

Financial Risk Management in SMEs in Dubai a study on a contracting company based in Dubai

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ABSTRACT

The topic of management of financial perils and risk for small & medium enterprises (SMEs) was largely limited in the business literature. This research aimed to study the present state of management of financial management in Dubai's small & medium enterprises. In the commercial and economic development, expansion, and growth of Dubai, small & medium enterprises (SMEs) are key. Nevertheless, only in a risk-free operating environment can this be possible. This study looks at the relation between Dubai's financial risk and SME sustainability. A series of risks are facing SMEs which require objective and conscious efforts to manage risks. A financial risk management evaluation of an organization was developed, resulting from an analysis of the semi-structured questionnaire survey, which was assisted by a research interview. SME entrepreneurs were recommended to treat management of risk as an integral segment of corporate governance. Regulators should also focus on minimum standards for SME corporate governance.

Keywords—Financial Risk Management, SME, contracting company

INTRODUCTION

Risk is the outcome of uncertainty linked to the course of action, and in business, it can be interpreted as the probability of financial or economic losses or benefits. Risk is prevalent with varying degrees in all human actions, and similarly, in all companies and all aspects of a company's management are at risk. In many cases, however, based on experience, the risk can be measured and managed to better the condition (Chapman & Cooper, 1983).

Risk Management (RM) is designed to identify threats, assess the likelihood and possible impact of incidents and mitigate risk, remove or reduce their impact through the limited resources expenditure. In many fields, for example, healthcare, public security, environment and corporate management, RM was developed and adopted.

The external factors, for instance, social, political, economic, technological, environmental, etc., or the internal factors, for instance, processes, manpower resources, technology applied, framework, etc., can be responsible for risk events (COSO, 2004).

The research paper examines the Management of Financial Risk in the context of small to midsize enterprises in Dubai. SMEs need a strategic and methodological approach in the risk management of internal and external threats more than large organizations because they have no resources to quickly respond to them, which could lead to huge losses that are seriously threatening their survival.

The chosen company for this proposed research study is a Dubai-based fit-out contracting company employing 150 in the workforce in various skills and having an annual sales/turnover of AED 35 million. For confidentiality purposes, the researcher shall be addressing the company with an assumed name, AB Contracting LLC (ABC). With major retailers, such as, EMax, MAF Fashion, Zara Home, Masimo Dutti, Missguided, Bershka, Urban Outfitters, Brands, Virgin Megastore, Deichmann, Oysho, Scotch & Soda; as clients, ABC is in the market for the last 20 years.

Research Questions

1. What are the reasons for SMEs in Dubai fail to identify the need for Financial Risk Management?
2. Which technological and other factors implemented in Financial Risk Management processes contribute to increasing the precision of risk assessment and increasing the efficiency of its management?
3. What are the trials and tribulations confronted by SMEs in Dubai to implement Financial Risk Management techniques?

The company owner is ultimately responsible for burden assessments because of the market size of SMEs and micro-businesses. The nature of risk management efforts are determined by the scale and size of the company. With one or two owners at the time as partners and staff, they do not face the same human resources burden as small businesses with more than five employees. (Duong, 2009).

Risk management is a part of systematic assessment and strategic threat reaction for companies of all sizes. Small companies are often entrepreneurs, successful and ambitious entrepreneurs in their essence. It is customary for owners of small businesses to list plans for management of risk as a priority and rely on their success in setting up and managing the business (Duong, 2009).

