

# The Effect of Suspended Salary Allowance on Business Loan in Saudi Arabia

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## Abstract

The research was carried out to study two factors; first the impact of suspended Salary allowance (about 20% of Saudi Salary per month) on borrowing loans from national and commercial Saudi's banks. Secondly, to analyze the effects of suspended salary allowance on re-payment of loans. This study showed that most Saudi banks' customers should be well-aware of the influence of suspended salary allowance on borrowing bank loans and re-payment of loans. It was noticed that the provision of loans to Saudi people after suspended salary allowance had a great impact on their businesses performance. The study also found that salary cuts together with other factors including high interest rates may be the most important causes of poor business performance.

**Keywords:** Suspended, Salary, Allowance, Financial perks, Quantitative, Qualitative

## 1. Introduction

The Kingdom of Saudi Arabia is a major oil producing country, in which the economy is mainly based on oil exports. At a time of cheaper crude oil, the Saudi government decided to significantly cut costs through reducing ministers' salaries by 20% as well as suspending or canceling some bonuses and financial benefits. It can be considered the first pay cuts for governmental employees, who make up about two-thirds of working Saudis (Financial Stability Report 2016).

The prime target of banks; just like any business organization, is to make profit. In order to maximize profit, banks attract and serve customers, elevate market shares to stay competitive (Kashyap et al., 1993 and Calza et al., 2001). The banks are usually fully compliant with all the ambiance of laws governing banking and they continuously operate under the umbrella of central bank (Bernanke, B. and M. Gertler M.1995). The Saudi government usually urges national and commercial banks to come up with attractive products and services such as giving loans that are intended to attract customers (borrowers), while charging certain fees and commissions (Allen 1988).

As the oil export revenues of the Saudi government are down sharply, there has been a growing pressure on the Saudi economy and banking system as they struggle to curb a budget deficit which totaled a record 367 billion riyals (\$98 billion) last year as reported by Financial Stability Report 2016.

The Saudi Arabian Monetary Agency has given commercial banks instructions to reschedule loans to customers hit by recent cuts in government spending due to low oil prices. Moreover, the agency has directed local banks to reschedule consumer loans for employees whose salaries were considerably reduced after the cancellation of a number of allowances and bonuses and other financial perks for public sector workers. The cabinet announced that it has cut a range of allowances for public employees to help curb a huge budget deficit caused by low oil prices. Under banking rules, monthly installments for consumer loans in Saudi Arabia must not exceed a third of a borrower's total salary.

The following questions will be addressed in this study:

- (i) What is the effect of suspended Salary allowance on borrowing loans from Saudi national and commercial banks?
- (ii) What is the impact of interest rates on loan repayment?
- (iii) What is the effect of re-scheduling on the loan repayment?

The main objective of this study is to investigate the effect of suspended salary allowances on borrowing from national and commercial banks in Saudi Arabia. Therefore, this study attempts to (1) determine the relationship between suspended salary allowances and borrowing money from national and commercial banks in Saudi Arabia and (2) determine the effect of interest rates and re-scheduling on loan repayment.

## 2. Literature Review

According to Saudi's bank law, the borrowers may not take a loan for more than 30% of their salary. It has become difficult for customers to borrow and to pay back their loans due to salary cuts and high lending rates and charges currently implemented by most banks. Evans and Adjei 2014 studied the impact of high lending rates on borrower's ability to pay back loans and concluded that Interest Rate Re-financial Loan should be adopted by all financial institution and the central bank, otherwise, there will be less people showing interest in the demand for loans and as a consequence it will be falling in private sector development which is very critical for the development of a young nation like Ghana. In connection with this study, some studies urge that loans cost should be adjusted to cost opportunity of banks loans (Calcagnimi et al., 2012). However, Banks are generally follow different strategies to maximize profit which is the main aim of any business organization (Annim, 2009). These different strategies are directed by Saudi Arabian Monetary Agency to attract customers (Borrowers) and maximize market shares.

