Family Businesses: handing over to the next generation

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September 2013

Along with oil, family businesses are the backbone of the Arab economies. The majority of family businesses in the Middle East are now transferring to the second generation and it is important that they have succession plans in place to ensure that the business survives and prospers following this transition.

Most family businesses have governance structures in place for their commercial matters, but fewer have formal ownership structures.

Unfortunately, corporate governance is often given a lesser status than profitability. It is important that a well defined succession plan or good corporate governance is implemented before the business passes to the next generation.

Why does a family business need restructuring? Arab families are large and continue to grow with each generation. The increase of family members calls for transparency and accountability. There may not be direct communication about the business within the family so it is important to ensure that business information is provided to all family members. The ownership responsibilities will inevitably pass from one generation to the next and conflict may result if strong policies are not in place. Corporate governance defines the members' roles and responsibilities, thereby reducing uncertainty and opportunity for conflict. Family businesses may function sufficiently under the founders with few formal procedures, but the lack of formality is likely to create conflict with succession.

In other parts of the world, family trusts are established to hold and regulate shares. Similar trust structures are not used in the Middle East. A number of models are available ranging from Western to Islamic Sharia that propose ways which family business can be structured and a family constitution drafted with the new generation in management. Families must instruct a competent advisor who understands their culture, family history and inner problems and can consequently propose the right model for the family. Respect for elders, a desire for privacy and exclusivity are common factors. There is no model tailored to suit a particular family and families must invest time in determining the structure most suitable to them. In my opinion, it would be wrong to try and fit one model to all families irrespective of whether it is Sharia compliant or not, because all families are unique. The model must live up to the expectations of the family and promote sustainability and continuity.

There are a number of considerations to take into account when restructuring a family business. For example, is there a clear and set criteria for family members joining the business or taking on senior roles? Will performance appraisal mechanisms and remuneration fixing processes be applied to family members? Is the business willing to have board members from outside the family? Will female family members be included on the board? The value of independent directors is becoming more recognised, particularly when they bring skills the board is lacking such as legal or financial expertise. Some families may prefer to include an independent member in a purely operational role so it is therefore important to define their role clearly.

In my opinion, it is fundamental that the founder carries out the restructure whilst he is still in control or at least while he is still an authoritative figure among the family. It is important that the new generation is given an opportunity to experience running the business while the founder is still alive. Any family business restructure requires stability, at least initially while the changes are implemented. The founder must continue to have some authority and autonomy, at least for the first few years until the younger members are given more responsibility. A number of the changes may not affect the business commercially, but are instead cultural changes. Without the founder being there to oversee the implementation of the restructure, it may collapse.

The purpose of the restructuring is to avoid turbulence or conflict that will affect the continuity of the management and to sustain the wealth and benefits of the business for future generations. It is important to consider the drive of the next generation to be engaged in the restructuring and invest in creating a drive if it does not exist. If the next generation is not involved in the restructuring process they may challenge the structure and it will have a weaker foundation.

The laws of the Middle East are lacking for encouraging family businesses to restructure at the right time. There is an absence of developed corporate or trust law which could facilitate a founder of a family business choosing the right option to restructure the business during his lifetime. In my opinion, the absence of developed corporate or trust law discourages founders from handing over the levels of power to non-family members or young family members during their lifetime. This may be due to there being no guarantee that the restructure will be sustainable or doubts as to whether the founder can retain control during his lifetime.

A relaxing of the requirements for listing family businesses will be beneficial as it will introduce public shareholdings, which in turn are likely to promote better management with a blend of private, public and family members. There is a need to raise awareness of governance issues, structures and policies among family businesses so that family businesses undergo restructure during the founder’s lifetime. Founders desire to pass on a healthy organisation to the next generation. Strong corporate governance leads to greater professionalism, confidence during succession and may enhance the international standing and competitiveness of the business.