Succession Planning – The Future is Now

Alyzeh Zahid - Senior Associate - Corporate / Mergers and Acquisitions
a.zahid@tamimi.com - Dubai International Financial Centre

If you are a business owner in the UAE with legacy driven ambitions, effective succession planning should be a priority. The ability for your business to thrive even after your demise will depend on the business surviving the transition to the next generation and this requires planning and preparation.

The first step involves asking yourself some key questions:

1. What would happen to your business if death or permanent disability should suddenly befall you?
2. Who would manage the business?
3. Would business operations be affected?

Without adequate succession planning, your business may fail due to unforeseen developments in your wellbeing.

In most common law or civil jurisdictions, succession planning is reasonably straightforward but for the UAE where we have the added complexity of Shari'ah law, things take an interesting turn. The forced heirship rules under Shari'ah law make succession planning much more complex.

Some of the main obstacles faced by founders of family businesses when it comes to succession planning in the UAE comprise:

- **It can be a taboo topic:**

  It is a sensitive subject. The founder will often avoid choosing a successor for fear that it will undermine his leadership to have an 'understudy' being groomed to take his place, not to mention the potential to disrupt family relations if the person selected is not assured of the whole family's support.

- **Controlling behavior patterns:**

  Some founders are intense micro-managers given that they have nurtured the business from its inception. This level of supervision and control often alienates family members and employees alike and leads to conflict.

- **Absence of formal structures and boundaries:**

  It is common in the region for family businesses to be managed like sole proprietorships with no demarcation of personal and business assets and no clear allocation of professional responsibilities between family stakeholders resulting in a muddled web of business relationships.

- **Family conflict:**

  Feelings of frustration and neglect on a professional level can develop between family members working in the business. The proximity of working and socializing together can create a 'pressure cooker' like environment that upon the founder's demise can erupt, leading to litigation and embarrassment for the family.

- **Legal and regulatory challenges:**

1. In the UAE, the UAE Personal Affairs Law (Federal Law No. 28 of 2005) prescribes a formula for division

of assets derived from Shari'ah principles of Islamic jurisprudence.
2. The object of Shari'ah principles is the fair division of wealth across the deceased's heirs whilst protecting the rights of minors and other vulnerable family members. For a family business, the challenge arises when Shari'ah allocation leads to division of a business' assets causing fragmented ownership. Fragmented ownership wherein individual owners have divergent goals will inevitably lead to conflict and damage the business irreparably.
3. Moreover, regulatory authorities historically take a conservative approach towards structures that challenge traditional inheritance principles. This adds to the challenge when contemplating succession planning.

Fortuitously many of these challenges can be mitigated through structures that respect Shari'ah principles and yet accommodate the flexibility and customized governance arrangements a robust succession plan needs.

Noteworthy legal developments:

Recently the UAE has experienced dynamic legal changes making family wealth planning an easier exercise, particularly for family businesses which represent 60% of the country's GDP and 80% of its workforce (as per multiple reports).

DIFC – ADGM – RAK

The increased use of the Trust and Foundation regimes in the free zones of Dubai International Financial Centre (DIFC) and Abu Dhabi Global Markets (ADGM) recently along with the introduction of the Foundation regime in Ras Al Khaimah (RAK) in 2019 through its free zone, the RAK International Corporate Centre (RAK ICC), have made tremendous inroads in helping family businesses circumvent the legal and structural challenges presented by forced heirship rules.

Family businesses can now ring fence their assets in these free zones through multi-layered (typically 2 layers) structures and have customized governance arrangements that are aligned with the founder's vision for the business. The structure can be vetted by reputed Islamic scholars to ensure compliance with Islamic inheritance rules.

Given that foundation and trust structures are specifically provided for in the law and that founders ensure that beneficial interest allocation in the assets is done in Sharia'h proportions to the beneficiaries, Islamic scholars in our experience, usually approve such arrangements. Such approval adds credibility to the legitimacy of these arrangements. Of course, this does not guarantee that local courts will uphold these arrangements and reject the application of Shari'ah principles.

Regulatory authorities have also made progress in their approach to structures of this nature and are keen to support family businesses and have demonstrated this by being open to dialogue.

UAE Family Ownership Law

In 2020, the UAE announced a new law regulating family-owned businesses in Dubai. The law introduces a formal structure to family businesses and will be voluntarily applicable to new or existing family businesses with certain exemptions.

Apart from taking advantage of the abovementioned positive legal developments, other key measures founders can take from the outset include:

Optimizing the corporate structure in place

Family businesses in the region typically proliferate in an opportunistic manner resulting in messy legal structures. The first step is to organize and streamline the existing corporate structure.

Preparing the Founder’s vision statement

The objective of this statement is to provide insight into the vision of the founder for the business. Through this statement, the founder provides guiding principles for those managing the business currently and in the future.

Choosing a successor

This is one of the toughest decisions for the founder of a family business. There is usually an inherent bias towards 1 child. It is advisable to have 2 or 3 viable candidates and professional advisors can help narrow it down. An alternative route is to have qualified industry experts on the boards of the trustee companies or as foundation council members and have them manage business operations using industry expertise.

Formalising internal policies and procedures

To manage family relationships at work, it is useful to implement a formal hiring policy. This would involve determining a subjective criterion for appointment and would help in managing family expectations in respect of securing employment at top positions in the business.

Developing or adopting a code of corporate governance

To formalize the way in which business is conducted, ensure accountability and improve standards of communication and transparency, it is advisable to develop or adopt a code of corporate governance.

Time for Action

Due to the economic fall-out from the ongoing COVID-19 pandemic, businesses, especially family businesses, have suffered on a global scale. If there was ever a time to get one’s house in order, the time is now.

And whilst it’s true that we have no control over the pandemic and its repercussions on our lives, there is some value in the old saying, ‘have faith in God but tie your camel’. Every family business must face generational change and the ongoing pandemic has made this all too clear. The time to build adequate safeguards for your business or ‘tie your camel’ to ensure a lasting legacy is now.

Al Tamimi & Company’s Corporate Commercial team regularly advises on Governance with an element of insolvency. For further information please contact Alyzeh Zahid a.zahid@tamimi.com or Abdullah Mutawi a.mutawi@tamimi.com.