FOCUS

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LIQUIDITY CRISIS

Is defined when a company does not have enough cash or tangible / liquid assets to meet its short/long term obligations. Obligations includes bills / accounts payable, loans, employee's remuneration, commitments /covenants to the banks etc. Liquidity crisis is not only experienced by companies or individuals but also by countries and their economies. Liquidity crisis in an economy happens when banks reduce or stop providing loans and commercial paper market reduces their activity.

Companies depend on financial institutions to provide short term loans for funding their operational needs. When such kind of funding is reduced or completely stopped, it is difficult for companies to manage their cash flows hence unable to meet their obligations. Further, companies over ambitiously take the growth path without understanding that each dirham worth of growth requires funds over and above the internally generated funds from profit. In a survey in the past cover, it was revealed that 55% of the companies in the US that went for chapter eleven bankruptcy were all profitable.

Managing Liquidity crisis:

For a company to manage their liquidity crisis, it must do the following:

- Have policies and procedures documented which defines clearly the limits to control the liquidity exposures inherent in its business. If these policies and procedures are properly followed, the financial impact can be easily mitigated.

However, liquidity crisis does not only happen due to internal factors but also it may be caused due to external factors giving rise to the possibility of a greater financial problem. In such cases, company's objective is to obtain additional funding and implementing additional defensive measures to ensure survival at that point of time.

Some of the key points to consider avoiding liquidity crisis:

1 Bill your customers in a timely manner, if possible, raise interim invoice and follow up for unpaid invoices. Few companies also offer discounts to their customers for settling their bills early. The most important point here is your relationship with your customer. The stronger the relationship, the easier and faster is the settlement.

2 A periodic analysis of the overhead costs to avoid unnecessary expenses can also help in managing and avoiding liquidity crisis.

3 Dispose off unwanted or obsolete inventory. The period depends on industry to industry or even depends on product lifecycle. Also, dispose off non performing asset and realise cash there from.

4 Always maintain a strong relationship and account with your financial institution so that they can help you in providing short term loans when it requires the most.

5 Maintain strong relationship with your suppliers so that you can negotiate better terms and period for settling your invoices.

Dr. Khalid Maniar
Founder & Managing Partner
khalid.maniar@crowe.ae

Common mistakes in tough economic times

Nearly all business houses wish that boom economic times should continue in perpetuity. The reality, however, is different and businesses have to face tough economic periods from time to time. Tough times call for more diligent and cautious approach though it is not uncommon that businesses, particularly SME's take rash and risky decisions during these times in anticipation of positive results even where the probability of achieving those results is low.

SME's with insufficient cash flow find it difficult to sail through the ebb of the economic slowdown. The situation is only worsened by slow recovery and / or defaults from existing customers which in turn could lead to a serious threat for the continuity of the business.

Many SME do not survive a long-drawn downturn as they make several common mistakes.

Mistake 1 – There is always a pressure on reduced sales and reduced margins in a tough market. Many entities, out of desperation, accept orders with very slim margins. Due to cost overruns such slim margins ultimately results in further loss to the entity. Some entities accept lower margin orders as a strategic move to reduce losses however such should be done with extreme caution and with continuous monitoring. Such strategy might work where the downturn is for a short period however if the downturn is expected to last for a longer period than the strategy will back fire.

Mistake 2 – Sell or agree to sell for an extended period of credit. SME's often fall prey to supply goods and services to customers with an unreasonable long credit period. The management should always be extra cautious when a customer wants an undue extended credit period and conduct proper inquiries regarding the creditworthiness of the customer. Here the SME is exposed both to a cash crunch and more than normal likeliness of default.

Mistake 3 – As the SME would face cash flow shortages in a downturn, they often resort to seek additional funding from banks. Banks normally are not very keen to fund in such economic times for working capital finance. SME's might, in such case, borrow against off books assets to fill the gap. Bank funding costs would thus increase the overheads for the SME. In the event of a default from the customer, the SME would face several threats; increase in overheads, default or untimely servicing of bank loans, attachment of assets by the banks and even criminal proceedings if the situation worsens.