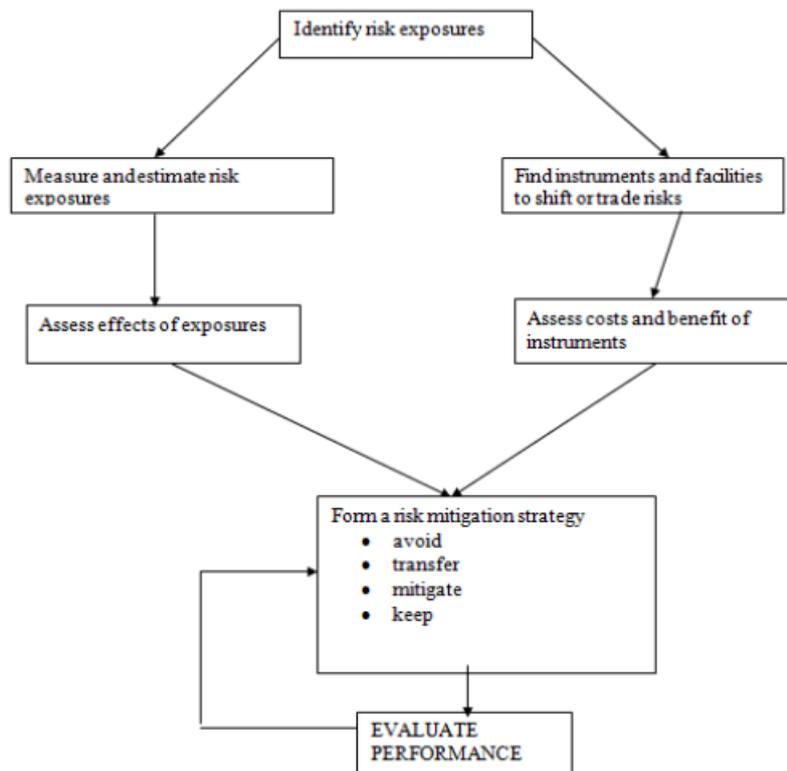


Figure 8: Risk Management Process (Crouhy et al., 2009)

Gap in Current Literature

While the literature on risk management specifics in SMEs has been growing in recent years, any literature with a focus on Dubai and covering Financial Risks by SMEs remains sparse and has not yet been systematically reviewed. This review would be worthwhile because systematic reviews incorporate existing research from diverse fields and provide a synthesized knowledge base that will allow future research to build upon (in this case: financial risk management by SMEs in Dubai). Therefore, the lack of a systemic risk management analysis in SMEs can be considered a void to be addressed in this paper. Therefore, it is intended to give an overview of the contemporary condition of managing the risk in small to midsize enterprises as well as fruitful research avenues.

Research Methodology

Survey research is outlined as "the accumulating, by answering questions, of data from a sample of individuals" (Check & Schutt, 2012). This study admits a range of techniques for participant recruitment, data collection and several procedures of instrumentation. Quantitative research methods can be used for survey research (e.g., using a questionnaire which are arithmetically graded), qualitative research approaches (i.e., applying receptive issues), or both (i.e., harmonized methods). Surveys are, consequently, often applied for community and psychosomatic research since they are often used for the explanation and analysis of social behavior (Singleton & Straits, 2009).

Methods of Collecting Primary Data

Qualitative data is primarily non-numerical in nature and typically illustrative, explanatory, and nominal. This signifies that the data are amassed as words and phrases. These data frequently (not always) record feelings, thoughts or subjective experiences. Qualitative approaches discuss the "how" and "why" of a system and seek to investigate the subject by using unstructured data collection methods (Kabir, 2016). Qualitative questions are open to the public. Focus groups, deliberations in groups and conversations are qualitative methods (Kabir, 2016).

Quantitative data is used to calculate the numerical nature mathematically. The quantitative data calculation uses several scales which can be classified as nominal, ordinal, interval and ratio scale. Sometimes (not always) measurements of something include such data. Quantitative approaches deal with the research program's 'what.' Their methodology is routinely structured and they use techniques like surveys and questioning (Kabir, 2016).

As part of the descriptive survey, the primary data are gathered through questionnaires (Ghauri et al., 1995). Illustrative surveys are apt for identifying and describing the variation of various trends. The reason for utilizing a survey as a means to collect information and statistics refers to its resourcefulness in that it allows for all types of evidence to be collected via questioners (Cooper & Schindler, 2006).

