

The Impact of Interest Rate on Profit among the United Arab Emirates UAE Small and Medium Companies

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Abstract

Interest rate has long been reported by different classical and neo-classical economists. Interest rate but has been recognized as one of the factors that verify the economy savings level. Although many economical cases of inconsistent findings indicate that interest rate has a positive relationship with savings. This papers intends to highlight the prior research that conducted to demonstrate the impact of the interest rate on the profit differ by various variables. A qualitative method was used in this study to indicate the interest rate impact level on the UAE small and medium companies profit. A questionnaire was administrated among 20 users from different medium companies in UAE. The result revealed that interest rate was highly effects on the companies' profit in UAE.

Keywords: Interest rate, profit, SME, business management, organizational behavior

1. Introduction

The definition of interest rate presents the rate amount at which involvement is remitted by a lender for the benefit of money that they lend from. For clarifying this process, an example illustrates a small company lends funds from a bank to invest in recent wealth for their company, and in return the lender gets significance at a destined interest rate for delaying the benefit of savings and rather loaning it to the lender, which measure by the percentages of the rate amount (Cull & Xu, 2005). Interest rate addressed to be an important financial issue for managing and tracking the worth growth (Boulier, Huang, & Taillard, 2001; Laubach, 2009). However, interest rate also involves completely managing the interest part in the gain and failure statement (Buiter & Panigirtzoglou, 2003). Furthermore, interest rate encapsulates the direction of the entire debt profile of the business, involving the perfection of the debt, the acceptance of the debt, the fixed-floating combination of the debt and anticipations of prospects involvement percentages (Brigo & Mercurio, 2006; Einav, Jenkins, & Levin, 2008).

A number of influences have conduced to the recent protuberance of interest rate in different countries such as Middle East companies (De Felice & Moriconi, 2005; Verdelhan, 2010). These influences contain the high inconsistency of interest rates in recent age, the dramatic rise in the utilization of corporate debt via shorter-term dealing initial the way for conducting and figuring these factors for maintaining the wealth growth, which reflects an incensement in the number of greatly leveraged agreements such as management buy-outs (Alvarez & Koskela, 2005). Several issues lying behind the interest rate changes in these countries, such as:

- Political short term gain: this kind of challenges highlights the ability of interest rates to provide the economy an initial growth along with a certain regulations. These terms can simply influence on the rate growth.

- Deferred consumption: this kind involve the process when the money is loaned the lender delays spending the money on consumption goods.
- Inflationary expectations: this challenges state that a given amount of money buys fewer goods in the future than it will now.
- Alternative investments: obtain different solutions for the lender or loaner to decide between using his money in different investments.
- Risks of investment: when lender dies, or otherwise default on the loan. This means that a lender generally charges a risk premium.
- Liquidity preference: People prefer to have their resources available in a form that can immediately be exchanged.
- Taxes: Because some of the gains from interest may be subject to taxes, the lender may insist on a higher rate to make up for this loss.

Therefore, this paper aims to indicate the impact of interest rate on profit among the UAE medium companies. This impact can be useful to report and track the profit growth among the UAE companies, which depends on general factors used for managing the interest rate in these companies.

2. Literature Review

According to Qawasmeh (2009) stated the key challenges that Jordanian banking sector are facing among the foreign companies. The study explained these challenges over different foreign banks operating in the Jordanian market. He described the main issues in reducing the profit growth among these companies. The author has recommended these companies to respond positively to all sources and types of foreign as well as domestic competition to increase and enhance their profit income. This study examined the relationship between implementing Strength, Weakness, Opportunities, and Threats (SWOT) analysis and achieving competitive advantage from the point of view of Jordanian banks' executive managers. The finding indicated that positive relationship between SWOT analysis and dimensions of competitive advantage were found.

However, Al-Khadash and Salah (2009) investigated the relationship among external users of financial statements that addressed to be capable of assessing goodwill impairment. They aimed to determine the relationship of goodwill write-offs from acquisitions among Jordanian shareholding companies in Amman. They also tested for the notion that the seeds of the eventual goodwill write-off are planted at the time of the acquisition. Additionally, result indicated that the relationship between goodwill write-offs and acquisition and performance indicators are positively. They revealed that external users will not be able to assess goodwill impairment effectively within the available information and disclosure.

In addition, Kader and Leong (2009) conducted their study to determine the impact of interest rate changes on the demand for Islamic financing in a dual banking system. They described the different changes in the interest rate that attached by the profit motive to substitute Islamic financing for conventional bank loans and vice versa. The data was adopted from the past years, the analyzing result addressed an increase in the base lending rate would induce customers to obtain financing from Islamic banks and vice versa.

Finally, Ghazali and Ali (2002) demonstrate the impact of the changes in open market interest rates on the interest rate spread of Malaysian commercial banks. They estimated these impacts through examining the relationship of causality and patterns of reactions of banking rates with respect to variation in open market

rates. The study stated that there is one-way causation running from the open market rates to banking rates. From another hand, the response of lending rates is shown to be low and to occur with some lag, thus, contributing to the decline in spread. The result was involving the role of banks as brokers as well as asset transformers.

3. Method

Generally, collecting data can be done by applying different approaches such as personally administered questionnaires, mail questionnaire and electronic questionnaire. Researchers stresses that the data from the survey allow the researcher to establish whether there are associations among the various variables that are reflected in the questionnaire. Hence, a qualitative method was used in this study.

The sample comprised 20 employees from different SME companies located in UAE. Also the firms in the sample listed related to the business with a minimum of between 10 and 30 employees.

SPSS program was used to statistical analyses the data which was gathered from the respondents. Data was described using frequency distribution by reporting the frequency and percentage along with its mean and standard deviation.

