دبي للمشاريع الناشئة
DUBAI STARTUP HUB
AN INITIATIVE OF DUBAI CHAMBER OF COMMERCE & INDUSTRY

HELPING STARTUPS ACCESS FUNDING

Addressing entrepreneurs' challenges in the UAE
Entrepreneurship advocacy I White paper series

Roland Berger

غرفة دبي
DUBAI CHAMBER

CONTENTS

EXECUTIVE SUMMARY

The UAE is on a journey to achieve global leadership in driving innovation. A flourishing startup landscape plays an important role in making this happen.

Shedding light on a key challenge for entrepreneurs in the UAE - Accessing funding

In this whitepaper, Dubai Chamber and its knowledge partner Roland Berger examine ‹access to funding› as one of the top 3 challenges facing startups in the UAE.

Entrepreneurs highlight two issues when it comes to securing funding:

- Navigating the complex local funding ecosystem
- High hurdle rates to qualifying for capital on the equity side, and insufficient risk appetite on the debt lenders side

Call for action

Raising funds is difficult for any startup in the world. Yet we believe there is an opportunity for the UAE to address specific roadblocks experienced by local startups today. This whitepaper explores several potential lines of action.

- **Playbook to help startups navigate the funding ecosystem**
  Today entrepreneurs can find a wealth of information on how to get funding in the UAE, but it is not consolidated in a single place. It should be easy to create a single step-by-step guide to raising funding. Examples from other countries or even cities can provide inspiration.

- **Continued building of the broader innovation ecosystem**
  The government and related entities in the UAE should re-examine if existing initiatives can be selectively strengthened to foster the broader innovation ecosystem. For example, building and financing more high-quality incubators could be one lever to consider. Equally, government-owned firms should consider opportunities to further step up their activities in incubation, acceleration and venture capital investments.

- **Helping equity investors invest in startups**
  Making it easier for equity investors to build confidence during the due diligence phase would make a difference, for example, by improving availability of reliable information (e.g. official sector statistics). Equally, it is worth exploring if government and related entities could further step up existing programs for startups to pilot and commercialize their products & services within the public sector.

- **Considering options for how to make loans available to early stage startups**
  First of all, banks should review their stance towards loans. What if loans were selectively granted as part of banks› Corporate Social Responsibility programs, or if banks invested in convertibles and warrants to strengthen their risk-reward equation. Additionally, the government could re-examine options for how to help make startup loans commercially viable for banks.

These action items require further examination to fully understand all issues at play, assess feasibility and craft a viable action plan. In this context, Dubai Chamber and Roland Berger look forward to initiating a dialogue with key public and private sector stakeholders with a view to jointly shaping a clear roadmap.

THE CONTEXT

The UAE is on a journey to achieving global leadership in driving innovation. The country is pushing to leapfrog the status quo with the implementation of a vast array of bold and interlocked initiatives.

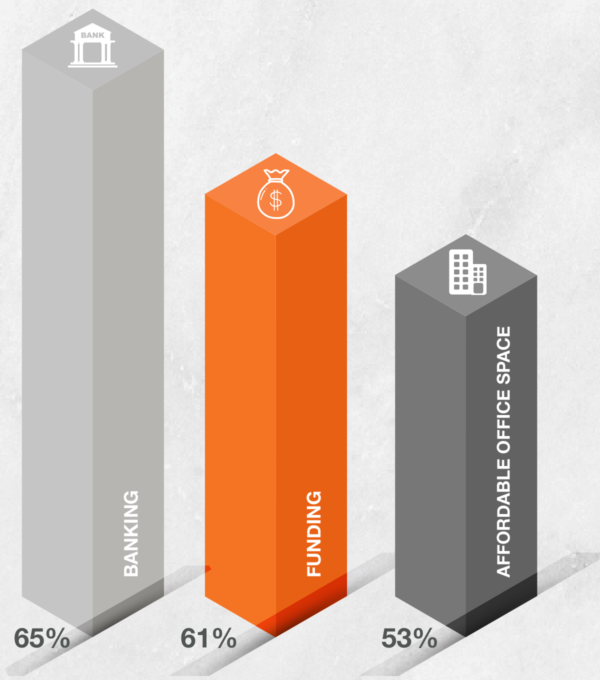
Both the public and private sector are investing heavily in building the innovation ecosystem. In this context, startups, SME›s and corporates need to play a key role in driving new technology adoption, overall economic diversification and job creation.