Survey Design

The design of the survey can be categorized in nomenclatures of investigative surveys and illustrative surveys. Autonomous, endogenous, and external variables are identified in the investigative surveys, while illustrative surveys are designed to identify the phenomenon that researchers want to clarify (Ghauri et al., 1995).

Population and Sampling Methods; and Justification for Same

The population for the intended research is SMEs which are in contracting / building / fit-out businesses in Dubai. Given that the subject is the management of financial risk; the data collection process may have restrictions due to the right of SMEs to keep their financial matters private and they are not obliged to report to any authority, except in some cases where they have to produce the audit reports to the bank and / or the free zone authorities. However, the researcher plans to approach 10 companies for data collection.

Working around the above limitation, the sampling method used is Convenience Sampling, a kind of non-probable selection of specimens that includes drawing the paradigm from the relatively close-hand part of the population or taking it from an easy - to - contact or reach a group of people (Bornstein et al., 2013).

Collection of Data

A reflective and profound interview were used for this research. The interviews were delicate and shapeless and aimed at identifying the thoughts, outlooks, and judgments of participants on a specific topic of research. The main benefit of personal conversations is that they require subjective and straight interviewing communication, along with reducing the risk of non-answer, but the interviewer must have acquired the requisite skills to carry out an interview successfully (Powell et al., 2005). Moreover, delicate and shapeless interviews

extend manageability about the flow of the conversation so that conclusions can be drawn that were not intended originally for a research discipline. There is, however, a peril that the interview can depart from the study's purposes (Gill & Johnson, 2002).

In respect of the data collection tools, it was the use of a semistructured questionnaire that was used for the researcher as an interview guide (Meed, 2019). Some questions were developed to channel the interview to the achievement of this study's goals. The sample questions that were included in the semi-structured questionnaire is appended in [Appendix A](#).

Ethical Requirement

Research ethics aims at ensuring that research activities have no adverse consequences or harm (Cooper & Emory, 1995).

Ethical aspects related to the proposal and preliminary level of access

When endeavoring to get a preliminary approach to probable participants, the risk of ethical glitches must be tackled. The right of individuals to refuse participation should be taken into account. Data protection also comprises the character and expectation of potential contributors in addition to the circulation and utilization of secondary study's statistics (Saunders, et al., 2009).

Reliability and Validity Measures

Reliability means the accurate replicability of procedures and outcomes in quantitative research. In qualitative research with various theories, this dependability description is complicated and contra intuitive in epistemological terms. Continuity, therefore, (Carcary, 2009) lies at the heart of quality research reliability. Qualitative research tolerates a margin of uncertainty for results, given that methodology and logistics are reliably derived from data identical ontologically but that may vary in value and atmosphere within comparable facets.

In qualitative research, the term validity means "appropriate" methods, processes and data. The selection of a research questioning methodology is appropriate, the methodology valid is suitable, specimen and data analysis are suitable, and the outcomes and inferences are final and useful for the sample and background (Waterman, 2013).

Limitations of Research

The current study is limited in that it is intended to study only 10 SMEs in Dubai that will not have been selected randomly from such organizations in the Emirate. Findings obtained in the research might not, therefore, be accurately generalizable to draw conclusions about SMEs managing financial risk. Surveys and interviews undertaken in the research will also expect respondents to recall information about the investigated SME, which might include recall bias. Moreover, the findings obtained in the research might be affected by personal desirability bias because of respondents being required to deliver their own judgments about the matters researched.

RESULTS AND DISCUSSION

The research was held in Dubai, the financial capital of the United Arab Emirates. The sample of the research was the small & medium enterprises in the Emirates of Dubai; and ten SMEs were randomly selected from it. The data were collected by the researcher's personal interview. In twelve (12) questions put by researcher, owners or working partner or leading management staff of the designated SMEs were needed to respond. The sample was composed of SMEs with a maximum of 100 employees engaging in either construction or its ancillary businesses such as fit-out, joinery, glassworks, etc.