Although in Saudi Arabia fluctuations in interest rates are very rare, one factor that influences the level of interest rates is the actions of the Saudi Arabian Monetary Agency in terms of raising interest rates to slow down the economy when expanding too rapidly and lowering them when the economy is heading for a recession. Rising and falling interest rates make the customer hesitant and will directly affect their financial decisions. Rising interest rates make saving relatively more attractive and borrowing relatively more expensive (Bernanke et al., 1999). Therefore, customers find it difficult to re-pay their loans due to salary cut together with high lending rates. Another factor that may impact business loans is the level demand for loans (Aryeetey et al., 1994). Therefore, the present study assesses the relationship between recent salary cut law implemented by Saudi governmental and the borrowing from national and commercial banks. The effect of interest rates on loan repayment is also examined. The research was carried out in National and commercial banks in Saudi Arabia.

## 3. Method

A quantitative survey was used in this study to investigate the effect of suspended salary allowances on borrowing from Saudi governmental banks. The survey was administered to 328 employees from both genders were selected randomly from different demographic areas of Riyadh. As this is the capital city, we tried to cover as many different locations as possible. The desired sampling design was stratified to select a sample of individuals had suspended salary allowance and are interested in taking loans.

The sample included 200 customers with loan repayment and 128 who were willing to take loans. This information was obtained from both bank officials and customers.

### 3.1 Data Collection

The questionnaire was administered to gather information about the influence of suspended salary allowances on borrowing bank loans and loan repayment. A questionnaire is an established written set of questions usually implemented to collect the data from the involved respondents. The questionnaire was used to obtain quantitative or qualitative data from both categories of respondents. Participants gave their responses independently, and their information was treated with strict confidentiality.

### 3.2 Data Analysis

Data collected from the questionnaire were carefully classified, based on categories of the questions. The data were edited, checked for accuracy and consistency to ensure reliability. Descriptive statistical analyses were performed for the study participants. Proportions were used for categorical variables and continuous variables were summarized using mean and standard deviation (SD). Responses to the questionnaire were compared by participants' characteristics including age, gender, marital status, salary, family size, housing status and occupation using the chi-square test. Statistical significance was considered at  $P < .05$ . All statistical analyses were performed using SPSS 21.0 (Release 21.0.0.0, IBM, USA).

## 4. Results

A total of 328 individuals completed the questionnaire, representing a response rate of 100%. Descriptive statistics of the respondents are displayed in Table 1. Seventy eight percent of respondents were aged between 21-40 years and 54% were females. About half of respondents were married; most of whom have a working spouse. Most salaries (62%)

ranged from 5,000-30,000 riyals. Forty one percent of respondents reported that they own a house, 31% renting and 26% were provided by housing through family or work. The distribution of occupation was as follows: 33% work in the private sector, 15% in the military, 13% self-employed, 13% government, 9% civil servant and 17% other.

Table 1. Profile of Respondents. N = 328.

<b>Factor</b>	
<b>Gender n (%)</b>	
Male	150 (45.7%)
Female	176 (53.7%)
Missing	2 (0.6%)
<b>Age group (years) n (%)</b>	
Less than 20	11 (3.4%)
21-30	141 (43.0%)
31-40	114 (34.8%)
41-50	38 (11.6%)
51-60	15 (4.6%)
Above 60	0 (0.0%)
Missing	9 (2.7%)
<b>Marital Status n (%)</b>	
Married	163 (49.7%)
Single	107 (32.6%)
Widow(er)	26 (7.9%)
Separated	27 (8.2%)
Missing	5 (1.5%)
<b>If married, does your spouse work? n (%)</b>	
Yes	121 (74.2%)
No	42 (25.8%)
<b>Salary (SAR) n (%)</b>	
Less than 5,000	86 (26.2%)
5,000-10,000	96 (29.3%)
10,001-20,000	67 (20.4%)
20,001-30,000	39 (11.9%)
More than 30,000	20 (6.1%)
Missing	20 (6.1%)
<b>Household (Family) Size mean <math>\pm</math> SD</b>	5.0 $\pm$ 3.1
median (range)	5 (1-29)

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**Housing Status n (%)**

Own	133 (40.5%)
Rent	101 (30.8%)
Provided by Family	58 (17.7%)
Provided by Work	27 (8.2%)
Missing	9 (2.7%)

**Occupation n (%)**

Civil Servant	28 (8.5%)
Self-employed	44 (13.4%)
Private Sector Worker	109 (33.2%)
Military	50 (15.2%)
Government Sector Worker	41 (12.5%)
Family Business	19 (5.8%)
Other	26 (7.9%)
Missing	11 (3.4%)