4. Result

Table 1 reports the respondents' background. The respondents of the study from business owner 60.00 % (12 respondents), business partner 25.00 % (5 respondents), and 15.00 % others % (3 respondents). However, the number of male was 75.00 % (15 respondents) and female 25.00 % (5 respondents). Moreover, the age of respondents was 10.00 % (2 respondents from 18-20), 35.00 % (7 respondents from 21-30), 50.00 % (10 respondents from 31-40), and 5.00 % (1 respondents from 41-50).

Table 1: Respondents Profile

Variables	Item	N	%
Occupation	Business owner	12	60 %
	Business Partner	5	25 %
	others	3	15 %
Gender	Male	15	75 %
	Female	5	25 %
Age	18-20 years	2	10 %
	21-30 years	7	35 %
	31-40 years	10	50 %
	41-50 years	1	5 %

Table 2 presents the descriptive statistic result. The overall Mean score was used for measuring the items level. Employees were asked to answer the questionnaire items that related to their level of confidence.

Table 2: Descriptive Statistics Result

	N	Minimum	Maximum	Mean	Std. Deviation
Q1	20	1	5	3.50	1.277
Q2	20	1	5	3.50	1.100
Q3	20	1	5	2.80	1.152
Q4	20	1	5	2.75	1.293
Q5	20	2	5	3.15	1.089
Q6	20	2	5	3.25	1.020
Q7	20	1	5	3.40	1.314
Q8	20	2	5	3.80	1.152
Q9	20	1	5	3.70	1.218
Q10	20	1	5	3.50	1.235
Q11	20	1	5	4.00	1.124
Q12	20	1	5	3.45	1.234
Q13	20	2	5	3.40	1.142
Q14	20	1	5	3.30	1.174
Valid N (listwise)	20				

As illustrated in Table 2, employees responded to 20 items related to the impact of interest rates on the profit growth among UAE SME companies. The highest percentage of interest rates scores among the participants was (combination of 'agree' or 'strongly agree') toward the statement number 11 "The client regularly receives clear and accurate information regarding the account" with Mean score (M=4.00) and Standard Deviation (SD=1.124).

The second highest score was (combination of 'agree' or 'strongly agree') toward the statement number 8 "Advertisements reflect the product that the customer can reasonably expect to receive and the full price that the customer can expect to pay" with Mean score (M=3.80) and Standard Deviation (SD=1.152).

While the third highest percentage among the participants was (combination of 'agree' or 'strongly agree') toward the statement number 9 "Interest rates on savings, fees for account maintenance, minimum balances required, and terms and costs of transaction accounts are provided" with Mean score (M=3.73) and Standard Deviation (SD=1.218).

On the other hand, the most low items were number4 "The financial institution avoids increasing debt levels of borrowers who are already indebted beyond their capacity to repay, avoiding re-financing the loan at a higher amount, and adhering to a standard protocol for debt re-structuring" with Mean score (M=2.75) and Standard Deviation (SD=1.293), and item number 3 "Credit approval policies give decision makers explicit guidance regarding borrower debt thresholds and acceptable levels of debt from other sources" with Mean score (M=2.80) and Standard Deviation (SD=1.152). The overall average for the Means of interest rates among UAE SME companies was (M=3.47) and the Standard Deviation (SD=1.12) indicating that the

interest rate effects the profit growth in the UAE companies.

5. Conclusion

This paper investigated the impact of interest rates on the profits in the UAE SME companies. A qualitative method was used in order to measure that effect based on questionnaire. The collected result was analyzed by measuring the mean of 14 items. The result found that the interest rate effects on the profit growth in the UAE companies. This finding gives first glimpse on how interest rate effects the profit growth in the UAE SME companies. Further investigation is still needed towards involving other factors and its effects on the profit growth of these companies.

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Appendix A: Questionnaire Items

	Questions	SD	D	NS	A	SA
1	The loan approval process requires borrower repayment capacity and loan affordability to be assessed.	1	2	3	4	5
2	The loan approval process does not rely solely on guarantees (whether peer guarantees, co-signers or collateral) as a substitute for sound risk management.	1	2	3	4	5
3	Credit approval policies give decision makers explicit guidance regarding borrower debt thresholds and acceptable levels of debt from other sources.	1	2	3	4	5
4	The financial institution avoids increasing debt levels of borrowers who are already indebted beyond their capacity to repay, avoiding re-financing the loan at a higher amount, and adhering to a standard protocol for debt re-structuring.	1	2	3	4	5
5	The financial institution offers multiple loan products or flexible ones that address different business and family needs. The organization ensures product suitability through careful product design and testing with the target market.	1	2	3	4	5
6	Prices, terms and conditions of financial products are fully disclosed to the customer, including interest charges, insurance premiums, minimum balances required on savings and transaction accounts, all fees, penalties, and whether those can change over time.	1	2	3	4	5
7	Advertisements and marketing campaigns clearly communicate complete and accurate descriptions of the product or service	1	2	3	4	5
8	Advertisements reflect the product that the customer can reasonably expect to receive and the full price that the customer can expect to pay.	1	2	3	4	5
9	Interest rates on savings, fees for account maintenance, minimum balances required, and terms and costs of transaction accounts are provided.	1	2	3	4	5
10	Customers are given adequate time to review the terms and conditions of the product and have an opportunity to ask questions and receive information prior to signing contracts.	1	2	3	4	5
11	The client regularly receives clear and accurate information regarding the account.	1	2	3	4	5
12	Balances are correct, recorded regularly, and investigated for discrepancies in a timely manner.	1	2	3	4	5
14	Promises of future benefits, discounts, and privileges are kept.	1	2	3	4	5

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