Mistake 4 – Business planning and allocation of resources are essential for any business. Some SME's do a forecast of numbers on a wrong notion that the downturn will not last long and thus a non-conventional approach is taken. Forecasting a rosy future with little or no back up cashflow would further land the business in dire straits. As sales forecast is high, the overheads resources allocation too is high. Where the said sales are not achieved the entity will still have to bear the high overheads.

Mistake 5 – Cash based overheads would be required to be paid by the businesses whether sales performance is good or slow. Failure to cut unnecessary overheads on a timely basis will be a heavy strain on the cash flow and result in additional losses to the entity.

Entities, particularly SMEs should tread carefully in such times and make decisions with due care.

Atik Munshi
Senior Partner
atik.munshi@crowe.ae

The value lies in the outlook of the beholder

Business Valuation is a technique to ascertain the value of a company and measure its worth at a given point of time. The value of the business can be divided into two types; the Market Value and the Economic Value. The Market Value of a company is the total value of its shares. Its shares may trade at a higher or lower value based on how the investors perceive the value of the shares maximum. The Economic Value of a business is the price, an investor or buyer is willing to pay for the business.

A valuation of a business can be an important information for investors such as venture capitalists, larger firms who intend to acquire a stake in the business or lending institutions such as banks, employees, the general public etc. The value of a business has varied meanings for its different types of users and stakeholders. For e.g. the value of a business to an acquirer depends on the strategic benefits and for the investor, incremental profits after the purchase of the business. This makes the value highly variable from one investor/buyer to another. In either of the scenarios, the acquirer or the investor would prefer a low appraised value of the business as it would provide a higher return on investment. However, the sellers would want the highest valuation possible for their company. The lifecycle stage at which the company is in, the industry in which it operates, the key personnel of the company, macroeconomic conditions, outlook of the market, the perception of its brand, its patents and copyrights, play a major role in valuing a company.

Valuation is an art more than a science. The valuation of a business varies due to many factors, such the negotiations between the parties, the underlying assumptions used to arrive at the valuation and the history of the company. These factors are equally important and must be considered along with the final value given to the business. The sellers may have the need to raise capital frequently but may not want to concede much of their ownership. Under such circumstances, a valuation will provide a realistic picture of the company, enabling a prudent deal. After a venture capitalist or investor makes an investment in the business, a valuation can be used to determine the pre and post investment value of the company.

Valuations are not just used for raising capital, but also can be used by companies to offer stock or stock options to attract people with a key skill set. It also provides them with the basis to invest in the company, and presents them with an outlook of the business' performance. It is extremely important to know that a valuation of a business is dynamic and as time passes, the variables used can change, the macroeconomic conditions may vary, thereby, limiting the validity of the business valuation. Each company is unique and every valuation that is carried out should be customized to the characteristics of their business.

A third party conducting business valuations, for e.g. a consultant, must be wary of the fact that the investors will challenge their assumptions and methods of valuation in order to reduce their risks and increase their return on investment, hence, making the valuation report a very critical aspect of a merger and acquisition.

Valuation is a difficult process and due to its specialized and complex nature, external experts can be involved, if needed. They must provide their insights and expert advice to the management and most importantly, maintain their independence so that, the users of a Valuation Report can rely and get a better sense of the future performance of the company. Many business owners have a vague idea about value of their business, and a few are merely guessing. A valuation helps them know their actual worth.

Tukul Dutta
Senior Associate - Advisory
tukul.dutta@crowe.ae

Come listen to our International Liaison Partner share his expertise

At Crowe UAE, we pride ourselves in helping our clients and stakeholders make smart decisions that bring lasting values. We are honoured to be a part of this year's exciting Accounting and Finance Middle East Show, hosted by Terrapinn, a global events company.

