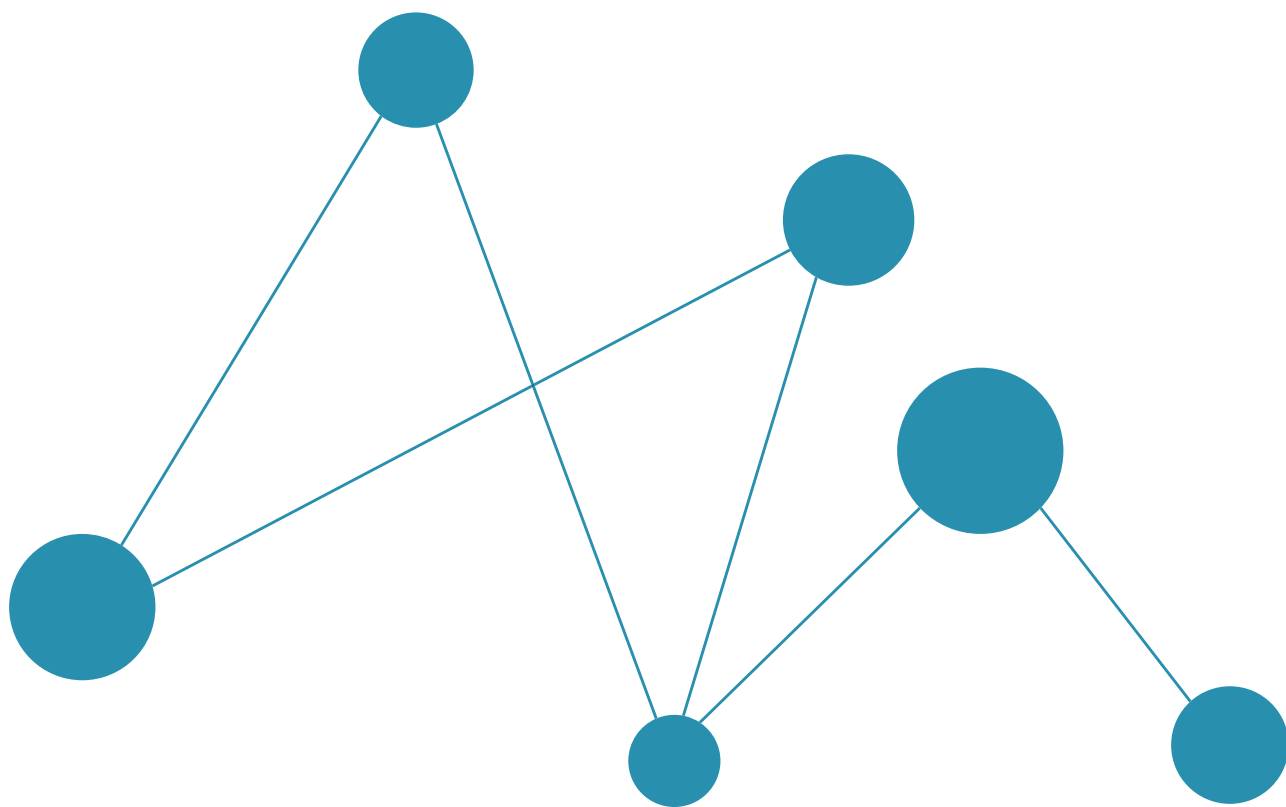




THE STATE *of* SME EQUITY FINANCING *in* DUBAI



THE STATE
of **SME EQUITY**
FINANCING
in **DUBAI**



His Excellency Sami Al Qamzi

Director General, Department of Economic Development, Dubai.

Dubai has drawn on its entrepreneurial culture, building an ecosystem that guides enterprises through the varied challenges of early-stage development to going global. As the agency of the Department of Economic Development mandated to develop the small and medium enterprise (SME) sector, Dubai SME focuses on enabling entrepreneurs to take advantage of Dubai's strengths and bridging gaps in the system, particularly in terms of knowledge and resources.

One of the major gaps in Dubai's SME ecosystem is the limited availability of externally sourced start-up financing. This is reflected in the fact that a majority (%80) of startups indicate personal money/savings as the primary source of finance for commencing their business operations in Dubai.

In addition, in a previous study, Dubai SME highlighted that only %10 of SMEs in Dubai have accessed long-term financing for their business growth.

Dubai SME as a government entity is addressing this market gap through the Equity Investment Initiative, built around a comprehensive study on the state of SME equity financing in Dubai.

From the findings of the study, Dubai SME has formulated appropriate strategies and initiatives for the coming years to improve SMEs' and entrepreneurs' access to equity financing and hopefully, enhance their competitiveness and value addition to the Dubai economy, in tandem with the growth of the Dubai economy.

Dubai's efforts to establish a knowledge economy will be ably supported by the Equity Investment Initiative for SMEs. It is therefore with great pleasure that I present the first-ever 'State of SME Equity Investment in Dubai' report. I believe this report will provide valuable insights on entrepreneurial growth as well support systems in Dubai.

The development of the overall equity ecosystem is possible only with the collective and collaborative efforts of a number of players as well as key linkages with the industry and academia, and hence, I look forward for your suggestions and feedback on this report.



His Excellency Abdul Baset Al Janahi
Chief Executive Officer, Dubai SME.

Dubai SME launched its Equity Investment initiative with the goal of channeling the abundant capital available in the local market into sectors where entrepreneurs and their start-ups have significant development potential. In fact, it's a path-breaking effort towards changing mindsets.

As a key initiative of our Dubai SME 2021 plan, the initiative is being rolled out in two phases, the first of which has already been launched - we studied the SME equity financing landscape in Dubai and the wider region, resulting in the 'State of SME Equity Investment in Dubai.'

This first-ever report provides a comprehensive picture of the SME equity investment ecosystem in Dubai. The study included inputs from different stakeholder communities and exploring the market size, scope and appetite for equity participation in SMEs as well as identifying potential venture capitalists, angel investors and private equity players.

Our role is to address related gaps, bolster linkages and enable a seamless flow of ideas, processes and funds in the ecosystem. The economic benefits related to equity funding are far reaching in terms of GDP stimulus, creative and innovative output, and productivity growth.

It presents a significant opportunity in the medium to long term, not only for SMEs in Dubai but across the region. Total investment into small firms in the region stands at around three billion dirhams. Clear strategies will help channel this money into sectors of high growth potential.

Based on the gaps observed and inferences drawn from the study (including international benchmarking, demand-supply assessment and legal perspectives) a number of potential interventions have been identified by Dubai SME. The recommendations are contextualized to the role that Dubai SME can play from the perspective of government participation.

Therefore, Dubai SME has identified some key initiatives to address the mentioned gaps as part of its SME 2021 Plan. These initiatives will be implemented in collaboration with the key stakeholders in the entrepreneurial ecosystem.

I hope all stakeholders will come forward to support Dubai SME in this strategic effort.

INTRODUCTION

Dubai SME, the agency of the Department of Economic Development (DED) in Dubai mandated to develop the small and medium enterprise (SME) sector, has launched an Equity Investment Initiative, aimed to unlock investment and funding in SMEs. The initiative aims to provide entrepreneurial projects with access to capital through equity participation of venture capitalists, angel investors, private equity companies etc. in line with the key tenets of the Dubai SME Plan 2021.

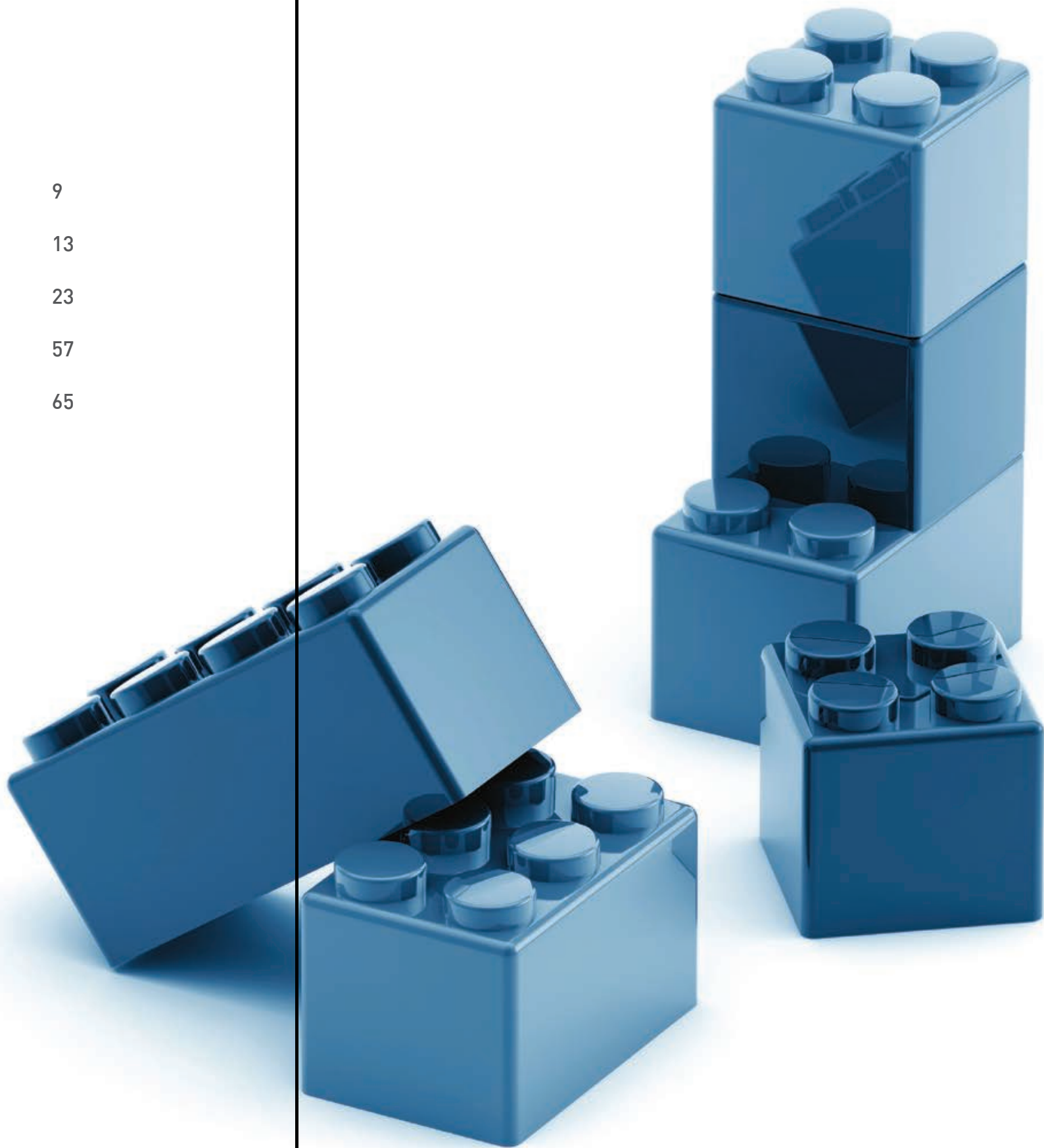
Additionally, the overall strategic focus of the UAE and particularly Dubai towards innovation, knowledge orientation and subsequent value-addition to the economy augurs well with the rationale of this Equity Financing Study.

