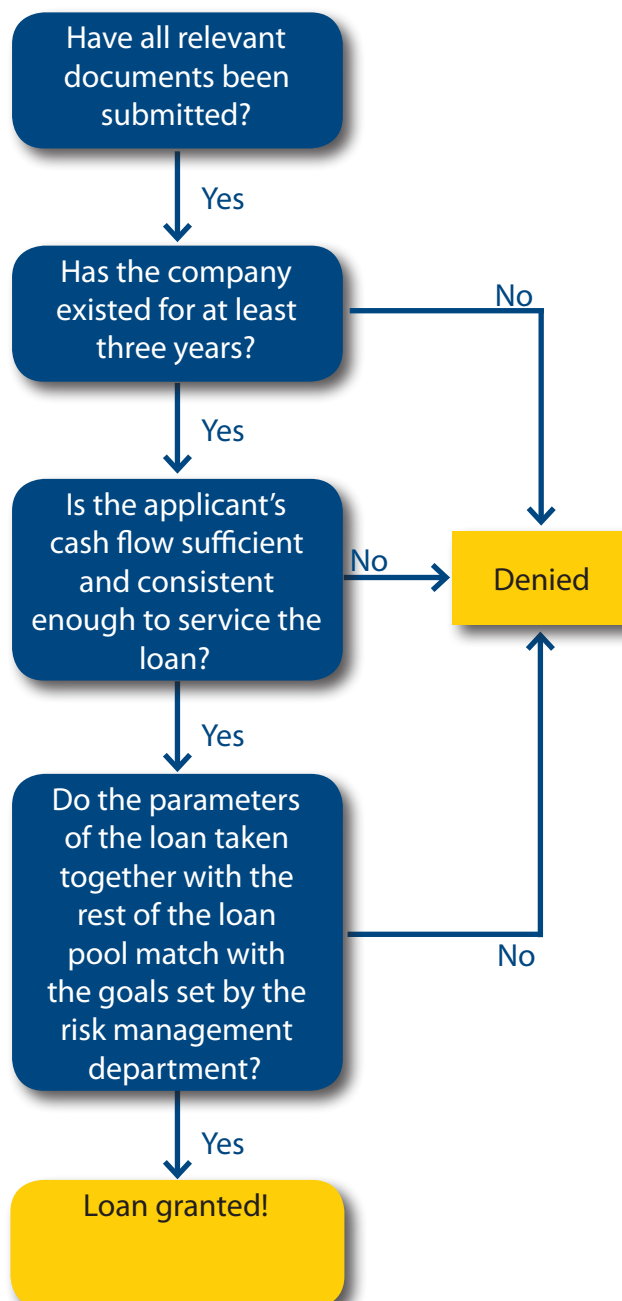
Letters of credits and overdrafts are the key product lines used by SMEs

Typical interest rates on SME lending



Typical 1-year EIBOR (Emirates Interbank Offered Rate) has been between 2% and 3%, but is currently almost 5% due to the international credit situation. The high interest rates for unsecured loans represent the risk premium that banks charge for lending to SMEs.

## Approval process



# SME BANKING IN THE UAE

Granting credit to a business is a risk, and banks aim to minimize this risk by screening applicants and granting credit only to those that meet standards. Naturally, **the standards for unsecured loans are tighter than for secured loans.**

Based on discussions with bank managers in UAE, the typical criteria / process for credit approval are highlighted below:

- Companies must have been in existence for a certain minimum period, usually between one and three years
- They must have financial statements to cover that period, ideally they should be audited, but for smaller companies bank statements (cash flows) over the period are often accepted instead.

Many banks specify a minimum turnover, typically between 100,000 and 250,000 dirhams

**Businesspeople will sometimes simultaneously approach various banks for loans**, so application turnaround time is considered a very important criterion in decision-making by SMEs and a point of competition among banks.