The finance and accounting ecosystems are constantly changing and to remain relevant (and stay in business), you need to be a step ahead. Thanks to innovative technology, lengthy and laborious jobs that have always been part of the traditional roles, can now be automated and moved to the Cloud.

So, whether you are a small start-up business, a growing technology company or one of our large multi-national clients, the Accounting & Finance Show is about a unique opportunity to learn from industry leaders and experts.

Spaces are limited so please register today by following the registration link: http://bit.ly/30WP2Q8

Zayd Maniar
International Liaison Partner
zayd.maniar@crowe.ae

Connecting minds, Creating Future

Connecting Minds, Creating Future: Dubai's universal theme for the upcoming Expo 2020 applies to the whole of humanity.

To be held from October 2020 up to April 2021, the expo is scheduled to be a large exhibition of Industrial, Scientific, Technologic and Artistic achievements of the 190 participating nations.

The Expo 2020 will be held on a 438-hectare site located in the newly formed Dubai South district also near to the new Al Maktoum International Airport. The expo site is equidistant from Dubai and Abu Dhabi.

The run - up to Expo 2020 is estimated to create about 277,000 new jobs with a reported investment of 25 billion dirhams in infrastructure related projects which include the extension of Dubai metro red line up to the expo site.

Dubai is expected to host 25 million visitors during Expo 2020. With an increase in hotel business, transportation, communication, catering and facilities in the organizing of t expo. Dubai will capture the worlds attention before, during and after the expo. The positive impact of this global event on the emirate's economy will be substantial.

Expo 2020 is set to showcase Dubai's characteristic appeal for foreign investment predominantly due to the pro business government, dynamic business community, world class telecom and infrastructure and strategic location.

The Expo 2020 will have a far-reaching impact on the real estate market. There will be more investments from foreign players in the property market while several new residential projects will also be completed before and after the mega event. Infrastructural development in the Emirate on account of the Expo 2020 will also spark widespread real estate development.

Although Dubai is already counted as one of the most preferred financial centers in the world, the upcoming Expo 2020 will promote this view globally in an unprecedented way.

The colossal value the Expo 2020 provides will boost the diversification and further enhance existing business sectors within U.A.E. Its positive impact will serve not only the domestic economy but also the wider region.

Maneesh Manoharan
Corporate Services Officer
maneesh.manoharan@crowe.ae

The UAE Cabinet announces a "positive list" for 100% foreign ownership

The United Arab Emirates (UAE) have recently announced for foreign investors to hold up to 100% ownership in selected economic sectors.

While Decree Law No. 19 of 2018 introduced a "negative list" with restricted sectors for foreign direct investment projects, the list of entitled activities had been approved by the government in July 2019.

The sectors eligible for full foreign ownership include 122 business activities. Thus, foreign investors may now establish a company without involvement of the UAE National in the areas of hospitality, food services and production, transportation and logistics, renewable energy, construction, communications, as well as professional, scientific and technical activities. The "positive list" also includes some administrative, support and educational services together with art, entertainment and healthcare spheres.

It is still in discretion of local governments to determine the ownership percentage of foreign investors in these activities. Thus, we are expecting more details shortly.

Such announcement aims to increase the foreign direct investments in the onshore market and targets the sustainable development of the UAE as an attractive hub for doing business.

Markus Susilo
Partner
markus.susilo@crowe.ae

A paradigm market shift towards acceptance of Crypto currencies and its potential VAT impact.

The use of crypto currencies as a digital means of payment is taking off with companies like Microsoft, PayPal, McDonalds, starting to accept as payment options.

The UAE has been a strong supporter of block chain technology. The Digital Assets Exchange (DEX) recently secured approval from Financial Service Regulatory Authority of Abu Dhabi after Abu Dhabi Global Market last year launched the region's first crypto asset regulatory framework.

Given the increase in popularity of crypto currencies, it is important to determine the potential impact of VAT.