Consequently, the report is the first authoritative study which highlights the need, market size estimates, potential impact as well as the overall status of SME (early-stage) equity financing in the UAE. The report covers the entire range of players and enablers within the equity funding ecosystem: Entrepreneurs, Investors, Venture Capital (VC) firms, Legal firms, Development entities and Academic Institutions (Universities, Government organizations, etc.).



REPORT STRUCTURE

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SECTION 1

SIGNIFICANCE
of SME EQUITY FINANCING

The Organization for Economic Co-operation and Development (OECD) research highlights the importance of equity financing in driving greater innovation, increased productivity and enhanced competitiveness. Equity funding activity fosters a knowledgeable / informed pool of investors that invest in sophisticated, creative and innovative businesses.

The premise of an active equity investment landscape is centered on the presence of entities and processes that create, foster and nurture such business ideas (including related support from Universities, R&D labs as well as patent protection, commercialization and enforcement regimes), thus generating deal-flow and encouraging investment activity.

In the UAE (particularly Dubai), the market for SME equity investments is presently nascent, albeit growing. The market offers opportunities in the form of a wealthy investor class (potential investors), although on the flipside, the proportion and flow of quality investment-worthy businesses (targets) remains limited.


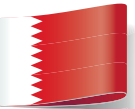
The role of Corporations and Universities in fostering quality deal-flow is currently limited, further corroborated by limited R&D output generation as well as the lack of government incentives for promoting innovation. The nascence of the equity market is further reflected and characterized by the unavailability of authoritative investment data to underpin the demand and supply of equity funding within the country.

Accordingly, the imperative for policy-makers to develop a strong base for an active investment ecosystem is evident. In recent times, the government has introduced legal and regulatory reforms, to spur investment activity. Additionally, the UAE Government's 'National Innovation Strategy' has a high focus towards promoting R&D / innovation and targets to place the country amongst the top 20 most innovative nations on the Global Innovation Index Ranking. These objectives further resonate with the importance of building a robust equity investment landscape.

SECTION 2

GOOD PRACTICES /
BENCHMARKING

The various countries selected for the purpose of benchmarking good practices within the equity financing landscape and the corresponding rationale underlying their selection are indicated in the table below:

Country	Rationale for Selection
<div>Singapore</div> <div></div>	<ul style="list-style-type: none">• Focus on early/mid-stage investments, with similar economic characteristics as the UAE.• Well-developed and most active equity market in South East Asia.• A large number of buyouts have been witnessed in the country over the recent past.• The typical sectors of investment are similar to that of the UAE.
<div>Ireland</div> <div></div>	<ul style="list-style-type: none">• Focus on early-stage investments.• Government strategic direction towards promoting a knowledge/ innovation oriented action plan over the next 5 years. (parallel to the UAE National Innovation Strategy)• Representative of the European countries and high degree of similarity to the UK laws and practices (considered best in class)
<div>India</div> <div></div>	<ul style="list-style-type: none">• Primarily focused on late-stage investments and rapidly emerging role in the VC and angel investment space.• A seedbed for knowledge-oriented and technology ventures, represented by a large Indian Diaspora which leverages on its relationships globally.
<div>Egypt</div> <div></div>	<ul style="list-style-type: none">• Egypt accounted for the highest proportion (%20) of the total private equity investments in the MENA region in 2013.• The UAE mainland regulatory framework is an adaptation of the Egyptian laws.
<div>GCC</div> <div></div>	<p>Qatar, Bahrain & KSA - These countries were studied to identify policies, programs and initiatives being adopted in the region to spur early stage VC investments</p>

Various criteria were evaluated across the selected countries pool and key insights were drawn as follows;

CRITERIA	KEY INSIGHTS
<div>ECOSYSTEM LINKAGES & COLLABORATION</div>	<p>Active equity markets are characterized by 3 critical linkages and collaborations between:</p> <ol style="list-style-type: none">1. Strong macroeconomic fundamentals,2. Active capital markets and3. A vibrant entrepreneurial culture. <p>Role of Govt: The role of the Government is to address related gaps, bolster linkages and enable a seamless flow of ideas, processes & funds in the ecosystem.</p> <p>As an example, governments typically take an active role in promoting incubators at the University-level, to foster entrepreneurship and stimulate quality deal-flow.</p>



Significance

Benchmarking

Ecosystem

Legal

Analysis

CRITERIA

KEY INSIGHTS

FUNDING &
NON-FUNDING
ROLE OF THE
GOVERNMENT

The figure below depicts the typical funding and non-funding role played by the Government within the equity financing landscape;

	Pre-Seed	Seed	Start-up	Growth	Pre-IPO	
Non Funding	Legal reforms and policies for angel investment, crowd-funding, etc.					
	Industry Association					
	Business information Portal (education, information, database, events, toolkits, regulatory/business guides, legal agreement templates)					
	Deal Flow Connection Platform to match investors, entrepreneurs and intermediaries					
	Mentorship Programs for SMEs					
	Accreditation for investors and SMEs to enhance their credibility					
	Training Programs for angel investors, SMEs					
	Advisory and Guidelines for Business Incubators (including training program for incubation managers)					
Funding	Grant for Establishment & Operation of Business Incubators, Technology & Innovation Centres (at universities)					
	Tax incentive Schemes for Start-ups & investors					
	Cash Grant (E.g. R&D)					
	Public Private Partnership Fund to invest in start-ups and SMEs					
	Equity Co-financing Schemes					

Typically, Governments follow a two pronged approach to develop a vibrant equity investment ecosystem within their economies;

1.

Provide support at the early stages to promote start-up activity and boost deal-flow. The support is mainly in the form of funding (seed capital, R&D grants) and knowledge infrastructure development (funding, advisory and set-up of industry focused and university embedded incubators, set up of R&D centers, entrepreneurship centers of excellence).
2.

Implement specific policies and programs to instill confidence in the investor community.

a.

Typically, mandated government entities co-invest with other private venture capital firms and angel investors focused on early-stage investments; this in turn tends to have a multiplier effect on the consolidated investment activity within the country.

b.

Government institutions in tax based economies such as Singapore, Ireland and South Korea offer tax incentive schemes to encourage angel investors to invest in start-ups and SMEs.

c.

Governments also work on strengthening the legal and institutional frameworks within their economies, in order to ease the process of establishing and operating businesses as well as from the perspective of enhancing investor protection rights.

d.

Government institutions also tend to partner with global incubator / accelerator and angel networks to implement cross border programs.

Significance

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Significance

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IMPACT
EVIDENCE

CRITERIA KEY INSIGHTS

Research strongly indicates that early-stage equity investment stimulates R&D and encourages innovation in an economy. Additionally, equity-backed firms tend to reflect a higher degree of productivity, governance and competitiveness, in comparison with their non-equity funded counterparts.

The figure below highlights the direct and indirect impact of equity investments on the economy.

Impact of Equity Investment on the Economy

- New Venture Creation
- Enhances Sales & Revenue Growth
- Encourages Innovation
- Strengthens Company's Board
- Provides Access to Funds
- Talent Retention

Direct Impact on the Business

- Impetus to Economic Growth
- Growth in Innovation (no. of patent fillings)
- Stimulates R & D

Direct Impact on the Economy

- Creation of high-skilled jobs
(innovation led firms)
- Encourage Serial Entrepreneurialism

Indirect Impact on the Economy



- In Singapore, government led equity investments are associated with a distinct multiplier effect, manifested in the creation of more than 700 VC-backed enterprises within a -10year time frame. Additionally, %10 of these firms have gone on to become listed entities.

- Between 2003 to 2012, Irish Government investment has led to a multiplier effect of over 12x in the total value of investments within the economy, 4x in terms of firm creation and 3x in terms of impact on GDP (particularly among the high-tech sectors).

Approximately %75 of the Irish University spin-outs raise venture capital and %66 of the SMEs collaborating within the National research centers are venture-backed.

- In advanced equity finance markets such as the USA; every dollar of venture capital invested between 1970 and 2010 resulted in generating USD 6.27 of revenue in 2010.

The key inferences derived from international benchmarking highlight the role played by the Government in ensuring a seamless flow of information, lending impetus to capital creation and instilling investor confidence. The economic benefits related to equity funding are far reaching in terms of stimulus to GDP growth, generation of creative & innovative output and enhancement of productivity.

The imperative for policy makers is to strengthen the linkages between the country's macroeconomic fundamentals, entrepreneurship ecosystem and capital market activity, via various funding and non-funding measures; aimed at developing a quality deal-flow which would in turn propagate further investment activity.

SECTION 3

**SME EQUITY FINANCING
ECOSYSTEM IN DUBAI**

The Demand-side and Supply-side perspectives, related to the Dubai equity market were studied in detail. Additionally, an estimation of the current equity investment market has been carried out (represented below);

In 2014, the total value of early-stage equity investments in Dubai amounted to approximately USD 30mn.

A brief snapshot of the demand estimation is provided in the following illustrative;

	Individual Angel Investors	Incubators Accelerators		Early - Stage VC Firms	Late - Stage VC Firms
No. of Active Entities Individuals	#35	#3		#8	#5
	x	x		x	x
No. of SMEs Funded in a Year per Entity Individual	#1	#8	Limited deals highlight nascent market and limited opportunities for VCs	#3	#2
	=	=		=	=
Total SMEs Funded in a Year	#35	#24		#24	#10
	x	x		x	x
Typical Investment Size per Deal (USD)	\$65,000	\$30,000		\$500,000	\$1.5mn
	=	=		=	=
Total Investment (USD)	\$2.3mn	\$0.7mn		\$12mn	\$15mn
* Does not include Investments made by PE firms	Total Early - Stage Equity Investment Investment (2014) : USD 30nm *				

KEY
GROWTH
DRIVERS

- The market (in terms of value) is expected to grow in the near term by %15 on the back of a ~%30 growth in the number of deals (fostered by an impetus in activity from existing incubators / accelerators and early-stage investment firms).
- Additionally, the expected increase in the number of industry-specific incubators and accelerators expected to come online, triggered by strategic government investments; is likely to further boost a growth of startups within the economy.
- UAE (particularly Dubai) has witnessed a lot of foreign interest from business angels in the US and Europe. There is an inherent opportunity to convert these into active investors, focused on UAE based businesses.
- Equity financing as an alternate investment avenue is gaining rapid acceptance and interest among wealthy individuals as well as corporate professionals, via recently launched crowd funding platforms like Eureeca and organized angel groups such as EnVestors, Venture Souq, WAIN and WOMENA.

The relative uptake of equity financing is observed to be more pronounced among knowledge oriented sectors like ICT, Life Sciences, Media and Healthcare. These sectors are also intrinsically associated with a higher degree of creative and innovative output.

The limited adoption of equity finance in traditional sectors like trading and construction is mainly due to the characteristic of such firms typically reinvesting their surpluses into operations, principal reliance on short-term working capital and limited need for growth capital which is quintessentially associated with equity funding.

Additionally, The research also indicates that local SMEs that do not avail equity financing tend to capitalize on retained earnings derived from high profitability growth, for chalking out capital investments.

Significance

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DEMAND-SIDE PERSPECTIVES

The key inferences related to the demand are based on a survey of 250 SME businesses, belonging to sectors that have a high propensity for uptake of equity funding. The survey also highlights the profile of entrepreneurs / SMEs who have successfully obtained equity financing.

KEY CHARACTERISTICS OF
AN ENTREPRENEUR
(SUCCESSFULLY AVAILED EQUITY FINANCE)

GENDER



%15 Female entrepreneurs have
successfully obtained equity funding.