In general, applications which are complete as of their submission will be decided on one way or the other **within two working days**. However, on many occasions the process gets significantly delayed due to incomplete or unclear applications. Banks in the UAE **generally reject between 50% to 70%** of the applications for credit made to them. The most common reasons for rejecting an application are:

- **Documentation provided with loan application is insufficient**
- **The business has not existed for long enough**

- **The business is too volatile and cash flow problems may prevent re-payment of the loan.**

- **The fundamentals of the business are unsound**  
**Some SMEs have looked to enhance their credit standing with banks by getting a rating from credit rating agencies.**

*“When our customers approach us for credit facilities, we do everything we can to meet their financial needs and process their applications with a quick turnaround.” – Senior Manager of Business Banking in a leading multinational bank in the UAE.*

## Other Sources of Finance

The scope of this paper is primarily the commercial finance situation in the UAE, but governments and NGOs also play a role in the SME finance market. Naturally, these organizations focus on funding and educating UAE nationals.

The Mohammed Bin Rashid Establishment for Young Business Leaders aims to promote new business creation and the expansion of existing small enterprises owned and operated by UAE nationals in

Dubai. They provide training and guidance as well as startup capital for aspiring businessmen, thereby closing the finance gap. The Establishment is also able to provide funds for expansion of existing small businesses through affiliate banks.

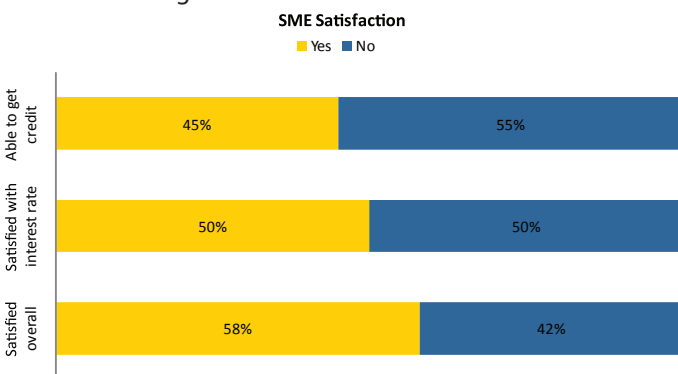
The Khalifa Fund provides startup loans, expansion loans and training for entrepreneurs in Abu Dhabi. In addition, the Fund is able to bring together aspiring businessmen and venture capitalists.

*Banks in the UAE generally reject between 50% and 70% of the applications for credit made to them.*

# MEETING SME NEEDS

## SME satisfaction

Clearly, many banks are optimistic about the SME segment as a business, but to what degree are the needs of the SME customers being met?



When surveyed, SMEs claimed to be satisfied with their bank, but many had complaints about the industry as a whole and about their previous banks. **55% of SMEs surveyed were not able to get the financing that they needed.** It should be noted however that this result is likely skewed, since the survey did not cover failed SMEs (that may have had greater problems accessing credit).

A particular complaint that was often heard was that interest rates in local markets were extremely high, particularly for unsecured installment loans. Half of all SMEs surveyed were dissatisfied with the interest rate they were paying. At 20%, the typical interest rate for an unsecured loan is twice the 10% interest rate prevalent in Western Europe

The following were the top complaints from SMEs about their banks:

- **Interest rates are too high**
- **Hidden charges**
- **Bank errors and lack of timeliness**

Businesses in UAE face greater difficulties in accessing finance during the start-up phase. In most developed markets, it is possible to get viability based financing, where an aspiring businessman applies for a loan on the basis of a business plan. On a commercial basis this is effectively non-existent in the UAE, due to the transient nature of much of the UAE's population.

When a business is getting started and is in need of capital, it struggles to get any credit whatsoever from banks; later, when the business has plenty of money, banks cold-call to offer now-unnecessary credit on favorable terms.

There are non-bank players who do engage in venture capital activities; in particular the Mohammed Bin Rashid Establishment for Young Business Leaders in Dubai provides training as well as finance to Emiratis looking to start a new business.

*“Transactions are not updated on a daily basis, amounts are wrongly charged, Disputes are always there with international transfer” - Finance manager of a Dubai based supplier of Audiovisual equipment*

## Bank perspectives

According to the banks, the exceptionally high interest rates on unsecured business lending in the UAE are a result of a significant risk premium. The perceived risk has two sources, one of them is that the difficulty in assessing the credit quality of businesses in a data sparse environment like the UAE. The UAE has a very **informal business** culture which leads to incomplete and unreliable financial statements.

Another reason for the high risk premium is the **demographic make up of the UAE**, especially Abu Dhabi and Dubai. There is always a risk that foreign nationals will simply take the money and leave the country, for this reason banks prefer lending to companies that have existed for some time. Bankers expressed some concern over the perception that there is **no standardized recovery mechanism** to seize the assets of defaulters. The legal framework for this is in place, but results and speed of the process can sometimes lack consistency. Apart from the above, there is a fundamental information gap which always exists between lenders and borrowers.