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The results in Table 2 showed that 46% of respondents reported having knowledge on loans in Saudi banks and 41% used bank loans; most of whom within the last 5 years. Also, 51% of respondents stated that they had 1-2 loans in the past 10 years and 16% had 3-6 loans. Fifty six percent of respondents had their largest loan in the past 10 years ranging from 51,000-300,000 SAR. While 46% had financed business projects, only 37% reported having successful business projects and 62% reported no increase in total income from their business. Only 33% reported facing challenges using bank loans; mostly due to high interest rates and short repayment period. Fifty three percent of respondents reported that they were charged up to 4% in interest rates. About 70% of respondents had duration of loan re-payment of 6 years or less. Lastly, 60% reported that they never bought a new car via bank leases.

Table 2. Previous Loans before Pay Cuts. N = 328.

<b>Item</b>	<b>Options</b>	<b>No. of Responses</b>	<b>%</b>
<b>Knowledge on loans in Saudi banks?</b>	Yes	151	46.0%
	No	171	52.1%
	Missing	6	1.8%
<b>Ever used loans from Saudi banks?</b>	Yes	133	40.5%
	No	189	57.6%
	Missing	6	1.8%
<b>If yes, how long have been using loans*</b>	Less than 1 year	42	23.6%
	2-3 years	65	36.5%
	4-5 years	33	18.5%
	6-7 years	12	6.7%
	8-9 years	11	6.2%
	10 years or above	15	8.4%
<b>How many loans in the past 10 years?*</b>	None	63	29.4%
	1-2	110	51.4%
	3-4	28	13.1%
	5-6	7	3.3%
<b>Largest loan in the past 10 years*</b>	10,000-50,000	14	17.9%
	51,000-100,000	16	20.5%
	101,000-200,000	20	25.6%
	201,000-300,000	8	10.3%
	301,000-500,000	11	14.1%
	>500,000	9	11.5%
<b>Number of business projects on loans*</b>	None	117	53.7%
	1-2	69	31.7%
	3 or more	32	14.7%
<b>Number of successful business projects</b>	None	206	62.8%
	1-2	81	24.7%
	3 or more	28	8.5%
	Missing	13	4.0%
<b>% increase in total income from business</b>	None	204	62.2%
	10-20%	70	21.3%

	21-30%	30	9.1%
	Missing	24	7.3%
<b>Facing challenges using the loans?</b>			
	Yes	109	33.2%
	No	188	57.3%
	Missing	31	9.5%
<b>If yes, what are the challenges? **</b>			
	High Interest Rates	76	43.9%
	Short Repayment Period	35	20.2%
	Small Loans	11	6.4%
	Social Problem	18	10.4%
	Fiscal Policy (Taxation)	17	9.8%
	Lack of Entrepreneurial Skills	16	9.2%
<b>Interest rate charged on loans</b>			
	2-3%	114	34.8%
	3.1-4%	60	18.3%
	4.1-5%	26	7.9%
	5%	23	7.0%
	Missing	105	32.0%
<b>Duration (years) of loan re-payment</b>			
	1-2	70	21.3%
	3-4	84	25.6%
	5-6	75	22.9%
	7 or more	29	8.8%
	Missing	70	21.3%
<b>How frequently you buy a new car via bank leases?</b>			
	Never	195	59.5%
	Every Year	20	6.1%
	Every 2-3 Years	25	7.6%
	Every 4-5 Years	23	7.0%
	Other	28	8.5%
	Missing	37	11.3%

\*Based on a subset of respondents answering “yes” for the second item in the table.

\*\* Based on a subset of respondents answering “yes” for the item 9 in the table.

Results from analyzing the effect of pay cuts on loan borrowing are displayed in Table 3. Almost half of respondents reported that they were affected by the latest round of pay cuts; 77% of whom had up to 24% reduction in their total salary. The majority of respondents (63%) reported that the latest pay cuts would impact their decision to take loans. Only 27% reported that they were thinking of taking a loan after suspended Salary allowance and 47% said they would use the loan for buying a house/car or for higher education expenses. Forty four percent said they had challenges with bank loans; mostly due to high interest rates or short repayment period.

Table 3. Effect of Pay Cuts on Loan Borrowing. N = 328.