Due to the current Covid-19 pandemic situation, most SMEs are going through a very tough time as the banks are reducing or restraining the credit facilities, increasing the margins, reducing credit periods from suppliers & are not cooperating with postponing of presentation of cheques given from earlier purchases, stricter measures & penalties from the government for enforcement of Wages Protection System (WPS), calls from the government department for payment of VAT dues, etc. In some cases, there were deaths of near and dear ones of SME owners due to pandemics. All these economic, social and personal issues were fueling the non-cooperative and resentful mindset of SME owners and were difficult to approach and to have a meaningful conversation and discuss the questionnaire; thus disallowed full participation to capture all relevant insights on business and financial risk mitigation practices.

Most of the SMEs from the sample population have not understood the concept of management of risk and the perception of management of risk. Very few (20% or 2 out of 10) managed to express their perception of the concept and its influence on the enterprise when asked to define risk in its own terms. When asked about formal corporate strategy, 80% percent indicated that no formal business strategy was in place, with only 20% having this strategy in place. No formal risk assessment was conducted despite new investment in the last year regardless of the fact that it is best practice to anticipate results that show that SMEs are not strategically planned. Likewise, 80% suggested that they were not highly educated, irrespective of whether they considered an inherent risk in their approach, and 20% found that they did not take the inherent risk into account. The majority of these SMEs are therefore vulnerable to risk.

The Financial Risks

On being asked to rank the financial risks faced by the construction companies in descending order of its severity, the ten companies in the survey ranked it as below.

Financial Risk	C1	C2	C3	C4	C5	C6	C7	C8	C9	C10
Late payments cause problems with cash flow	8	8	8	8	8	8	8	8	8	8
Excessive competition erodes margins	3	2	4	4	3	7	4	5	3	2
Client conflicts	2	4	2	3	2	3	5	4	6	4
Lack of new opportunities for business	4	5	7	7	4	5	3	2	5	3
Unfair contractual risk sharing between customers and contractors	6	6	5	6	5	4	6	3	2	6
Lack of finance	5	7	3	5	7	2	7	7	4	7
Abuse of performance bonds by clients	7	3	6	2	6	6	2	6	7	5
Other	1	1	1	1	1	1	1	1	1	1

Table 3: Ranking of Financial Risk

On an analysis (simple average and mode) of the above ranking, it is observed that the late payment causing the problems with cash flow is the biggest financial risk faced by contracting companies, followed by lack of finance and abuse of performance bonds.

It is observed the late payment causing problems to cash flow is increasing the working capital and cost of conducting business. The average payment period from clients ranges between 150 to 180 days for projects' later stage progressive payments. In many cases, the retention amount (approximately 10% of the project value) is not paid even after 1 year is overdue.

There is a significant lack of finance in SME's due to late payment and banks' offer credit facilities like bill discounting and overdraft. Invoice discounting is offered by banks on 90 days credit period and as there is late payment, SMEs discount further invoices only to settle the previous past due to discounted invoices and incur additional discounting charges. Further, it is noticed that banks do not monitor the usage of funds raised by SMEs. The overdraft is offered by the bank against a lien on fixed deposit by the SME owner, which in effect is no addition to working capital and only incurs additional interest charges.

The third major risk is the abuse of SME owners' performance bonds given to the main contractors / clients. Certain loopholes made it easy for the beneficiary to make alleged unfair calls. In order to achieve uniformity in its implementation, all SME owners recommend implementing a standardized scheme and structure for the application of performance bond.

Lack of Up-to-date Regulation

On being asked if the lack of up - to - date regulations on the use of new technology stopped developments from being introduced in construction; 5 out of 10 answered in affirmative, 3 disagreed and 2 remained neutral.