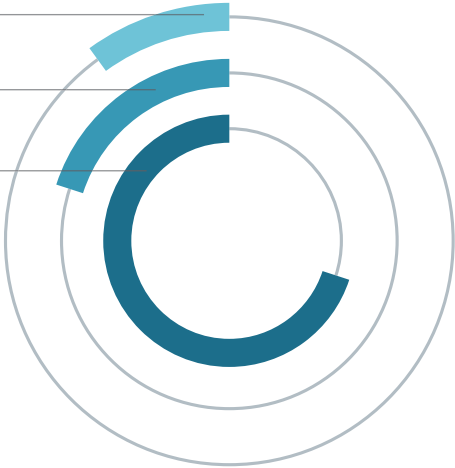


AGE



More than %70 are young entrepreneurs (40-30 years).
Majority of the female entrepreneurs are less than 30 years old.

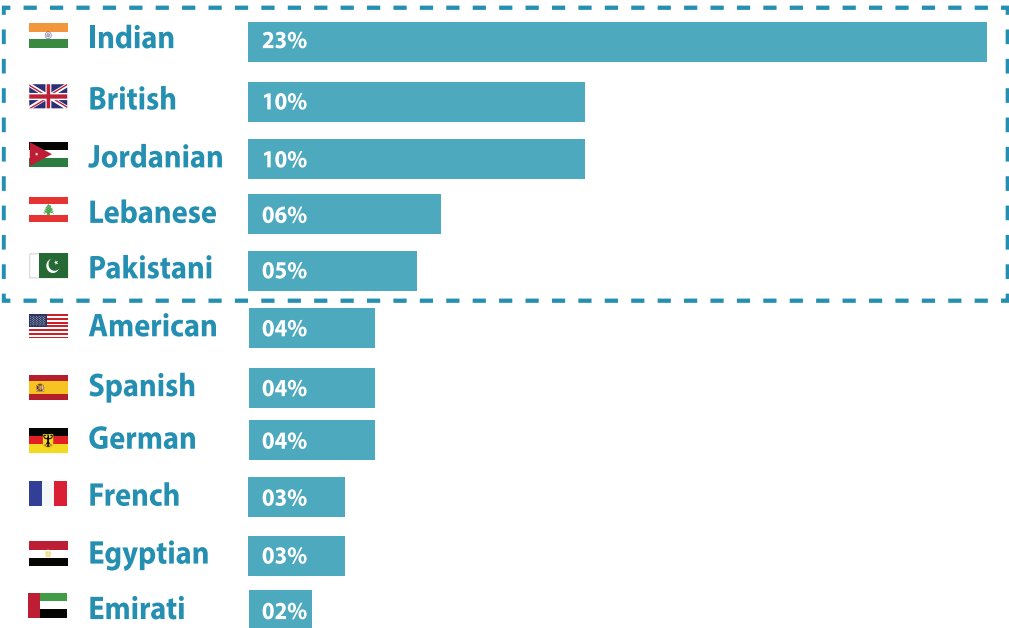
9% < 30 Years
19% 40 - 50 Years
72% 30 - 40 Years



TOP 10
NATIONALITIES



The top 5 Nationalities that have received equity funding are similar to the top 5 Nationalities within the angel investment community; this highlights a trend of “Community based financing”.



Significance

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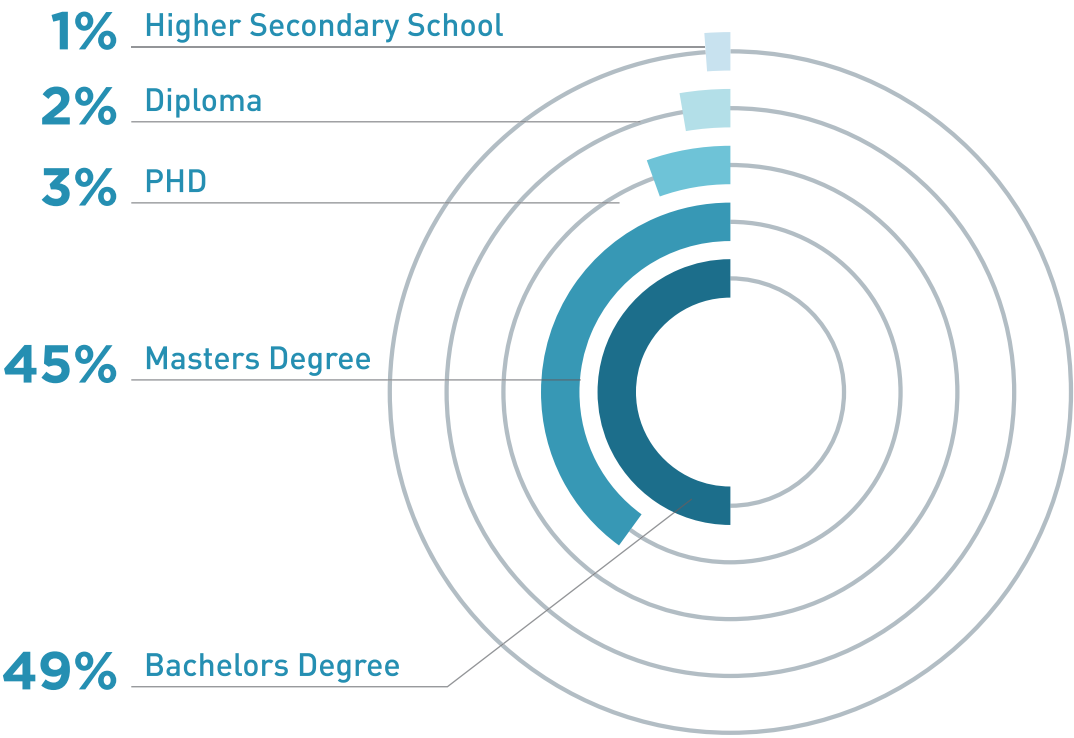
Legal

Analysis

EDUCATION



Entrepreneurs typically tend to have a good educational background (Majority US educated)



BACKGROUND



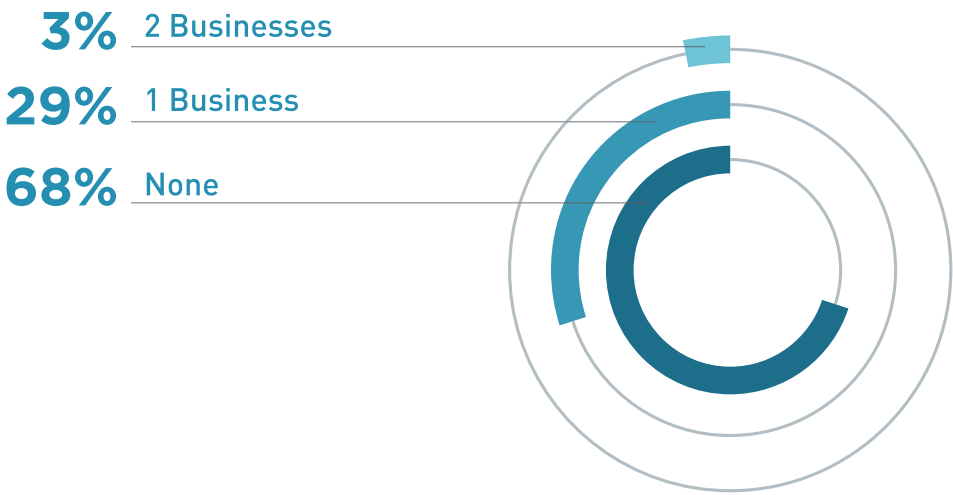
79% are “corporate crossovers”.



NO OF BUSINESSES PREVIOUSLY FOUNDED



68% have no prior entrepreneurial background.



- A relatively high percentage [%68] of first-time entrepreneurs have been successful in obtaining equity financing on the back of a strong educational background and relevant corporate exposure (highlighting early-stages of the industry and a relatively sophisticated pool of entrepreneurs).
- A relatively higher ratio of women entrepreneurs are seen to have availed equity financing. Establishment of women specific angel investment networks in the UAE (WOMENA, WAIN) evidentially corroborates with the ongoing formalization of the equity investment industry in the country as well as the growing interest in investing in women-led enterprises.

Significance

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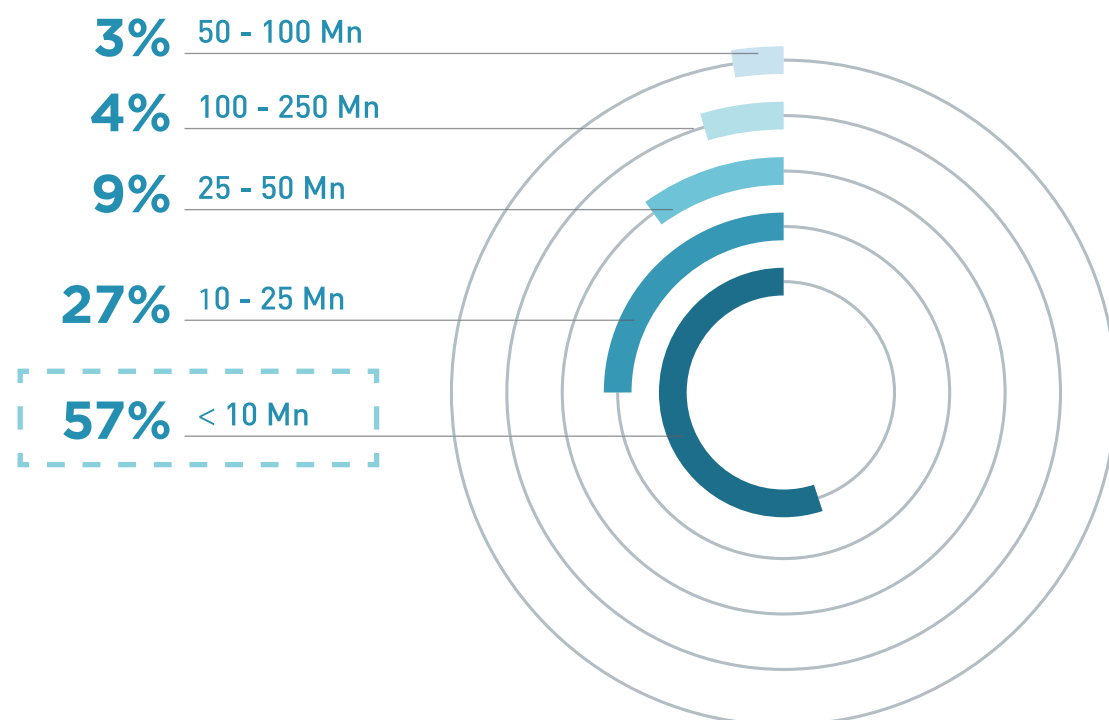
Analysis

KEY CHARACTERISTICS OF AN SME

(SUCCESSFULLY AVAILED EQUITY FINANCE)