<b>Item</b>	<b>Options</b>	<b>No. of Responses</b>	<b>%</b>
<b>Affected by the latest round of pay cuts?</b>			
	Yes	159	48.5%
	No	141	43.0%
	Missing	28	8.5%
<b>If yes, % reduction in total salary*</b>			
	<10%	72	36.0%
	10-24%	81	40.5%
	25-39%	40	20.0%
	>40%	7	3.5%
<b>Enough knowledge on borrowing loans</b>			
	Yes	119	36.3%
	No	186	56.7%
	Missing	23	7.0%
<b>Do you know how bank loans operate?</b>			
	Yes	130	39.6%
	No	180	54.9%
	Missing	18	5.5%
<b>Ever used bank loans?</b>			
	Yes	133	40.5%
	No	178	54.3%
	Missing	17	5.2%
<b>Thinking of taking new loan during next year?</b>			
	Yes	90	27.4%
	No	180	54.9%
	Maybe	42	12.8%
	Missing	16	4.9%
<b>Maximum loan you can afford (SAR)</b>			
	100,000 or less	44	13.4%
	101,000-200,000	24	7.3%
	>200,000	23	7.0%
	Missing	237	72.3%
<b>Most likely payment duration you might choose?</b>			
	1 year	44	13.4%
	2-3 years	79	24.1%
	4-5 years	100	30.5%
	Other	61	18.6%
	Missing	44	13.4%

**Kind of loans you prefer to take?**

Personal	128	39.0%
Commercial	72	22.0%
Car Lease	23	7.0%
Mortgage (Housing Loan)	69	21.0%
Missing	36	11.0%

**Most likely purpose of taking a personal loan?**

Buying a House	86	26.2%
Buying a Car	40	12.2%
Higher Education	30	9.1%
Marriage	5	1.5%
Buying Stocks	20	6.1%
Vacation	18	5.5%
Other	82	25.0%
Missing	47	14.3%

**Latest pay cuts will impact your decision to take loans?**

Yes	208	63.4%
No	96	29.3%
Missing	24	7.3%

**Major factor affecting your decision to take loans**

Need for Money	89	27.1%
Interest Rate of the Loan	106	32.3%
Purpose of the Loan	50	15.2%
Whether Already Having Loans	59	18.0%
Other	0	0.0%
Missing	24	7.3%

**Any challenges with using loans (other than salary cuts)?**

Yes	143	43.6%
No	157	47.9%
Missing	28	8.5%

**If yes, what are the challenges? \*\***

High Interest Rates	89	40.3%
Short Repayment Period	62	28.1%
Social Problems	33	14.9%
Lack of Entrepreneurial Skills	37	16.7%

**Loan interest rates you have been charged**

2-3%	114	34.8%
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	3.1-4%	65	19.8%
	4.1-5%	36	11.0%
	5%	36	11.0%
	Missing	77	23.5%
<b>Duration (years) of loan re-payment</b>			
	1-2	43	13.1%
	3-4	91	27.7%
	5-6	97	29.6%
	7 or more	47	14.3%
	Missing	50	15.2%
<b>Duration extension (years) for loan re-payment</b>			
	1-2	50	15.2%
	3-4	96	29.3%
	5-6	80	24.4%
	7 or more	46	14.0%
	Missing	56	17.1%

\*Based on a subset of respondents answering “yes” for the first item in the table.

\*\* Based on a subset of respondents answering “yes” for the item 13 in the table.

Table 4 shows data on pre pay cuts responses by participants’ characteristics. The reported knowledge on bank loans and actual use of these loans were significantly different by most respondents’ characteristics including gender, age, marital status and salary ( $P < 0.05$ ). Significantly higher rates of reporting knowledge on bank loans were observed among males (60% vs. 36% among females), older respondents (59% for those aged above 30 vs. 33% among aged 30 or below), married or separated/widower (55%/49% vs. 34% among singles) and among those with lower salaries (68% vs. 32% among those earning above 10,000 riyals);  $P < 0.001$ ,  $< 0.001$ , 0.004 and  $< 0.001$ , respectively.

Data on post cuts responses by participants’ characteristics are displayed in Table 5. The percentage of respondents reporting that they were affected by pay cuts was significantly higher among males, older respondents and among those with lower salaries;  $P = 0.006$ , 0.047 and 0.027, respectively. No significant differences in rates of reporting effect of pay cuts on decision to take loans were observed by any of the respondents’ characteristics ( $P > 0.05$ ).