The depth of the startup ecosystem is multiplying with the support of such initiatives as the UAE Centennial Plan with its Area 2071, a physical space connecting all ecosystem players, such as startups, corporations, accelerators, VC firms, the government and many more.

Dubai Chamber plays an active role in fostering entrepreneurship in Dubai and beyond. In this whitepaper, Dubai Chamber and its knowledge partner Roland Berger, highlight what entrepreneurs today see as one of their key challenge in the UAE: funding.

Top 3 challenges for entrepreneurs in the UAE

[% of respondents qualifying topic as (Very) Challenging]



This is the second whitepaper in a series focusing on entrepreneurship topics that is published on a regular basis. The previous whitepaper focused on the difficulties in ‹opening a bank account›.

In drafting this whitepaper, we conferred with multiple stakeholders, either via surveys and interviews with startups, or through interviews with selected other stakeholders in the startup ecosystem such as angel investors, VC firms, incubators and accelerators, banks, and selected government stakeholders.

This paper makes a call for action with a clear vision to leapfrog the status quo when it comes to funding startups.

Our ambition is to engage with relevant stakeholders to foster a dialogue on how to translate this vision into reality.

“We must look forward and anticipate the future, so that our country lead globally”

His Highness Sheikh Mohammed Bin Rashid Al Maktoum

THE FUNDING CHALLENGE
An entrepreneur›s perspective and why it matters

Funding is critical for any startup, be it in early stages to develop the minimum viable product or subsequently to scale the business. Without a doubt, getting funding is a daunting and stressful pursuit anywhere in the world.

Therefore, it is no surprise that startups in the UAE see access to funding among their top 3 challenges. A closer look at our startup survey reveals that this challenge extends to both initial funding to start the business (pre-seed, seed) and subsequent funding to fuel growth. Equally, entrepreneurs highlighted the difficulty in gaining access to investors.

ENTREPRENEURS
SEE FUNDING
AS THE **#2 CHALLENGE**

Issue 1: Not knowing how to navigate the funding ecosystem

If you are an entrepreneur, finding your way through the funding ecosystem in the UAE can be a daunting endeavor. This is despite the considerable number of entities (e.g. Dubai SME, incubators and accelerators, angel syndicates, VC funds, crowdfunding platforms, etc.) that are playing a facilitator role.

Entrepreneurs can find a wealth of relevant information and educational resources on how to get funding. The issue is that this information is fragmented across many different websites, forums and other sources. Given the dynamic nature of this asset class, the likelihood of the sources being up-to-date is low. Magnitt is one of the few sites where regularly updated information is shared. Note, however, that for detailed information a paid subscription is necessary.

Navigating this information jungle can be rather frustrating and time consuming. Almost all startups we talked with echoed this view, but it is specifically accentuated for first-time entrepreneurs and recent arrivals in the country.

> **“There is a lot of information out there, it's just very time consuming to find and puzzle together”**
>
> Quotes from startup focus groups

> **“It's all about who you know when it comes to getting the initial attention from potential investors”**
>
> Quotes from startup focus groups

Issue 2: High hurdle rates to qualify for capital

Knowing how to navigate the funding ecosystem is obviously only the first step. The ultimate objective is to secure funding. This is the real acid test. In this context, startups highlighted two themes.

Very restrictive equity investment criteria

- Large swaths of the investor ecosystem are reported to ignore companies that have not started monetizing, even if the startup has a minimum viable product that is disrupting / meeting an unmet need. Investors typically wait for a paying or pilot customer before taking the risk

- Investors in the region have an appetite for only a limited number of business models, technologies and sectors. Startups with an unfamiliar focus find it difficult to be considered relevant even for initial screening. Hardware focused technology startups were mentioned as one of various examples

- In some cases, investors signaled interest, but ‹wait and see› for a lead party to commit funds first. Startups believe that having secured an anchor investor can be an investment criterion for others. Long lead times for commitments to turn into actual cash are a major issue for most startups

Inaccessibility of debt funding

To further aggravate the situation, bank loans are simply not accessible without an established company track record of 3 years, and even with that amount of experience, they remain difficult to obtain.