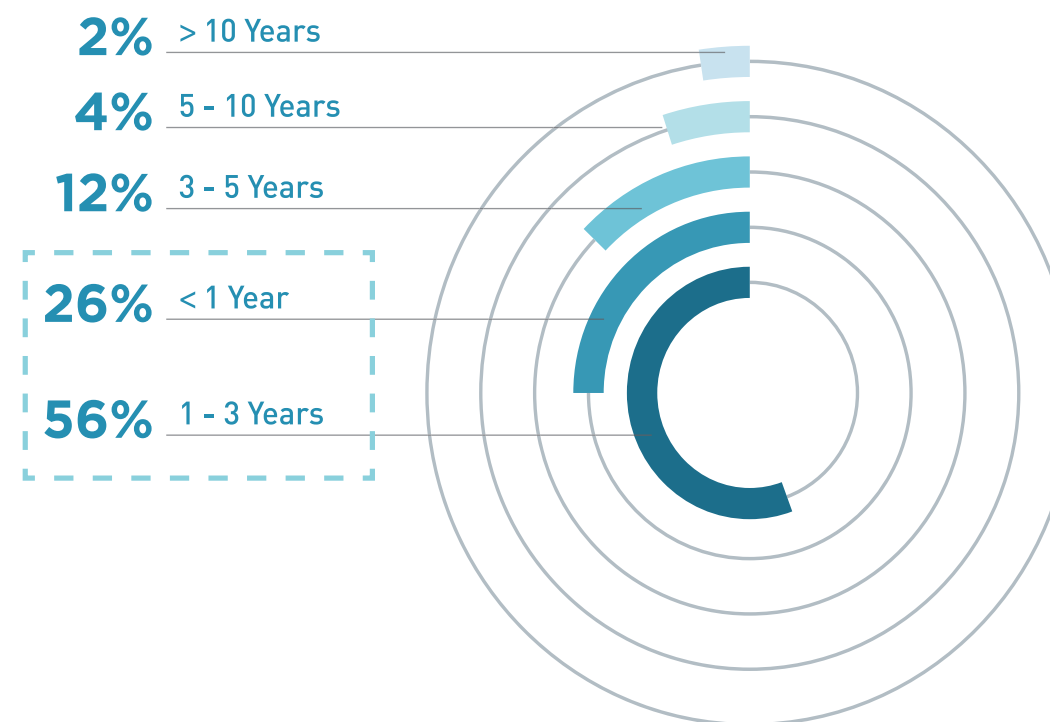
ANNUAL SALES TURNOVER

Majority of the SME's (%57) are micro businesses with a sales turnover of less than AED 10 Mn.

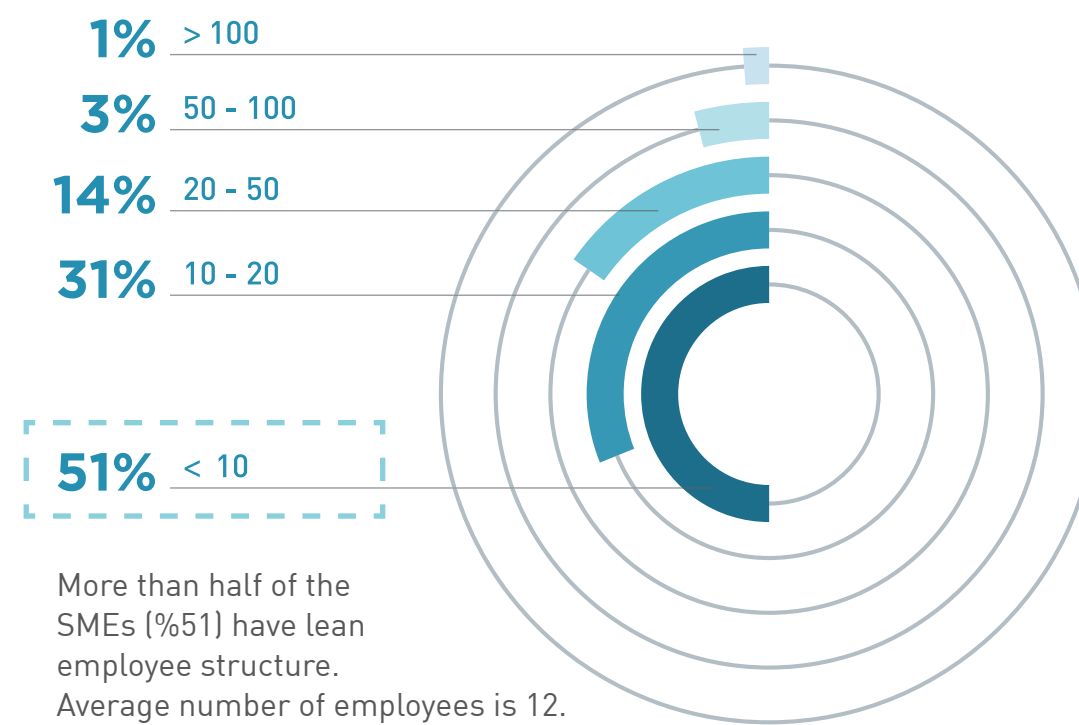


BUSINESS VINTAGE

More than %80 of the SMEs are young businesses with vintage of less than 3 years. %94 of the SMEs came into existence post the economic crisis; only %6 were established before 2008 and survived the crisis.



NUMBER OF EMPLOYEES



Significance

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REVENUE AND PROFITABILITY GROWTH (LAST 3 YEARS)



- %16 of SMEs that have availed equity financing have witnessed high top line growth rate of %15
- SMEs who have not availed equity financing have experienced revenue & profitability growth rate of 10 to %15 in 8 to 10 years of business operation whereas equity backed SMEs have grown relatively faster at 5 to %10 in a matter of less than 3 years

Revenue Growth

Average: 9.4%

Range: 5 - 10%

Profitability Growth

Average: 8.9%

Range: 5 - 10%

BUSINESS MODEL



B2B: B2C ratio is 1.3:1 for Dubai which is relatively lower than start-up cities such as Silicon Valley and Singapore (2:1).



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- Majority (%54) of the businesses were found to be sole proprietorships, vis-à-vis less than %5 that had multiple promoters.
- Majority of the SMEs (%57) within the respondent set are early startups with a sales turnover of less than AED 10mn. More than half the businesses (%51) have a lean employee structure (average number of employees is 12).
- More than %80 businesses have an operating vintage of less than 3 years; %94 of these came into inception, post the economic crisis.
- The average revenue & profitability growth rates of these businesses are in the range of 5 to %10 and %16 businesses that availed equity financing witnessed a top-line growth rate of over %15.



PURPOSE of **AVAILING EQUITY FINANCE**

The survey found that the primary reason SMEs availed equity finance was to manage operational costs rather than fund their strategic growth/expansion plans. Typically there exists a tendency amongst businesses in Dubai to bring in personal equity, set-up their business operations and subsequently approach angel investors to finance operational expenses and cash-flow requirements during the start-up period; this is also a debt funding gap that angels and early stage VCs are able to address.

In conjunction with the deployment of funding availed to finance operational expenses during the startup years, a significant proportion of businesses (%76) has also indicated the use of equity funding for new product / prototype development. Examples of such businesses include Apptuto: developing wearable's technology to track ideal study time, WMS Metals: technology to recycle industrial waste & Little Thinking Minds: Arabic learning apps for children.

Primary research indicates a slow but growing pace of innovation among Dubai based SMEs. These innovative ideas are likely to attract the attention of potential investors in the near to medium-term.

SOURCE OF EQUITY FINANCING

In spite of a relatively invisible angel financing landscape, a number of startups that have resorted to equity funding, have been successful in garnering investments from angels and incubators / accelerators.

Business angels are increasingly investing in qualified SMEs through dedicated Incubators / Accelerators. Such platforms provide angels with a pre-screened and validated deal-flow.

Although angels appear to be relatively ‘invisible’, businesses tend to identify them through their own personal networks and via online global angel networking platforms.

Around %48 businesses have obtained funding from multiple sources (Angels, Incubators / Accelerators and VC funds), across the startup phase. This indicates the emergence of investment syndication / pooling efforts amongst different players.

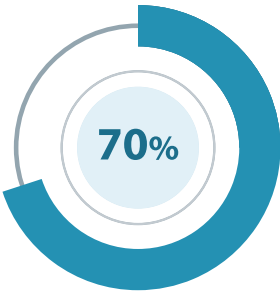
In terms of other sources, the survey indicates that %33 of the businesses received funding from VCs and less than %4 were able to avail funding from corporate venture set-ups (STC Ventures & MBC Ventures are the 2 prominent CVCs that have invested in businesses across the MENA region including the UAE).

There is also a visible trend observed, amongst large firms, to scout for opportunities to stay ahead of competition through deployment of / investment in disruptive technology startup ideas.

Firms such as Nestle, Du, 3M, etc are utilizing co-working spaces in the UAE (particularly in Dubai) to promote open innovation platforms, entailing presentation of key business issues, impacting them and seeking solutions through innovative startups and ideas. Such initiatives are likely to witness a growing trend in the coming few years.

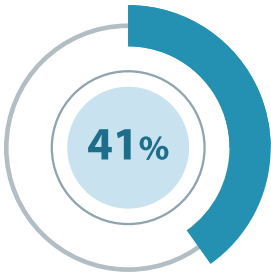
Crowd-funding as a concept has taken shape in the form of reward-based platforms like Aflamnah as well as an equity-based platform like Eureeca. Both these platforms are offering new investors opportunities to invest and become a part of the start-up ecosystem in the region.

MOST COMMON SOURCES



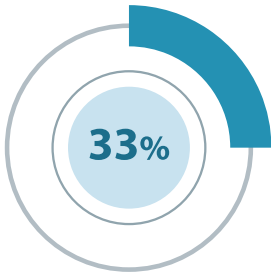
Angel Investor

Active market but not visible



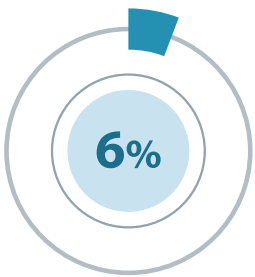
Incubator | Accelerator

Angel investors through incubators/accelerators

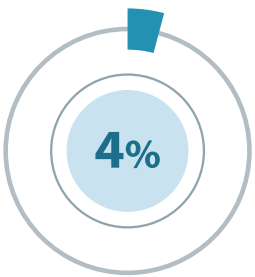


VC Firm

LESS COMMON SOURCES

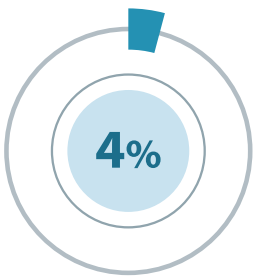


Family and Friends



Crowd Funding

Nascent | emerging concept



Corporate Venture Capital

Significance

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DEAL CHARACTERISTICS

The table depicted below, exhibits the typical deal characteristics with respect to percentage stake, investment value and lock-in period, portrayed by investors engaged in investments across the SME business lifecycle;

TYPICAL DEAL CHARACTERISTICS	PRE-START	START-UP	GROWTH
Percentage Equity Stake	15 to 20%	15 to 20%	10 to 15%
Investment Value per Deal	USD 55,000 to 65,000	USD 130,000 to 140,000	USD 440,000 to 450,000
Lock-in Period	3 to 4 years	4 to 5 years	4 to 5 years

Research highlights that investees in Dubai are comfortable in giving-up around %20 of their equity stake at early-stages of the business, as compared to a maximum stake of 10-12% partaken by startups in developed markets, for a similar equity injection. This is an indicator of the relatively higher risk premium associated with early-stage investment in Dubai based start-ups.

The typical exit period associated with investments in Dubai also tends to be slightly higher than the global market average, reflecting the limitations in exit options and the significant vesting of time and effort required in the identification of appropriate exit avenues by investors.

%64 businesses continued to garner equity financing throughout the startup phase (from seed to post revenue). Only around %30 companies are found to have graduated further to the growth / expansion stage. Thus, only %19 of the total businesses surveyed have progressed from the pre-start to the growth-stage, highlighting the nascence of investment activity in Dubai.