Table 4. Pre Pay Cuts Responses by Participants' Characteristics.

<b>Knowledge on Bank Loans in Saudi Banks</b>				
	<b>N*</b>	<b>Number</b>	<b>%</b>	<b>P**</b>
<b>Gender</b>				<0.001
Male	150	90	60.0%	
Female	171	61	35.7%	
<b>Age group (years)</b>				<0.001
30 or below	149	49	32.9%	
Above 30	167	99	59.3%	
<b>Marital Status</b>				0.004
Married	160	88	55.0%	
Single	105	36	34.3%	
Other (separated or widow)	53	26	49.1%	
<b>Salary (SAR)</b>				
10,000 or less	128	87	68.0%	<0.001
Above 10,000	179	57	31.8%	
<b>Use of Bank Loans in Saudi Arabia</b>				
<b>Gender</b>				<0.001
Male	150	89	59.3%	
Female	171	44	25.7%	
<b>Age group (years)</b>				<0.001
30 or below	148	42	28.4%	
Above 30	168	88	52.4%	
<b>Marital Status</b>				0.009
Married	160	77	48.1%	
Single	105	31	29.5%	
Other	53	24	45.3%	
<b>Salary (SAR)</b>				<0.001
10,000 or less	128	78	60.9%	
Above 10,000	178	49	27.5%	

\*Number of respondents with available data

\*\*Based on the chi-square test.

Table 5. Post Pay Cuts Responses by Participants' Characteristics.

<b>Affected by the Latest round of Pay Cuts</b>				
	<b>N*</b>	<b>Number</b>	<b>%</b>	<b>P**</b>
<b>Gender</b>				0.006
Male	147	90	61.2%	
Female	152	69	45.4%	
<b>Age group (years)</b>				0.047
30 or below	140	66	47.1%	
Above 30	155	91	58.7%	
<b>Marital Status</b>				0.26
Married	146	84	57.5%	
Single	99	48	48.5%	
Other	51	24	47.1%	
<b>Salary (SAR)</b>				0.027
10,000 or less	124	76	61.3%	
Above 10,000	164	79	48.2%	
<b>Latest Pay Cuts Affecting Decision to Take Loans</b>				
<b>Gender</b>				0.24
Male	146	105	71.9%	
Female	157	103	65.6%	
<b>Age group (years)</b>				0.12
30 or below	142	91	64.1%	
Above 30	156	113	72.4%	
<b>Marital Status</b>				0.23
Married	148	108	73.0%	
Single	102	65	63.7%	
Other	50	32	64.0%	
<b>Salary (SAR)</b>				0.24
10,000 or less	125	80	64.0%	
Above 10,000	166	117	70.5%	

\*Number of respondents with available data

\*\*Based on the chi-square test.

## 5. Discussion

Saudi debt has increased rapidly over the past 20 years. A rising number of Saudis are taking out loans, to pay for buying a house, car and for other living expenses. The cost of loans is rising, at the same time, banks have begun diverting money to buy bonds that finance the government's deficit, as oil export revenues are down sharply. The Saudi Arabian Monetary Agency's data signaled some signs of slower consumer spending; cash withdrawals from automated teller machines fell to their lowest level this year.

Suspended salary allowances make banks more cautious in their services especially in supporting loans. Based on studies by Aryeetey et al., 1994, Peek and Rosengren, 2005; Caballero et al., 2008, this lending disruption created by high loans compromises the country's long-run growth prospects. Today, most banks find giving loans to private customers risky and therefore they increased the threshold of service charges that are associated with borrowing to discourage non-qualified customers (Paget, 2007).

Our results showed that half of respondents had enough knowledge on loans in Saudi banks while 41% used bank loans; most of whom within the last 5 years. Also, half of respondents had one or more loans in the past 10 years ranging from 51,000-300,000 SAR while a small number had 3-6 loans. Only 37% stated that they had successful business projects. However, 33% demonstrated that they face challenges using bank loans; mostly due to high interest rates and short repayment period. Fifty three percent of respondents reported that they were charged up to 4% in interest rates.

