The rise of alternative financing

Easy access to and the provision of suitable financing options continues to be a concern at the forefront of many corporates and financial institutions across the UAE, in particular the small to medium sized enterprises. With the backdrop of the growth of financial technology and constraints on working capital, the UAE market has witnessed a growing trend towards alternative financing models, including receivables financing, factoring and securitisations. These alternative financing methods seek to bridge the gap where traditional bank lending is no longer considered a viable option for businesses.

Receivables financing

While receivables financing has been a longstanding feature of alternative financing models in the UAE, recently more innovative ways to help business free up working capital have been deployed and banks are now seeing receivables financing as a key feature of their portfolio. It comes as no surprise that the rise in more financing solutions coincides with the development of technology in this area. Not only has technology emerged in the UAE to extend the reach of receivables financing to a previously untapped and under-served market but it also has helped to provide more streamlined and diversified alternative financing. Traditionally, businesses would undertake a general assignment of its accounts receivables or obtain vanilla discounting facilities as a means to obtain short-term financing. Unlike securitisations and factoring, typically the receivables are not (truly) sold or transferred to a lender but merely a lender would be entitled to collect the assigned receivable in the event that the business fails to keep up with its loan repayments.

Common themes which are prevalent in the UAE include using technology to establish electronic platforms in which receivables can be financed. Further, schools, insurers, developers and landlords are recognising the benefits of receivables financing and it is becoming commonplace in the UAE for such institutions to use receivables such as school fees, rent, sales proceeds and insurances proceeds as collateral for obtaining short-term financing. This is an emerging trend across the UAE and an example of how receivables financing is being adapted to suit the cash flow needs of businesses.

Securitisations

Another dominant feature of the alternative financing market in the UAE is securitisations. Securitisations, while a common feature of alternative financing in the US market, are becoming more prevalent in the UAE. This is, in part, due to the UAE financial free zones (including the Abu Dhabi Global Market and Dubai International Financial Centre) which have continued to be attractive to international investors seeking investment opportunities in the UAE in jurisdictions with familiar legal systems based on international best practice but also due to the change in the regulatory landscape across the UAE. For securitisations, the additional ability to house the relevant special purpose vehicles in these free zones makes it more attractive.

Essentially, a securitisation is a legal structure which enables businesses to transform their assets to working capital. A growing concern for businesses is managing their balance sheets and a key feature of securitisations is to remove the relevant asset being securitised from the businesses' balance sheet and to allocate the receivables as income (also known as a true sale). Where a transfer occurs on a true sale basis the assets to be transferred should be ring-fenced in a special purpose vehicle established solely for the purpose of holding the assets. Such ring-fencing of assets seeks to ensure that the bankruptcy of the originator of the assets does not have an impact on the transferred asset. Further, structuring the securitisation on a non-recourse basis is beneficial to businesses to ensure that it (as the originator) has no obligation to repurchase the transferred assets on enforcement and to restrict the investor's recourse solely to the assets that the special purpose vehicle holds and over which the investor has taken security.

Whilst the UAE market is seeing an increase in traditional securitisations as an alternative funding source, a wave of Islamic finance securitisations has also gathered pace across the GCC as a result of the market becoming more sophisticated in understanding and structuring Islamic securitisations. Islamic finance securitisations seek to rely on the principles of a traditional securitisation structures but have been developed in such a way so as to ensure compliance with the main principles of Islamic finance.

Factoring

Similarly, factoring has also become a pivotal channel for small to medium sized enterprises seeking to sell their assets (usually account receivables, i.e. outstanding monies owed to that business) to third parties at a discounted price. Whilst factoring usually involves the sale of assets to banks and financial institutions, securitisations commonly seek funding from the wider investment and capital market.

Factoring is gaining traction across the UAE as it is seen to play an important role in the growth of small to medium sized enterprises the access of which to finance has historically been restrained due to, for example, regulatory restrictions or a lack of credit history due to the infancy of the business. Taken together the market is becoming more sophisticated in understanding factoring and the increase in the number of banks offering factoring as an alternative, factoring is gaining momentum in the UAE and is moving away from the stigmatism that this type of financing is only employed by entities in financial difficulties.

It is clear that securitisations, receivables financing and factoring are paving the way as viable alternative financing options where traditional bank lending is no longer appropriate or available.

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