EXIT STRATEGY

Exits are not visible indicating that investors still remain invested within their portfolios.

The survey results indicate that only a handful of investors (%6 businesses) have exited their investments. The most preferred modes of exit include share buybacks and secondary buyouts. In the event of exits from investors, founders typically tend to buy back the company's shares to maintain their majority stake and control in the business.

Secondary buyout activity has been limited only to a few deals in Dubai (e.g. Cobone, Souq.com, etc.). Exit activity is anticipated to increase by 2016 (once recent investments complete a 4-5 year lock-in period), given that most of these investments were around 2012, post the crisis.



KEY CHALLENGES ACROSS THE INVESTMENT CYCLE

It is interesting to note that most businesses (more than %50) indicated that they did not face any challenges in seeking and availing equity financing; this is reflective of the business sophistication and maturity of the founders.

This is also an indication of the higher degree of investment readiness of potential investment targets within Dubai. Some of the challenges highlighted by the remaining proportion of businesses across the investment cycle are depicted in the table:

INVESTMENT LIFECYCLE	KEY GAPS / CHALLENGES
SOURCING INVESTMENT	Identifying pitching / showcasing events and identifying relevant investors with commitment and interest are the topmost concerns of potential investees. In addition, businesses also cited that investors typically tend to be inexperienced and lack the suave and expertise related to due diligence and investment structuring fundamentals.
PRE -INVESTMENT	Investees typically face difficulty in accessing relevant advisory support and negotiating terms with investors. Certain businesses have also indicated that investor motives typically tend to be centered on gaining a majority stake in the business, without investing the efforts and due diligence required in gaining an in-depth understanding of the underlying operating model and fundamentals of the target business.
INVESTMENT	The principal concern reflected by investees at this stage is the lack of access to support / expertise in developing term sheets and legal documents related to the deal structure.
POST-INVESTMENT	The principal concern post investment is around obtaining follow-on funding and non-cash support (access to contacts, networks, opportunities) from the investor.

Significance

Benchmarking

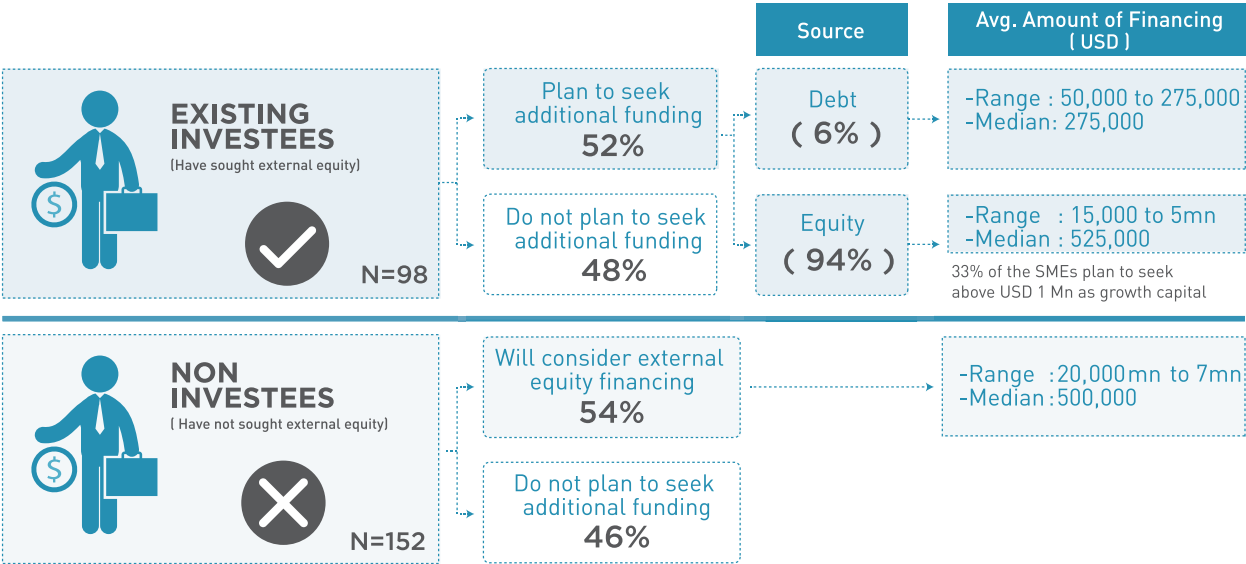
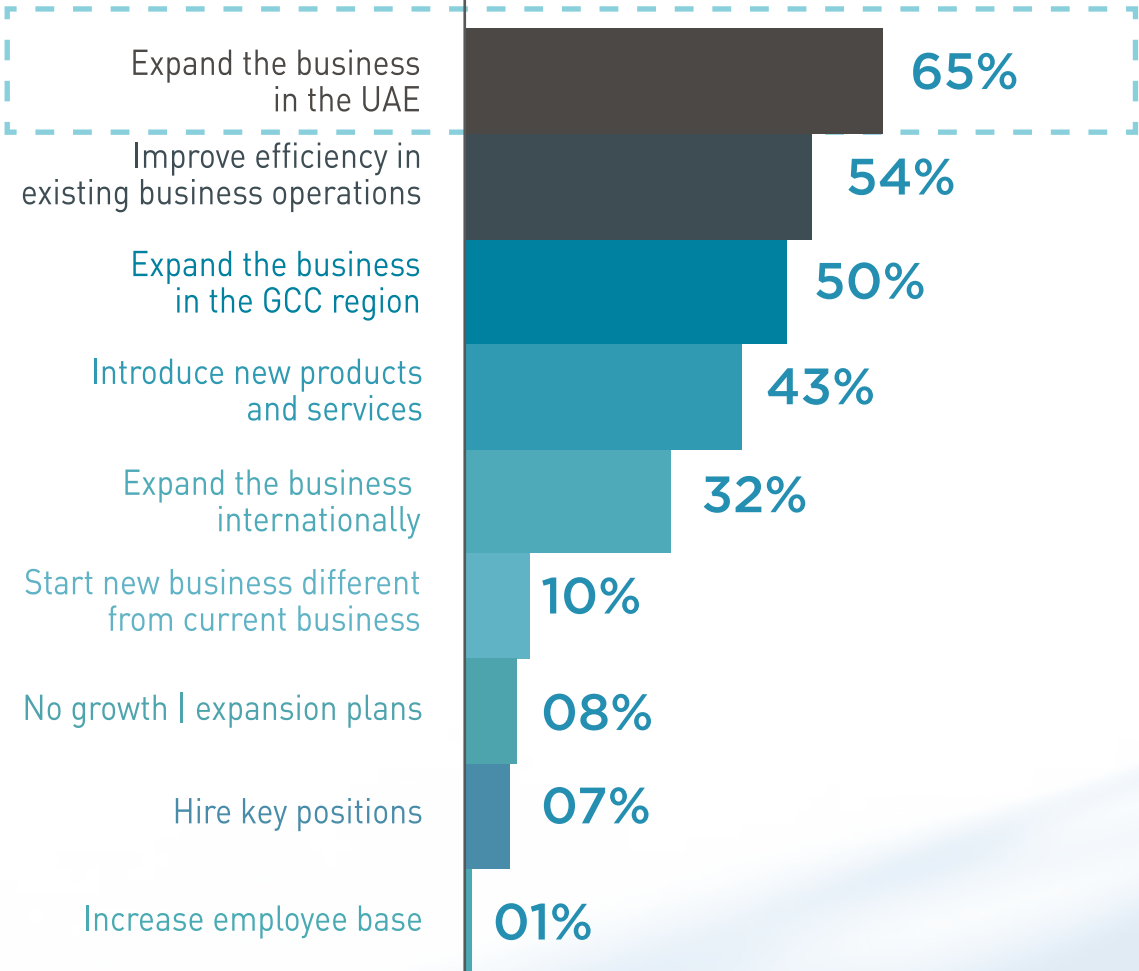
Ecosystem

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Analysis

EXPANSION
PLANS OF
BUSINESSES

Equity-backed SMEs with scalable business models tend to chalk out rapid growth & expansion plans as compared with SMEs who have not availed any equity finance.



Majority of the businesses (~%65) plan to expand their operations locally and continue catering to the UAE market. While %50 plan to expand into the GCC region, %32 plan to take their operations, global. It is interesting to note that more than %80 businesses that plan to expand internationally are less than 3 years old. This highlights that these businesses have a strong inherent focus towards internationalization, right at the inception-stage.

More than %50 of the businesses surveyed plan to seek equity funding in the near future, to fund their working capital and growth needs.

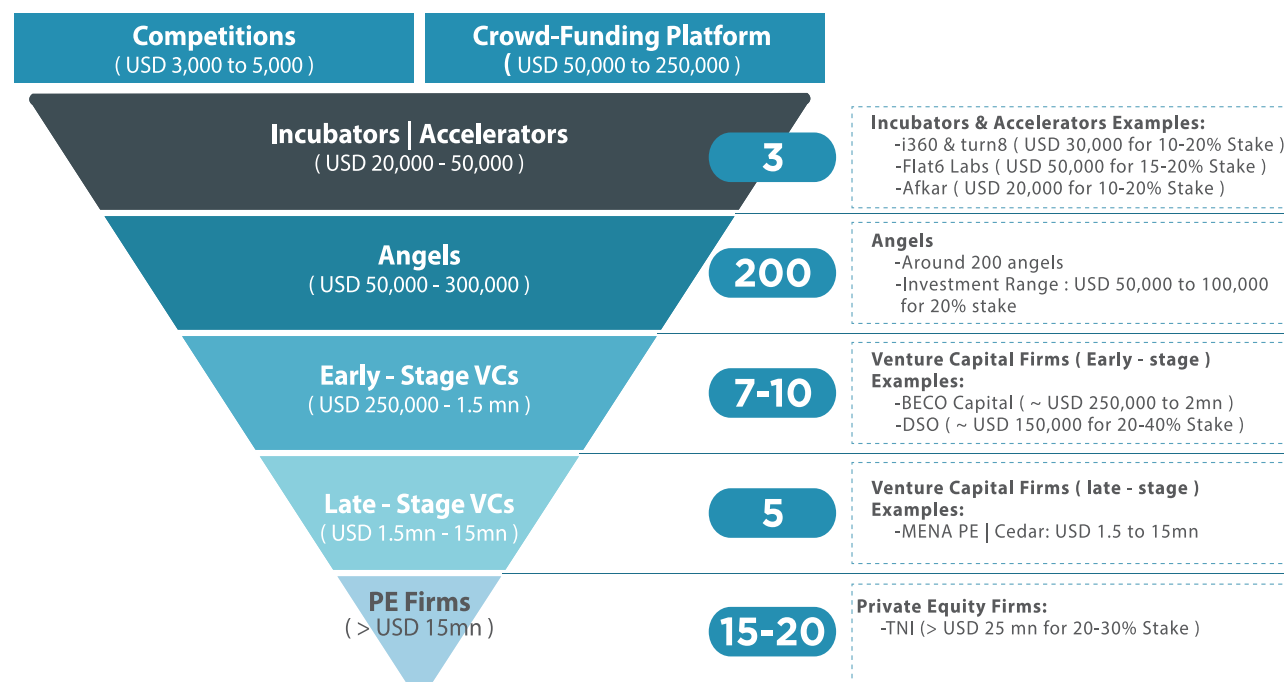
SUPPLY-SIDE PERSPECTIVES

The supply side perspectives have been compiled from the inputs obtained through in-depth interviews with key industry players across the landscape, including incubators / accelerators, angel investors, VC and PE firms. This was supplemented with a telephonic survey, covering over 50 players, conducted to capture key investment profiling details.