The role of credit in a society is to improve the welfare of the poor directly (consumption smoothing that reduces their vulnerability to short term income shocks) (Friedman, and Kuttner.1993, Binswanger and Khandker 1995; Heidhues and Scheider 2000; Nwanna 1995) and to enhance productive capacity through financing investment by the poor in their human and physical capital.

Most Saudi loans are non-performing loan (NPL), which are several months overdue or in default. NPL is more than just an indicator of a debtor's inability (or unwillingness) to pay, but also a burden for both the lender and the borrower. For a debtor, an NPL traps valuable collateral and the unresolved debt makes it more difficult to obtain new funding and make investment (Bernanke et al., 1999).

In our study, half of respondents declared that they were suffering from the latest rounds of pay cuts; high percentage had up to 24% reduction in their total salary. Furthermore, a significant number of respondents showed that the latest pay cuts would impact their decision to take loans. A relatively low number of respondents reported that they were thinking of taking a loan after suspended Salary allowance and 47% said they would use the loan for buying a house/car or for higher education expenses. In connection with the Saudi bank law, the borrowers cannot take a loan that exceeds 30% of their salary. Therefore, it had become hard for customers to borrow and to pay back their loans due to salary cuts and high lending rates and charges implemented by most banks. This study therefore clarified the information about the impact of suspended Salary allowance on borrowing from banks to the extent to which it impedes their growth from customers' point of view.

The data on pre pay cuts responses by participants' characteristics presented in the current study showed that the actual use of these loans were significantly different by most respondents' characteristics including gender, age, marital status and salary. Significantly higher rates of reporting knowledge on bank loans were observed among males (60% vs. 36% among females), older respondents (59% for those aged above 30 vs. 33% among aged 30 or below), and among those with lower salaries (68% vs. 32% among those earning above 10,000 riyals). While data on post cuts responses by participants' characteristics were higher among males, older respondents and among those with lower salaries.

The fluctuations in interest rates in Saudi banks are very rare, and are controlled by the Saudi Arabian Monetary Agency. The agency sometimes raises interest rates to slow down an economy that is expanding too rapidly and lowers them when the economy is heading for a recession. Rising and falling interest rates will make the customer hesitant to make financial decisions. Rising interest rates make saving relatively more attractive and borrowing relatively more expensive. Falling interest rates have the opposite effect. Consequently, the effect of an interest rate rise or fall will depend on whether you are a saver or a borrower.

It has been reported that there is an inverse relationship between interest rates and the consumer's ability to re-pay a loan, since interest rates directly impact the customer's ability to repay a loan. Bharath et al., 2011, showed that when interest rates are low, people are willing to borrow because they find it relatively easy to repay their debt. However, when the interest rates are high, people are hesitated to borrow because repayments on loans cost more. Furthermore, some consumers may even find it difficult to repay the loan because interest rates increase exceeds the

rise in a consumer's income. If interest rates rise sharply and stay high for a long period, some consumers will default on their loans (Hou and Dickinson 2007, Beck et al., 2013, Klein 2013 and Bergthaler et al., 2015).

The strength of this study is its methodological contribution in terms of enabling the researcher to get an in-depth description of the impact of suspended salary allowances on borrowing from banks and also on the business performance, overall and by consumers' characteristics. Moreover the study provides the basis for understanding the relationships between rate of borrowing from banks and business performance.

The major limitation of this study is that participants were specifically selected from the capital city of Riyadh, which is not necessarily representative of the population of bank customers in Saudi Arabia. Nevertheless, our study covered the vast majority of bank customers in Riyadh as evidenced by the perfect response rate of 100%. However, the choice of the population is not random process. Since the study variables are specific concern, the study has been based on selected population with salary cut and responsible for and in charge of loan repayment or interested for borrowing loans. Therefore, the sample population depended upon the number of customers (borrowers) or interesting in borrowing loans.

## 6. Conclusion

This result of this study reveals a close relationship between suspended salary allowances and borrowing loans and also with the loan repayment. We observed a negative impact of suspended salary allowances and high interest rates on customers and the Saudi economy in general. Therefore, there will be less people showing interest in taking loans, which will negatively affect private sector development that is critical for the development of Saudi private sector economy. Furthermore, there are also other external factors that may trigger the demand for loans by the customers irrespective to suspended salary allowances or high interest rates, as some customers are forced to take loans to make sure their businesses survive.

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