The SMEs which had affirmative opinion added that there is a risk that the ongoing constructions are oriented to the fulfillment of Expo 2020 goals rather than what is required for sustainable residential growth, trade, education, or any other field. Many construction activities seem to be more related to the necessity to build empty plots and complete construction by 2020 than catering to demand. On the other hand, some innovations, if introduced, will add to administrative costs and cannot be easily assimilated by SMEs.

Level of Performance Bond

In the construction industry, a performance bond is generally used to protect a client against the possibility of the contractor failing to meet his contractual obligations. On being asked what a contractor should maintain as a performance bond as a standard of contractor performance obligations; 3 out of 10 opinioned for 5% of the contract value; whereas currently, it is 10% of the contract value. 2 out of 10 each are the opinion that it should be less than 5%, between 5% and 10% and 10% of the contract value.

On further probing on the change that will lead to the biggest improvement in the risks related to performance bond faced by contracting SMEs in Dubai; 3 out of 10 opinioned for legislation to make performance bond cashing dependent on certification or arbitration from third parties.

Capital Adequacy Law on Banks, Impact of it on Contracting SMEs

Rigid international financial policies have forced banks to retain higher core capital levels and raise capital financing costs since the 2008 financial crisis. This means that a bank's relationship with the contractor has higher costs. As part of an ongoing effort to improve and reinforce the banking regulatory framework for banking supervision, the Basel Committee has followed the devastating effects of the 2007-08 financial crisis on banks worldwide, built upon the Basel I and Basel II guidelines. Basel III aims to equip the banks to handle financial shocks by improving legislation, risk management, transparency and capital requirements to improve their financial stability. The emphasis is on increasing banking liquidity and reducing the leverage of banks so that capital ratios, short-term necessities, such as, liquidity coverage ratio and also long-term financing, such as net stable funding ratio, can be reinforced (Mendoza, 2015).

On being asked the influence of Basel III on Dubai's contracting and fit-out SMEs, 7 out of 10 had an opinion that there is an increase in the cost of borrowing from banks in terms of various banking charges over and above the agreed interest rates; whereas the remaining three maintained that cost of borrowing has slightly increased.

Impact of VAT

VAT or Value added tax is being effected by the United Arab Emirates to form an economic powerhouse and world-class business hub, according to its many fiscal strategies. By its definition, VAT is a flexible tool for governments to control their annual budgets, contribute to increased revenue and stable economic growth (OCED, 2017).

On being asked about the impact of VAT on their business 7 out of 10 opinioned to have a moderate impact, three considered to have high impact and none of them mentioned having no impact.

VAT is a neutral tax. It flows through businesses and tax supplies to the final consumers, which is essential for an economically neutral tax. However, the impact is explained as that the SME contractors file for VAT based on their tax invoices and a tax invoice is raised based on the payment certificate raised by the main contractor/client. Though in many cases, the main contractor/client does not honor the payment certificate on the due date, but the SME pays the uncollected VAT on time to avoid penalties/interest on the accrued VAT.

On further being asked if the entities have VAT experts for advice and deal with the impact, surprisingly, none out of 10 had consulted VAT experts on a regular basis. They had been consulted only during the implementation stage.

On further inquiring if they think their business will be impacted by the introduction of VAT in other GCC countries, 6 out of 10 felt in affirmative. In other GCC countries, some of

those challenges may be replicated, notably because other GCC countries, such as Saudi Arabia and Bahrain, introduced their own rules on building services exemption and ratings for real estate. Exemptions will usually challenge the safe functioning of the VAT system. A further example given is that Saudi Arabia is the regional manufacturing hub and the increased VAT in Saudi Arabia in recent times will impact the pricing of products and projects adversely.