# MEETING SME NEEDS

## *Lender vs Borrower: the information asymmetry*

Lender and borrower naturally take very different views on the credit transaction; there is a **fundamental information asymmetry** between the bank and the borrower. The borrower knows in detail their own credit record and intentions, while the bank can only guess at either. This asymmetry cuts both ways, on the one hand, borrowers with poor credit records can evade them and may still be able to borrow because their payment history is unavailable to the bank. It is common in the UAE for small businesses to apply for loans from several banks simultaneously, and there is nothing to prevent them accepting multiple loans if more than one is approved. Of course, these loans are not present on their balance sheet at the time they submit them for credit approval. Unfortunately **borrowers with sterling credit records are unable to leverage their creditworthiness** to apply for loans or to prove that they will not take money from unsecured loans and leave the country.

**The nature of business in the UAE also contributes** to the difficulty, small trading and services companies are prevalent, which makes it quite difficult to predict their long term cash flows or have business assets that serve as useful collaterals.

It is a well known economic fact that where goods of inferior quality cannot be told apart from those of normal quality, the price will find equilibrium between the values of the two. A similar principle applies in this case. Banks are unable to accurately ascertain the creditworthiness of their borrowers, so they must add a hefty risk premium to their interest rates.

Bank View		SME View
Unknown credit history	<b>GAP</b>	Known credit history
Unknown intentions/honesty		Known intentions
Not sure about full financial situation of borrower		Knows and understands own financial situation
Unfamiliar with assessing viability of business plans in particular market.		Either - Familiar with market - Unfamiliar with market

**The information asymmetry can be reduced through credit bureaus. Credit Bureaus acts as a third party which can manage transaction information and maintain a credit record of individuals and businesses.**

In the UAE, the first private credit bureau, Emcredit was founded in 2006. Emcredit would have to meet the challenges of the data sparse environment in the UAE to maximize its effectiveness.

## *Outlook*

Despite the economic slowdown, lenders remain **cautiously optimistic** for the continued growth of SME lending. All banks surveyed expressed that they were "Optimistic" about growth. **Growth rates in SME lending were around 20%-30% pa in the banks surveyed.** This is higher than the GDP growth rate, indicating that the market is not yet saturated and there may be room for growth in SME lending even as economic growth slows.

According to the Abu Dhabi Commercial Bank, year on year loan growth may decrease from a high of 50% in June 2007 to 2008 to the **10%-15% level** for the next few years as credit conditions tighten. The EIBOR has almost doubled in the last year, indicating a much higher cost of funds.

The UAE Central bank has cut rates to try and bring EIBOR down. But the efficacy of this is not yet known.

# SUMMARY & ANALYSIS

## ■ **High cost of unsecured borrowing a major concern:**

Interest rates for unsecured lending are around 15%, twice what is typical prevalent in the USA. The high rate is the result of a risk premium, the perceived risk of lending in the UAE is high. Typical interest rates for secured lending and for overdrafts were 4% and 10% respectively which are close to international norms. This is in sharp contrast to the interest rates for unsecured installment loans.

## ■ **Information Asymmetry an impediment to growth:**

The risk premium that drives up interest rates is primarily the result of information asymmetry between lender and borrower.

## ■ **High loan rejection rates:**

The loan rejection rates were estimated to be in the range between 50-70% largely due to the gap in banking requirements vs ground level realities. Some banks commented that lack of accurate financial statements and difficulties in loan recovery were reasons for caution in SME lending.

## ■ **Working capital and letters of credit the key product lines required by SME's:**

25% of small businesses have used a secured loan, only 13% have used an unsecured loan. 45% have used an overdraft and 55% a letter of credit.

## ■ **SMEs are not satisfied with finance facilities:**

55% of SMEs were unable to get the finance that they required and more than 50% of SMEs surveyed were unhappy with the interest rates.

## ■ **Strong governmental focus on SME development in UAE:**

Governmental institutions like Mohamed Bin Rashid Establishment for Young Business Leaders and the Khalifa fund have been playing a catalyzing role in the development of SMEs owned by Emiratis.