Overall, the SME equity supply landscape in Dubai is observed to be emerging, fragmented and currently reflects minimal collaborations, investment pooling & consortium efforts as well as the prevalence of public private partnerships. Additionally, in the absence of a formal association governing early stage investment activity, the market lacks appropriate standards and regulations.

INVESTMENT PYRAMID

Highlights presence of players across a wide range of investment sizes (USD 20,000 to USD 25mn)



- Incubators and accelerators typically provide an average investment of around USD 30,000 at the concept / business idea stage for a relatively high equity stake (15 to %20) in investee businesses. Accelerators in the UAE (particularly Dubai) typically fund around eight to ten businesses per year. A number of incubators and accelerators are expected / planned to be set-up in the near term, this is expected to accentuate the quality and volume of deal-flow and provide a stimulus to the overall investment activity. Accelerators are either established global brands (Astrolabs) or regional brands (Flat6labs, Afkar.me) that have made inroads into the UAE. This highlights the potential for the UAE to emerge as a regional hotbed for early-stage investment activity. Every incubator and accelerator typically tends to be associated with an Angel network and a council / association of accredited mentors.
- There are around 200 angel investors in the UAE (majority of them based in Dubai), %33 of them are 'Active' angels making at least one investment in a year. Angel investors typically tend to invest in the range of USD 50,000 to 300,000 in exchange for a %15 %20 - equity stake, in the target business.

Although the Middle East has the fastest growing and maximum number of 'Ultra High Net-worth Individuals' (UHNIs), their interest in early-stage business investment is limited. The limited equity investments tend to be community-led and the preference is primarily centered on investment propositions entailing physical assets (viz. property onshore and offshore). These investors may also keep a low profile due to tax implications in the home country and to avoid the public display of their private wealth.

KEY CHARACTERISTICS
OF ANGEL INVESTORS
IN DUBAI

(HIGHLIGHTS AN EMERGING CLASS
OF FINANCIALLY SUAVE INVESTORS)

DATABASE

Dubai has a relatively high (~%9)
proportion of women Angel
Investor.

33%

Active

96% 04%
N = 48

67%

Committed

90% 10%
N = 138



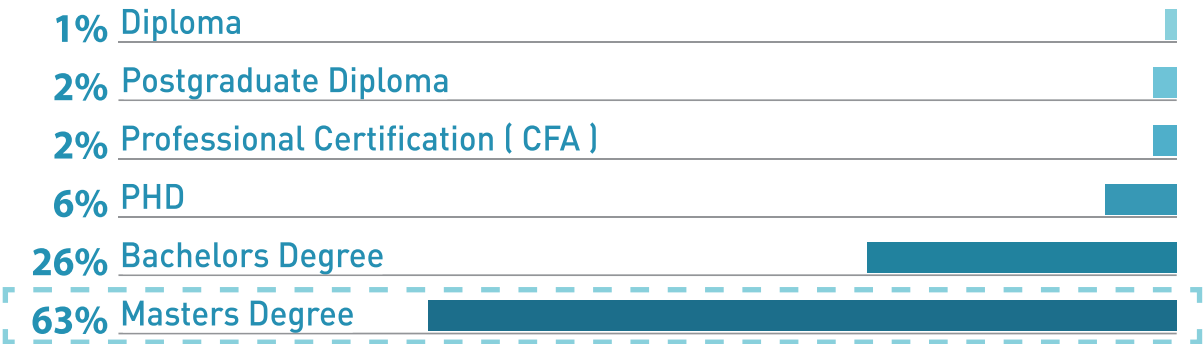
NATIONALITY

%88 Angels are expats, Indian
investors have the maximum
visibility.



EDUCATION

%63 Angels are expected to be
sophisticated (Business matters)
given their educational
background.



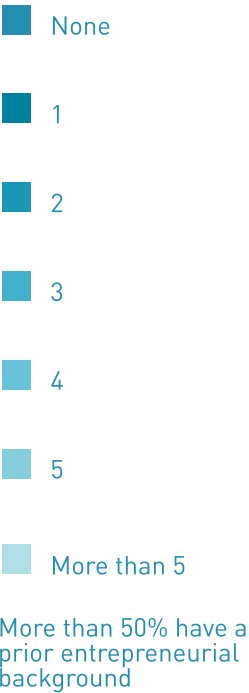
Significance

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NUMBER OF COMPANIES FOUNDED

More than %50 have a prior entrepreneurial background.

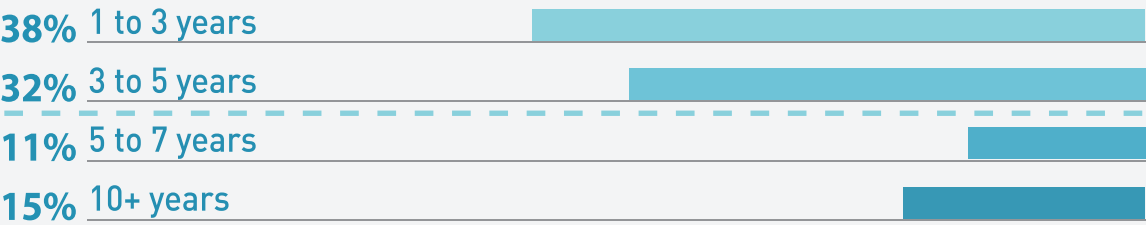
Relatively new investors with less than 5 years of investing experience.

Majority of the investors are still invested in their portfolios.

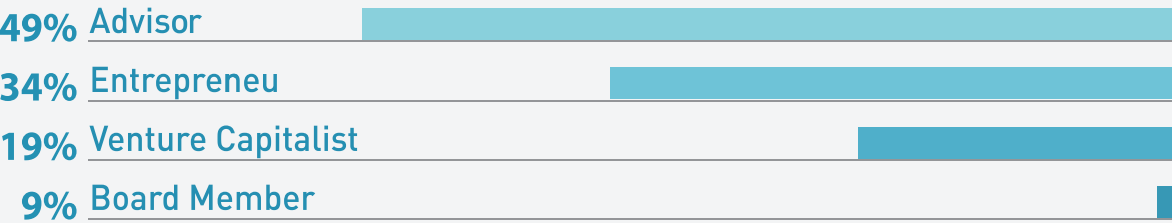
%49 prefer taking a mentorship role.

Over %95 prefer to invest independently with only %7 investments done through a syndicate.

ANGEL INVESTING EXPERIENCE






ROLE OF THE INVESTOR



ANGEL INVESTMENT ACTIVITY IN THE UAE

(Particularly Dubai) vs. Globally

Determinant	 USA (2013)	 Europe (2013)	 UAE (2013 - 2014)
Total No. of Angel Investors	Accredited 298, 800	Sophisticated 271, 000	200 Visible Angels
No. of Angel Networks	300 [Avg. 42 members each]	400 (Avg. 70 members each)	3 [Avg. 15 members each]
Total Capital Invested	USD 24.8 bn	USD 6.7 bn	USD 2.3mn
Avg. Individual Invst. per Deal	USD 37, 000	USD 26, 000	USD 65, 000
No. of Deals per Year	70, 730	33,400	30 - 40
Average Deal Size	USD 394, 000 [avg. stake acquired of 12.5%]	USD 200, 000 [Avg. Stake acquired of 8 to 10%	USD 100, 000 (Avg. stake acquired of 20% with exclusivity)
No. of Jobs Created till Date	290, 020 [4.1 jobs per deal]	184, 170 [6 jobs per deal]	3168 [Avg. 12 jobs per deal]
Portfolio Returns	- Overall Multiple : [EV/Sales] 2.6x - AvgHolding Period: 3.5 Years - Average IRR: 27%	- Overall Multiple: [EV/Sales] 2.2x - Avg. Holding Period: 3.6 years - Average IRR 22%	-Overall Multiple: 3 to 5x -Avg. Holding Period: 4 - 5 years -Average IRR 20 - 25%
Hours of Due Diligence per Deal	-Pre investment ~ 59 hours [Spread over 3.5 months] - Post investment [weekly] 10 Hours	At least 20 hours	Not optimal higher time and effort spent due to lack of audited financial

Below par At Par

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In comparison to the angel investment activity in Europe and the USA, Dubai can be categorized as a relatively nascent market, based on the following observations:

- The angel penetration in Dubai is 6 angels per 10k businesses (as compared to the USA: 3 angels per 10k businesses and the UK: 56 angels per 10k businesses), reflecting the inherent potential for a strong emergence of angel activity in Dubai. These investors are likely to get formalized through various angel networks and crowd-funding initiatives (Eureeca), in the near term.
- The key demographic characteristics of angels in Dubai tend to be similar to their counterparts in developed investing economies like the US & UK (where the typical angel investor is generally male, around 45 years old, has a college degree and holds around 15 years of working experience). However, most Dubai angels are seen to be purely financial gain driven and lack seasoned entrepreneurial acumen to guide their investee businesses. In contrast, majority angels in developed markets are typically found to be 'serial entrepreneurs'.
- Majority of the US angels have more than 9 years of experience investing in private companies; contrastingly, in Dubai only %19 investors have more than 5 yrs of investment related experience.
- Each sophisticated US investor has a lineage of investing in at least 10 businesses with an exit experience of at least 2 firms. For Dubai, this compares to less than one business in a few years and no real exit experience (current scenario).

- The average investment per angel (individual) per deal of ~USD 65,000 in Dubai, is comparatively higher to that of the US and Europe (where the metric is close to USD 30,000). Additionally, Dubai angels typically tend to demand a relatively higher stake of %20 with preference for exclusivity as compared to the relatively smaller stakes of less than %10 typically demanded by their peers in the US and Europe. This is indicative of the higher risk premium associated with angel investment in Dubai.
- 'Active Investors' globally invest anywhere between 4-5 deals per year to diversify their portfolio. In comparison, Dubai angels typically invest in less than one deal over a 2-3 year time frame; reflective of a relatively lower risk appetite as compared to their global counterparts.
- The presence of a limited number of formalized networks in the UAE vis-a-vis global markets further reiterates this risk aversion characteristic (most angel networks within the UAE are informal groups). EnVestors, a UK based Angel Network is a popular group in the UAE. Following its success women led angels groups like WOMENA and WAIN and others like VentureSouq have also been formulated. However, the traction in activity and success of these groups is to be observed over the next 4-5 years, once exits become inevitable.
- In Europe, the average investment amount in SMEs increases at least 3 to 5 times when investments are made in consortiums or via structured co-investment fund platforms; moreover each deal is syndicated by an average of 3 angels per deal. In the UAE (particularly Dubai) majority of the deals tend to be solo, with a limited prevalence of syndication amongst angels.

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- VC firms in the UAE typically invest in target companies which have the potential to grow to ~USD 20mn enterprises within 5-7 years (if investing in the company at the early-stages) and up-to USD 100mn within 5 years (in the case of late-stage investments). While early-stage VCs focus on investing between USD 300,000 to 1.5mn in SMEs (in exchange for a 20 to %30 equity stake), late-stage firms typically have an appetite to invest significantly higher amounts in the range of USD 1.5 to 15 mn. The typical entry multiple associated with a late-stage target is 4x and the exit multiple expectation tends to be ~8x over an investment horizon of 3 to 5 years.