Tax authorities around the world with more mature tax jurisdictions have struggled to identify the correct tax treatment.

There are various transactions associated with crypto currencies. It would be relevant to understand the VAT impact on each of such transactions from a UAE VAT standpoint:

1 **Sale and purchase of crypto currencies in lieu of fiat currency**

As per the VAT Law in UAE; VAT is to be imposed on every taxable supply of goods or services made by a taxable person conducting business in UAE.

It is unlikely that crypto currencies would fall within the ambit of 'goods' which is defined as physical property that can be supplied.

The definition of service however is wide to mean ''anything that can be supplied other than goods'' which would may enable FTA to consider exchange of crypto currencies as service, if desired.

However, Article 42 of the VAT Executive Regulation provides that financial services are exempt. Financial services are defined to be services connected to dealings in money and its equivalent. However, the legislation does not allow to determine without ambiguity whether the exemption covers only traditional currencies (i.e. currencies used as legal tender) or also other currencies.

In absence of the clarity from the legislation, it is important to look at the rationale behind such exemption.

Financial services are generally exempted from tax under the VAT systems around the world. The VAT exemption is not on any social or economic rationale but on account of the conceptual and administrative difficulties associated with measuring the value of financial services. This is because there is no explicit consideration for the financial intermediation services of deposits and loans. The consideration for these services lies in the spread between the interest charged on loans and that paid on deposits. This margin cannot be readily measured for individual transactions for purposes of applying a VAT.

Given that the transaction involving crypto currencies are financial transactions which may face similar difficulties, it can reasonably be argued that these are financial services exempt from VAT.

However, the UAE VAT authorities may take a different view in absence of any specific guidelines provided.

2 **Use of crypto as consideration to acquire goods and services**

It seems fairly certain that if crypto currencies are used to purchase goods and services in the UAE, then VAT will be payable on such goods and services to the same extent that they would be payable if the consideration was made in AED or any other fiat currencies. However, it would not be easy to identify the suitable exchange rate to translate the crypto price into AED value i.e. the legal tender of the country.

As per the VAT law in UAE, the foreign currency needs to converted using central bank rate given on the date of transaction. Given that crypto currencies are not regulated by the Central Bank and is volatile in nature, it would be difficult to value the consideration for supply of goods and services.

3 **Intermediary services supplied by exchange platform**

With increase in exchange platforms acting as intermediary to enable buyers and sellers of virtual currency to transact with each other, it is important that appropriate VAT treatment is determined for such intermediary services.

In case the intermediary charges a fee or commission for providing platform to offer exchange services, such fee or commission should be chargeable to VAT at the rate of 5 percent.

Conclusion

It is advised that proper independent review of particular specific transactions should be carried out by counterparties prior to arriving at specific tax treatment.

Closer consideration is warranted by the parties engaged in crypto currency trades. Now that corporate tax / VAT is being considered by various countries in the GCC to diversify revenues and closely integrate local economies with the developed and emerging markets. Increasing transparency and compliance will contribute to global trade and investment flows in the region.

Vivek Batra
Partner
vivek.batra@crowe.ae

Rohit Agrawal
Manager
rohit.agrawal@crowe.ae

About Us

Your global partner

Crowe is ranked as the 8th largest accountancy network with globally more than 42,000 partners and people in over 130 countries.

We share a common purpose of building value for clients through international business. Still placing great emphasis on establishing long-term relations with each of our clients. This enables to work together in an atmosphere of openness and trust. Simply stated, it is how we live our core values – care, share, invest and grow.

The firm continually demonstrates a commitment to quality while serving clients through our international expertise and talent. Our commitment to the highest technical standards and integrity, ensures that our clients receive the most accurate and relevant advice.

We provide professional services by leveraging through extensive local experience and high level of partner involvement. Our aim to provide due diligence with care has enabled us to serve a diverse range of clients ranging from small family owned businesses to large multinational conglomerates.