> **Local investors shy away from making the first move. It took 9 months to find the first investor securing USD 0.6m. Then it took only 2 weeks to secure an additional USD 0.8m from other investors**
>
> Quotes from startup focus groups

> **We had our first clients and good traction. Investors told us to come back when we have 20x sales. But how can we scale up without funding?**
>
> Quotes from startup focus groups

The entrepreneurs› voice is only one side of the story. One could simply respond that raising funds is difficult for any startup in the world, and only the best succeed. Yet we believe there is a significant funding gap, particularly for early stage startups, compared to best-in-class startup ecosystems (Silicon Valley, London, Berlin, Bangalore, Shenzhen / Beijing, etc.).

This warrants a closer examination of the status quo, and a dialogue with all stakeholders in the startup ecosystem on how to selectively boost funding with a view on cementing the UAE's position as technology and innovation hub in the region and beyond.

THE ROOT CAUSE

The investor ecosystem is evolving fast but needs time to mature

While the UAE has successfully attracted a diverse set of investors (such as angels, accelerators and VC firms), investing in startups as an asset class is still relatively new. Only a few years ago, the local startup universe was still in its infancy and success stories could be counted with one hand. Furthermore, appetite to invest was held back by the attractiveness of other asset classes such as real estate and commodities.

This is changing fast, but various obstacles remain:

- Lack of reliable market data adds complexity, cost and uncertainty when it comes to due diligence
- Sector depth requires more specialization (e.g. construction, transport, financial services) and technology (e.g. AI, IOT, Blockchain), and investing in such firms requires additional deep expertise. For the investors, building such know-how can only be justified if there is a sufficient deal flow
- There are few ‹spread and pray› funds investing in very early stage startups. Most of the region's funds typically invest in less than 10 start-ups each per year. Their fund mandates do not support portfolios larger than 30 companies (except for a few like 500 Startups)
- The venture funds are still at the maturity stage where they compete with each other for both Limited Partner money and portfolio opportunities. There is a very small number of institutions that are funding the VCs. A substantial share of «family office» funds are invested abroad or in fairly traditional instruments. The family offices have only recently taken to investing into VCs locally. The regional sovereign funds have also only recently started to invest into VCs starting with Bahrain (Al Waha Fund of Funds, managed by BDB) and with KSA (PIF). For example, we have not yet seen Mubadala invest directly into any of the local VC funds

The innovation & startup ecosystem is evolving fast but needs time to mature

The key building blocks for a thriving ecosystem are in place. The number of startups are multiplying fast and the UAE remains the key preferred country for entrepreneurs in the region. Now the focus can shift to elevating and deepening the ecosystem to the next level.

To selectively build deep sector and technology specific ecosystems a stronger tie-up between universities, government institutions and funds is required. For example, today there less than a handful of real AI startups in the country.

This holds true for many emerging technologies. As outlined earlier, for investors to shift from a broad to a deep and specialized investment approach (which requires building deep sector / tech know-how) requires a critical mass with regards to potential deal flow.

Equally, there is room to multiply the impact of the various key building blocks of the ecosystem. For example, incubators (while not providing direct funding) play a critical role in the funding journey. Incubators can provide cheap office space, training, mentoring and networking support.

The UAE boasts some excellent innovation, incubator, accelerator and co-working spaces such as IN5, Dtec and Astrolabs, but they do not have the capacity and complete ecosystem that would suffice to cater to the growing number of entrepreneurs. Most of these spaces still come at a cost that require startups to run for a fair period on a self-financed basis. Very few provide free and/or very early stage funding.

The risk profile of startups makes it difficult for banks to extend loans:

As shown in our previous whitepaper[1], startups already struggle to open a bank account in the UAE. This is largely due to the limited appetite of banks to serve startups given their risk and the local banking system's high cost structure. Very few banks have created a low-cost digital-only servicing model to drive profitability in servicing this sector.