Major Risk and Insurance Coverage

On being asked about risk perception and its insurance coverage, most SMEs consider legal and fiscal issues only as of the major risk, followed by supply chain disruption and equipment & vehicle damage. Below is the graphical representation of the risk perception. On the insurance coverage of the business risks, the coverage is limited to equipment breakdown, loss of wages, and office insurance.

Discussion on Findings

To iron out the structural gaps in regional project spending following the oil prices crash in 2014, contracting industries are undergoing an important transition. At the same time, in order to improve productivity and performance, the traditionally slow-moving industry aims to use new technologies such as applications of digital design, etc. While much of the transition in Dubai SME companies come from within the sector, developments outside of the industry have also taken place, which entails actions. Increased regulatory standards and new laws require changes by these companies to ensure that fines and penalties are avoided. The upcoming Dubai Expo 2020 transformed the area towards the international level and pushed SMEs to adopt best practices for the industry. The frontiers in this area are health and safety, technology and innovation, but the absence of clarification by the regulatory bodies makes it difficult to determine the implementation quality or level. Increased rules can also lead to increased costs for all players and not all players are willing to accept an expense. As it aims to lift standards to the highest level of global standards, contracting companies are also being pursued to improve standards and creative ways of working more effectively.

The study has shown that SMEs are, although in varying degrees, vulnerable to a variety of financial risks. This depends on the activities of the company, among other factors. The delay in payments from the main contractor and/or client is the major financial risk faced by the SME contracting company in Dubai, which catapults to an increase in working capital, lack of finance and adverse impact of neutral tax like VAT.

The contractors use the 'pay-when-pay' provision to make payments to their subcontractors subject to payment by their employer of the corresponding amount. In contracting business, in particular at the subcontracting level, such clauses are notorious. Such structures of conditional payments favor the main contractor but hinder the cash flow of a subcontractor in a serious financial way. The law in Dubai stresses the implications of these provisions because, unless the principal contractor transfers its employer rights to the subcontractor, the subcontractor cannot demand directly from the employer under this Civil Code (Ibrahim & Elliott, 2017). Given the practical reality that a contracting SME is at the bottom of the payment food chain, it has very limited steps to minimize such risk.

The potential Financial Risk to the SMEs in Dubai currently is late payment from the main contractors/clients, lack of finance, and abuse of performance/retention bonds.

The sustainability and economic success of any organization in the 21st century rely heavily on the strategic design and application of the management of risk plans. In all small and medium-sized companies, the major problem remains the absence of inclusion for business planning of identified risks. The businesses are unable to assess the entire risk standing of the enterprise without such integration. The size of the enterprise is a vital feature in determining the value of risk management systems. For enabling the operation of the management of risk procedures, it is also important that the existing enterprise planning systems are integrated holistically. Without this integration, risk management would be just 'empty talk' and worthless for the company. Employees would not see any benefit; only their workload would be increased by this. If risk management is, in turn, integrated into the normal planning process, acceptability is improved, and a more systematic and comprehensive risk assessment is carried out. Only in this way is it possible to develop risk management in SMEs, which guarantees feasibility and low costs.

The study found that handling payment delays in Dubai is a major challenge for SME contractors and the main cause for late payment is the presumed withholding of payments by main contractors. The legislation lacks various provisions that could protect SMEs from late payment problems. The author believes that late payments are an important issue because their economic and social implications should be dealt with. High-profile events at the global level, such as the Dubai Expo 2020, are expected to boost regulatory reforms and the implementation of best practices in the business.

Research Limitations

The research aim was set in good faith and intent to carry out a wider study with an increased sample size. However, due to the pandemic situation, restriction in travel & movement in inter-Emirates and intra-Emirates, and the dull economic environment, the researcher was not able to develop a compelling research document. The sample size is too small and the statistical tools utilized are too basic and do not capture accurate results.

Also, given the researcher has no previous experience in conducting academic research and producing study or research papers, the extent, scope, profundity, and depth of deliberations in this paper are compromised in several stages compared to the works of qualified and practiced researchers.

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