While there are only a few (7 to 10) locally incorporated VC firms: BECO Capital, Active M Ventures, Emerge Ventures and Mulverhill Associates; foreign branches of WAMDA, iMENA Ventures and MEVP also have a base in Dubai. Locally incorporated firms have a primary focus on the UAE (up to %75 of their portfolios comprise local companies). In contrast branch offices of foreign firms (located in the free zones) like Iris Capital & Genero Capital (typical fund size ranging ~USD 18 to 20mn) have less than %10 of their portfolios invested in local businesses. A few regional focused corporate VCs have activity in the local market (STC Ventures, MBC ventures) but tend to seek investments only in highly profitable businesses, with strong growth upsides.

- Equity crowd-funding platforms like Eureeca have been recently established in the UAE and encourage investors to be a part of new business / investment opportunities by investing smaller amounts through qualified equity stake. The emergence of crowd-funding in the UAE highlights the growing intent of high net worth individuals to invest in local and regional ventures.

In addition to the above categories, a visible emergence of multiple co-working spaces in the UAE (viz. The Cribb, Impact Hub, etc.) housing quality startups; is anticipated to contribute to the vibrancy of the overall equity investment ecosystem.

The overall landscape analysis reflects the current emerging status of the industry and its strong potential to grow in the near-term; however a robust regulatory and institutionalized governance framework is a strong pre-requisite.

SECTION 4

LEGAL BENCHMARKING
AND INSTITUTIONAL
IMPERATIVES

The presence of a robust legal and institutional framework to govern investment activity in any economy improves the overall investor confidence, thereby creating a momentum in equity capital flows and enhancing the overall market attractiveness. A strong legal environment addresses investors' concerns with regards to the protection of their rights and enforcement of contracts. Furthermore, a robust legal environment strongly influences the size of a country's capital markets and the ability of local companies to raise and receive external financing.

The report has assessed the key laws and provisions underlying SME equity investment in the UAE. Additionally, the UAE has been benchmarked with well-developed equity investment markets (viz. Singapore, UK, India, Egypt and relevant GCC countries) to study the prevalent legal frameworks within these countries and to draw on relevant best practices.

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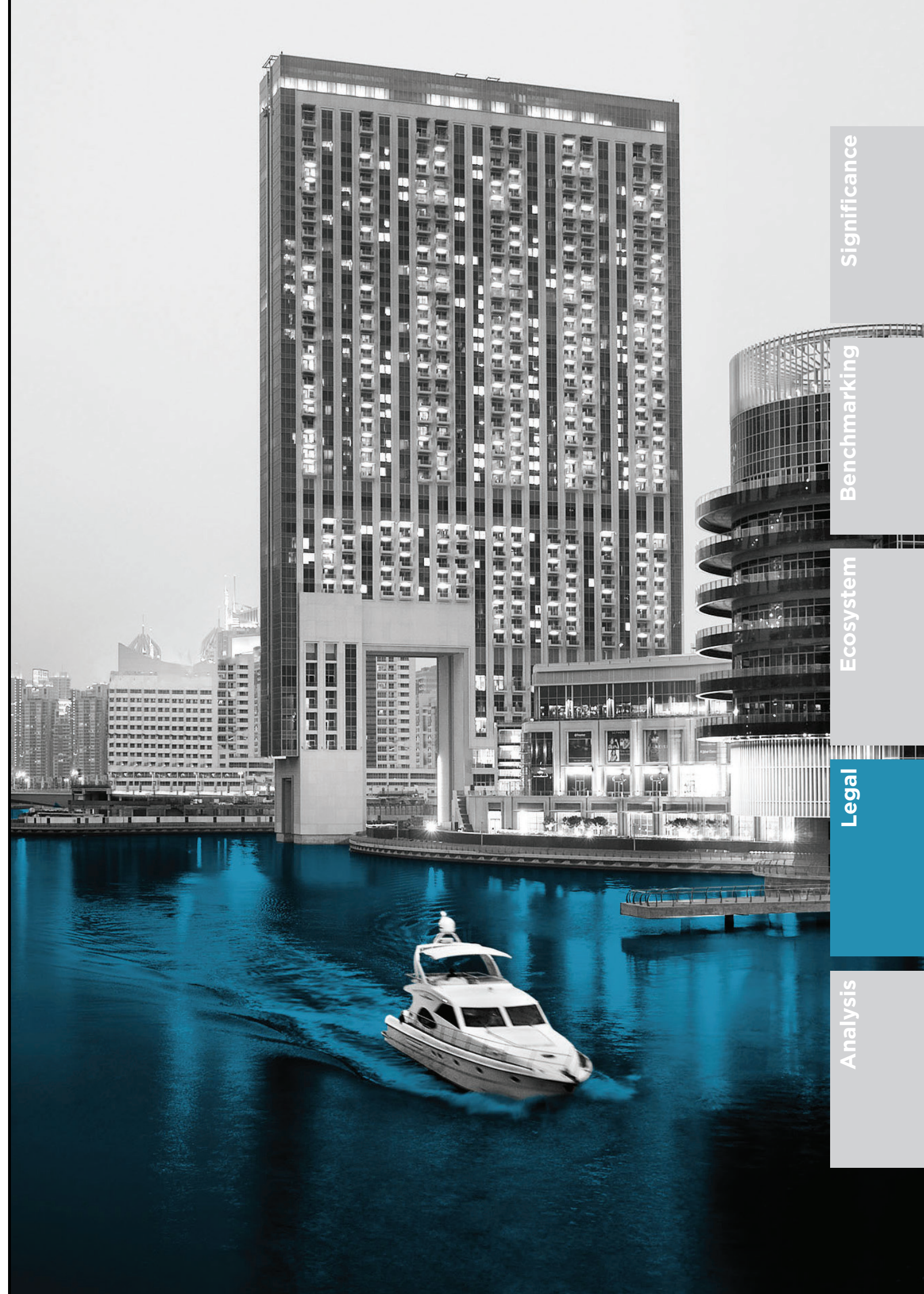
The key gaps in the legal and institutional framework in the UAE are highlighted below;

1. The Legal landscape is characterized by 2 sets of laws/provisions related to the Mainland CCL and the Free Zone regulations which differ for each Free Zone. The Commercial Companies Law, 2015 (CCL) and the Emirates Securities and Commodities Authority of the UAE is the primary law and authority respectively, governing various aspects of the equity investment market in the UAE. The CCL has provisions related to capital increase, share transfers, corporate structure, capital contribution obligations, shareholder rights and duties, assignment and pre-emption rights, obligations of the management and profit distribution. The Collective Investment Law, 2010 is applicable to collective investment funds established in the DIFC.

Outcome: Existence of multiple regulatory entities (DED, DIFC, Free Zones) and corresponding jurisdictions (mainland and Free Zones) in the UAE create complexities related to interpretation and enforcement. This makes investors apprehensive about selecting the right investment structure locally and hence they typically tend to select common offshore BVI / Cayman jurisdictions to set-up.

2. There are no specific regulations in the UAE relating to the accreditation and qualification of individual investors. In developed jurisdictions such as Singapore and UK, the regulator has defined specific eligibility criteria for qualification of individual investors. The financial and non-financial eligibility criteria are monitored actively by regulators in relation to both the domestic as well as foreign investments made by individuals. Regulatory intervention in these economies is possible on account of their tax regimes; this enables effective due-diligence and the dissemination of angel investor incentives accurately.

Outcome: For a young and emerging investment market like the UAE, the imperative is to ensure an all encompassing / participative criteria to build on a sufficient pool of qualified investors. However, the imposition of more selective criterion is critical in the long-term to ensure more effective governance and control.



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3. There are no regulations relating to crowd-funding in the UAE. Developing a set of clear regulations to allow crowd-funding platforms to operate under a robust legislative environment is a logical mandate for regulators, given the benefits of crowd funding as a platform for accentuating seed stage investments as well as in terms of institutionalizing a qualified pool of entry level investors.

Outcome: Investors are apprehensive about investing through existing crowd-funding platforms in the UAE. A large number of investors are awaiting regulatory certainty prior to engaging in full fledged investment activity.

4. Availability, enforceability and transferability of investor rights are a key determinant for developing a conducive equity investment ecosystem. Typically, in the UAE most structures / rights are agreed as additional clauses and riders within investor agreements (term sheets, shareholder's agreement, Articles of Association, etc.), to have the required circumvention and solution related to the limitations of the CCL.

Outcome: Due to the ambiguities related to the interpretation of certain rights and the absence of the legal recognition of certain investment classes (mainly preference shares) within the remit of the CCL; investors typically circumvent the system, through detailed term sheets and legally binding shareholding agreements. Legal structures are registered and maintained at offshore locations like the Cayman / BVI to benefit from the recognition, clarity and enforceability of investor rights and protection remedies, within the remit of these jurisdictions.

5. One of the key challenges faced by investors in the UAE is registering changes to share capital (related to uncertainty & lengthy procedures in relation to onshore and offshore requirements). Additionally, the process to arrange for all the relevant shareholders to sign before the notary at the Local Courts and the corresponding documentation is time consuming and not practical.
6. Capital markets play an essential role to serve as a source for raising finance for strategic investments as well as to provide an exit route for investors. However, the UAE capital markets are relatively underdeveloped as compared to global VC / PE hotbeds.

In spite of the multiple exchanges, liquidity and market capitalization in the UAE is relatively much lower than that of the developed markets like Singapore, UK as well as regional hubs such as Egypt and KSA. Moreover, NASDAQ Dubai is focused on established mid-sized firms (more than USD 10mn in revenues), family groups & conglomerates that are willing to invest time (12-18 months) and money (%2 of the IPO listing value) to avail the related benefits of public listing. The criteria and listing requirements are not very suitable to the needs of SMEs or smaller investors.

Outcome: Dubai's capital markets have witnessed limited IPO activity mainly attributable to the inherent inertia associated with local firms to go public and the presence of family groups who prefer to remain closed private group structures.

7. The regulations and covenants related to insolvency and restructuring of legal systems in the UAE are described as "EVOLVING" due to the proposed changes in certain related provisions. Certain laws that were drafted a number of years ago; now need to be extensively updated to keep up with the rapid pace of development of markets, legal structures and the increasing complexity of financial products.

In the absence of clear and well-developed laws, the problems faced by debtors, creditors, their lawyers and other professional advisers are compounded since many of the projects and transactions undertaken in the UAE are increasingly very large, complex and often funded on a multi-source and multi-tranche basis and are cross-border in nature (typically involve participants from multiple jurisdictions). The process of trying to put together the deals in the first place often pales in comparison to the complexity of trying to unravel, restructure or "repair" the deal when it goes wrong or borrowers are unable to meet their contractual or other obligations ('conflicts of law').