The KYC and AML requirements remain cumbersome and legacy issues do not help. Several UAE banks burnt their fingers with non-performing SME loans in the past. They also do not have the required specialized know-how to run due diligence on the early stage entrepreneurial sector. Add to the mix the concern that most entrepreneurs are foreign with a flight risk to leave the country at any moment, bank loans are out of reach for most startups in their first few years of existence.

In many Western countries, governments and public institutions often play a critical role in making bank loans available to startups via the provision of (partial) guarantees for commercial bank loans (effectively reducing the default risk born by private sector banks).

The UAE has two well-established public funds, the Khalifa Fund and the Mohammed bin Rashid Fund, providing loans and grants to Emirati startups. Both funds play a critical role in supporting the country's National Innovation Strategy and UAE Vision 2021.

Similar support, be it direct via direct loans or indirect via guarantees, is not available to non-Emirati entrepreneurs. Such support for non-Emirati entrepreneurs might not be a viable option in the UAE, but it should be recognized that this would typically constitute an important element in the toolbox to make debt funding available.

[1] Dubai Startup Hub. 2018. Opening a bank account.

CALL TO ACTION

We believe the funding journey can be made easier when it comes to helping startups understand how to get funding, and when it comes to increasing availability of funding.

- **Playbook to help startups navigate the funding ecosystem**
  Today, entrepreneurs can find a wealth of information on how to get funding in the UAE, but the information is fragmented across many websites and players. The solution is easy: creating a single dedicated website and/or guidebook providing a practical step-by-step guide covering the startup funding journey in the UAE. This starts with educational material on different funding types and their suitability, extends to mapping the investor ecosystem and listing relevant contact details, and provides insights into how to build a convincing business plan and pitch to secure funds. Such guides exist in many other countries or even cities and can serve as a source of inspiration. This can be further extended to a holistic navigator for all key questions along the startup journey from company formation to scaling up the business.

- **Continued building of the broader innovation ecosystem**
  We believe the government and government related entities need to seize the opportunity to bring the innovation ecosystem to the next level.

  Government initiatives will be critical to make the UAE home to a deep ecosystem of specialized technology startups. In this context, continued building of priority industry clusters (e.g. pharma and healthcare) should remain the focus. For each cluster a clear plan is required (if not yet existing) for how to embed, attract and nurture technology startups. This might involve specific technology hubs or dedicated investment funds. It should also be examined how selected building blocks of the broader ecosystem can be further strengthened. For example, building and financing more high-quality incubators could be a high-impact lever as long as the full ecosystem is also enabled behind the incubators.

  Equally, government-owned firms should be encouraged to increasingly engage in incubation, acceleration and venture capital investments. This might not be the right choice for all entities, but it is likely that a strong case can be made for several entities (and in fact, some are already active).

- **Helping equity investors to invest in startups**

  The lack of reliable information (ranging from sector statistics to need for audited accounts) complicates due diligence and drives up cost. Improving this situation would not only help financial investors but would also contribute to further improving ease-of-doing business in the country.

  Likewise, many investors shy away from early-stage startups with no proven client track record. Government and government-owned entities could help by more actively opening their doors for startups to pilot their products & solutions or making it easier for these startups to be considered in the procurement process. Much has happened already, but it is worth exploring whether more can be done.

- **Considering options for how to make loans available to early-stage startups**

  Making loans available to early-stage startups will not be easy, but potential options should at a minimum be explored.

  First, banks could reframe the way they are looking at startup loans. Rather than applying a commercial lens, banks could consider startup loans as part of their Corporate Social Responsibility programs contributing to the development of the country. Obviously, the total amount set aside would need to be small compared to the overall balance sheet. Second, banks could envision offering convertibles rather than standard loans.

  This would allow banks to benefit from the upside of having financed successful startups. Third, it should be considered how to alleviate the burden on banks when it comes to due diligence.

  And ultimately, the government could re-examine the possibility to very selectively offer startup loan programs (or partial guarantees) beyond the existing program for Emiratis.

  The ambition is clear. Now it is time to act. Some suggested lines of action will require a closer look to fully understand all issues at hand, assess feasibility and craft a viable action plan.

  Dubai Chamber and Roland Berger want to initiate a dialogue with key public and private stakeholders and help shape a clear roadmap to help entrepreneurs get access to funding and propel the UAE startup ecosystem forward.

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