## ■ **Cautiously optimistic lending outlook:**

Leading banks in the UAE are now looking at SMEs as a distinct market segment. Banks have seen 20%-30% year on year growth in lending to the SME sector. Despite the global financial crisis, banks remain cautiously optimistic for the sector during the coming years.

SME borrowers complain that interest rates are too high while bankers are concerned with the risks associated with SME lending. The very high interest rates on unsecured SME lending in the UAE are not necessarily indicative of high profit margins for the banks, but represent a risk premium.

High interest rates for small businesses are a brake on economic growth. Interest rates are high because it is difficult to distinguish between high and low risk debtors, this is the result of the information asymmetry between borrowers and lenders.

If banks can improve their assessment of debtors then they will be able to quantify risk more precisely.

Based on findings of this study, we have listed a few key recommendations below that would improve the scenario for SME lending in UAE:

- Credit bureaus play a crucial role in creating a favourable environment for SME lending. Collaboration between banks and credit bureaus under guidance of banking regulators needs to be encouraged.
- All businesses should be encouraged to adopt a more formal attitude towards their accounting; in particular the mixing of personal and corporate assets should be strongly discouraged. The rights of credit grantors should be strengthened and collection procedures further streamlined.
- Banks that focus on SMEs and provide low-cost finance to entrepreneurs need to be encouraged, SME focused government agencies could identify such banks and create joint programmes for SME financing and development.

# ABOUT DUN & BRADSTREET

Dun & Bradstreet (NYSE:DNB), the world's leading source of business information and insight, has been enabling companies to Decide with Confidence™ for 167 years. D&B's global commercial database contains more than 130 million business records.

D&B Research & Advisory Services provide strategic, operational and market insights required for maximizing business value through improved strategies and processes. D&B Economic Analysis Group provides insights on economies, markets and industries globally.

The local entity **Dun & Bradstreet South Asia Middle East Ltd.** (D&B SAME) is in charge of D&B's business in over 70 countries across Middle East, South Asia and Africa. D&B's regional headquarters are located in **DIFC, Dubai**.

## **D&B association with SMEs**

D&B has been closely associated with the development of the SME sector across the globe.

D&B has built specific expertise in SME business rating & scoring as well as in SME studies and industry analysis.

D&B is the leader in establishment of credit bureaus and SME rating agencies in association with banks and regulatory authorities in this region. These initiatives in countries like – Egypt, UAE, Oman, Kuwait, India, Sri Lanka, Nigeria, Libya etc. would help promote a robust credit environment and facilitate SME growth.

D&B has also engaged with SME focused government agencies like SME Rating Agency of India, Mohammed Bin Rashid Establishment of Young Business Leaders (Dubai) and Tamkeen (Bahrain) on various assignments. These projects range from research on various industry clusters to providing advisory support for formulation of policies / development schemes.

---

## **Contacts:**

Mathijs van den Bergh  
Business Analyst,  
Research & Advisory Services,  
Dun & Bradstreet South Asia Middle East  
Tel: +971-4-3695700 / +971-50-4659369  
Email: vandenberghm@dnbsame.com

Karthik Ganesan  
Consultant,  
Research & Advisory Services,  
Dun & Bradstreet South Asia Middle East  
Tel: +971-4-3695700 / +971-50-1544923  
Email: ganesank@dnbsame.com

---

Dun and Bradstreet South Asia Middle East  
5th floor, Gate District Building 5  
Dubai International Financial Centre,  
Dubai - UAE  
Website: <http://www.dnbsame.com>

---

Disclaimer: The information contained in this report is of a general nature and is not intended to address the circumstances of any particular individual or entity. All information contained herein is obtained by D&B from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind and D&B, in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein is based on a study conducted on a select sample of banks, SMEs and other key respondents and must be construed solely as statements of opinion and D&B shall not be liable for any loss incurred by users from any use of this report or its contents. No part of this document may be reproduced, copied, distributed or made available in any form whatsoever to any person without express prior written permission of Dun & Bradstreet ("D&B").

For private circulation only  
Copyright Dun & Bradstreet  
Reproduction and transmission in any form without prior permission is prohibited. All rights reserved.

While Dun & Bradstreet endeavors to ensure accuracy of information contained in this publication, it does not accept any responsibilities for any loss or damage to any person resulting from reliance on it.



Decide with Confidence