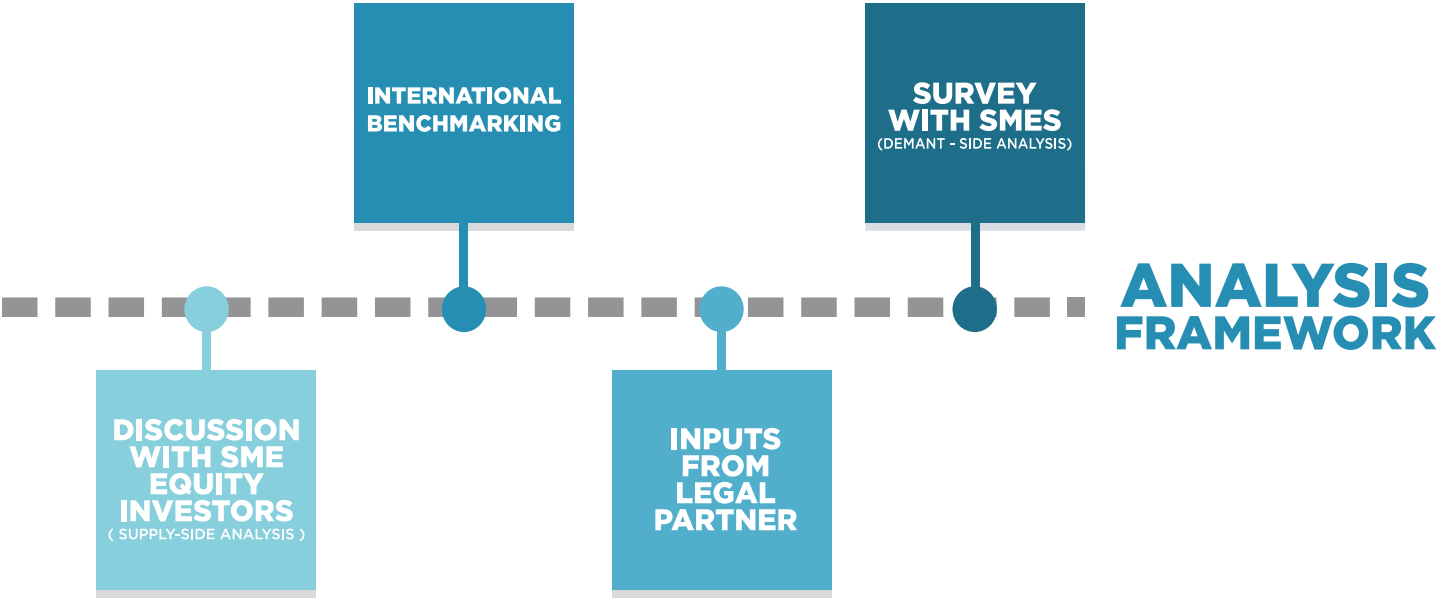
Investors typically navigate all the challenges and ambiguities related to the interpretation and enforcement of investor rights by setting-up investment vehicles in common offshore jurisdictions such as the BVI / Cayman Islands. Such havens are typically recommended by legal advisors and favorably sought by local investors as well as foreign investors. Furthermore, these structures allow the investor and investee to develop legally binding agreements with appropriate clauses, terms, riders and covenants to appropriately protect their interests.



SECTION 5

ANALYSIS AND
RECOMMENDATIONS

The areas of improvement in the SME Equity Investment Ecosystem have been assessed based on the following input framework;



**SUMMARY OF
RELEVANT
INFERENCES FROM
DEMAND-SIDE
ANALYSIS**

- **Presence of intent to avail equity** - The survey results reflects a clear growing intent amongst startups and SMEs towards adoption of equity finance (to enable rapid growth) in the near future.
- **High readiness & sophistication of firms** - Although the volume of deal-flow is low, the high investment readiness of local businesses makes them attractive targets particularly for early-stage VCs.
- **Deal-flow exists but is limited** - It is observed that the same deals (limited flow) tend to traverse across multiple sources including Incubators / Accelerators / Angels / Angel Networks / Crowd funding sources, to garner funding as investee candidates. Furthermore, although deal-flow exists, more than %70 of the deals originate from outside the UAE.
- **Overall funding gap is evident** - The debt financing gap attributed to the limited propensity of banks to funds start-ups, implies that these firms tend to turn to angels for financing; however their tendency to get their working capital requirements financed, often offsets the opportunity to leverage Angels for more strategic growth capital. Resultantly, the funding gap in the debt market related to start-ups creates a ripple impact on the overall seed and early-stage equity funding.
- **Presently the ecosystem is not innovation friendly** - There are limited schemes to incentivize and induce local and international businesses to set up their R&D centers in the country. Investment and public private collaborations for set of tech hubs and R&D centers of excellence is currently limited. Furthermore, the costs related to business failure tend to be high, thus limiting experimentation amongst local businesses.

Significance

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SUMMARY OF
RELEVANT INFERENCES
FROM SUPPLY-SIDE
ANALYSIS

- The early-stage equity supply market can be described as emerging, fragmented (multiple players with limited collaboration efforts), unstructured (lacks an Association, guidelines and valuation benchmarks) and untapped (relatively underpenetrated investor community: including Angels, VC firms).
- Angel investing can be considered relatively novice in the current state (low risk appetite of angels, informal operations, lack of consortium / syndicated fund pooling, investors with little / no knowledge of investing fundamentals)
- Growing wealthy class emerging as business angels
 - The impetus to angel investing in the UAE is likely to stem from a growing economic class looking at angel investing as an alternative investment avenue to grow their wealth, further accentuated by the influx of sophisticated investors from developed markets.
- Lack of quality mentors - The landscape in particular, lacks professional entrepreneur angels with the relevant level of industry and entrepreneurial experience to effectively guide prospective business start-up ideas and the related investees.
- Restricted flow of capital - The fact that angel investing is a recent phenomenon in Dubai and that most angels still maintain their investment portfolio and are mining exit opportunities over the next 2-3 years; implies that their ability to make near term future investments will remain constrained.

- The emergence of innovation inducing and facilitating infrastructure (accelerators, incubators, innovation labs as well as other platforms such as business plan competitions, industry – academia linkages and open – innovation forums; is only a recent phenomenon and there is some lag expected in the manifestation and culmination of key associated benefits.
- Valuation is difficult to ascertain in the absence of authoritative precedent trading benchmarks. As a result potential investors tend to become apprehensive about the viability of business ideas and the risks associated, thereby impacting their ability to reach appropriate / objective enterprise valuations. Presently, investors in Dubai are in a price discovery phase and as the market matures (investors become active, industry-specific incubators introduce industry benchmarks, deal benchmarks start to emerge etc.); a higher implied confidence related to pricing is inevitable and will manifest in the form of enhanced deal flows

Based on the above analysis, the following illustration provides a perspective into structural and economic realities associated with the state of the SME equity financing landscape in Dubai. The market is presently in a ‘Discovery Phase’; the ecosystem is evolving and provides an opportunity for investors.

Start-up investors are leveraging on equity investment opportunities, as an alternative to traditional investment avenues; while SMEs are exploring the deployment of equity funding as a replacement for conventional debt, particularly in the early stages of the start-up.

Additionally, as anecdotal evidence, it is also observed that the small proportion of local SMEs that have successfully on-boarded start-up equity have in cognizance of the associated benefits; further pursued with additional follow-on equity to fund their business growth plans.

Significance


Benchmarking

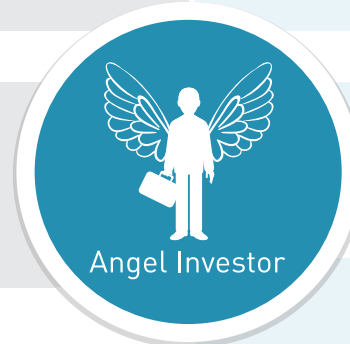
Ecosystem

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THE CURRENT STATE OF SME EQUITY FINANCING IN DUBAI:
“DISCOVERY PHASE”

STRENGTHS		WEAKNESSES	
Expanding Start-up population		Limited R & D / Innovation Focus	<ul style="list-style-type: none">• Young economy with a few established companies (too early-stage for VCs) providing great opportunities.• Intent to avail equity financing, to navigate and mitigate early-stages of start-up, however apprehension on the structuring of the deal and commitment of investor prevails.• Weak innovation ecosystem.• Bite-sized investments not enough for SMEs to sustain their growth plans and hence resort to multiple sources for financing.• SMEs are not aware of the ecosystem and what is available to them.
Entrepreneur sophistication & Readiness		Expat-driven (Not Necessary full-time on business)	
Need for Capital & Business Guidance		Short - Term Planning horizon	
Confidence in benefits of equity investments (through follow-on rounds)		Lack Scalability	

STRENGTHS		WEAKNESSES	
Investor Confidence in the economy & Individual wealth creation		Difficulty in Valuation and true assesment of Target	<ul style="list-style-type: none">• Large number of angles vying for same SME pool.• Perceived poor quality of deal-flow in the absence of relevant industry benchmarks (to gauge valuation).• Limited time to mentor investees, as angles typically tend to be corporate professionals with full time jobs.• Steep learning curve for investors, who tend to have limited entrepreneurship experience and business acumen.• Without foreseeable exits angels might have to hold on to investments longer than anticipated.• Prefer “Control Mode” rather than “Syndication Mode”, therefore manifesting in solo angel led deals, versus consortiums.
Next Generation of Family groups open to Tech investments & Seed Capital		Long-hours spent in due-diligence	
Willingness to provide / test through “bridge” financing		Limited Capital chum / re-investment	
		Low Risk Appetite	

Significance

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The triggers to facilitate / accelerate progression towards maturity are related to the development of critical enablers as highlighted in the adjoining illustration. These enablers form the tenets of the key recommendations.

TRIGGERS FOR A VIBRANT
EQUITY ECOSYSTEM

- Build a pipeline of “Innovative SMEs”
(Investors typically follow deal-flow activity)
- Aggregate a critical mass of “Sophisticated Investors”
- Foster collaborations for “Market Maturity”
- Build “Sophisticated Businesses”
- Promote Sectors which have a competitive advantage
in Dubai (Logistics, Healthcare, Tourism, Fashion & Retail)
- Celebrate & publish “ Exit Stories ”
(Investors invest only if exits are visible)
- Build Knowledge Awareness
- Enable Information Dissemination

KEY RECOMMENDATIONS

- Adopting a robust insolvency and bankruptcy regime onshore.
- Implementing a secondary market, which could allow SMEs and mid-sized companies across multiple jurisdictions (with robust set of company laws); to list without complex regulatory pre-conditions related to corporate governance, prospect preparation and accounting regulations.
- Introducing a sponsor supervised capital market model (e.g. Catalist in Singapore and AIM in UK), wherein an SME is brought to list by a sponsor with expertise in corporate finance and regulatory compliance.
- Implementing a robust regulatory framework on the lines of the JOBS Act in the US that allows SMEs to raise up to USD 1mn, without significant regulatory burden.
- Setting-up of 'Professional Advisory Committees' to provide counsel and advisory for specific components of the UAE legislation as well as changes in the investment environment (capital markets, crowd-funding, fund structures, etc.).
- Enhancing collective investment regulations to structure open and close ended retail fund structures on the mainland.
- Developing a robust regulatory framework for crowd-funding to legalize and stimulate lending.
- Deploying certain relaxation criteria related to foreign ownership restrictions for priority sectors.
- Deploying cost effective 'Small Claims Court' framework for small financial claims (serves as a huge boost to investor and SME confidence)



In addition to the mentioned legal recommendations and based on the gaps observed and inferences drawn from the study (culmination of gaps / observations from international benchmarking, demand–supply legal perspectives); a number of potential interventions have been identified by Dubai SME.

The development of the overall equity ecosystem is however possible only with the collective and collaborative efforts of a number of players as well as key linkages with the industry and academia.

Therefore, Dubai SME has identified some key initiatives to address the mentioned gaps as part of its SME 2021 Plan. These initiatives will be implemented in collaboration with the key stakeholders in the entrepreneurial ecosystem.

Significance

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