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The Family Firm: Central to the success of the Middle East

PwC Family Business Survey 2012

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Contents

Introduction

This report sets out the findings of the 2012 PwC Family Business Survey for countries in the Middle East.

The 2012 PwC Family Business Survey covered almost 2,000 firms across the world. It involved businesses from both developed and emerging markets, and from a wide variety of sectors including manufacturing, retail, automotive, and construction.

In the Middle East there were 65 in-depth interviews, covering broadly the same range of sectors. Over 80% were businesses established for more than 20 years, and nearly 70% of the respondents were from firms with a turnover of over US$100m. The comparable figure for the whole survey was 28%, so the firms taking part in our region were, on average, considerably larger. This reflects the significant cultural importance, political influence, and economic power of the family firm in the Middle East - most of the region's GDP outside the oil sector, and over 80% of its businesses, are either family-run or family controlled, making family businesses crucial to both economic activity and employment. Family firms in our region are also unusual, compared to the rest of the world, in that they are very often highly-diversified conglomerates. Many started life as trading companies, but have since diversified into sectors as varied as retail, automotive, construction, import/export, shipping, insurance, agriculture, financial services, real estate, and manufacturing.

The overarching message from the survey for the Middle East is that family firms here are thriving, confident, and less concerned than those elsewhere in the world by the on-going economic situation. The survey findings prove that there are many characteristics that all family businesses share, regardless of their size, sector, or market, but family firms in this region do have a slightly different profile, which raises some significant and interesting challenges, which we will explore in the pages that follow.

Summary of survey figures – by market etc – in graphic form

The characteristics of the family business

Both globally and within the Middle East, there is a marked similarity in the approach family firms take to business, and a high degree of agreement about the distinctive characteristics of such firms.

Those characteristics can be summarised as

Longer-term thinking and a broader perspective

Family businesses take a long-term approach to business, and when they invest, they do so with the needs of future generations in mind. Most are unlisted, so they are not constrained by investor pressure to make quick returns, or the need to observe a quarterly reporting cycle.

65% of Middle Eastern firms believe that family businesses play an important role in ensuring economic stability, which is rather lower than the global figure of 72%. 46% consider that family businesses take a longer-term approach to decision-making, compared with 53% globally.

"Each family business is different, but the ambition and dedication of the family to grow the business is always there" (India)

"We take a long-term approach to investments" (Middle East)

"We leave a legacy for future generations" (Middle East)

"It is important to learn from your mistakes – you have to lose money to make money" (Middle East)

"There is always a unified decision. Despite differences, family members tend to end up agreeing on a course of action. The decision-making process is faster" (Middle East)

"Family businesses are generally stable, and decisions are made much faster than in other types of businesses" (Middle East)

"Family businesses are more controlled. They are more focused in terms of goals, growth. The objectives of family businesses are clearer" (Middle East)

"We have a more autonomous decision-making capacity. And especially more flexible management" (France)

"If the owner is close to their people, loyalty is a key factor" (Middle East)

"Employee loyalty is very important" (Middle East)

"The things that are really powerful about family businesses are the values, which are genuine corporate responsibility" (UK)

Quicker and more flexible decision-making

Family businesses believe that their ability to make decisions quickly is a distinct competitive advantage.

An entrepreneurial mind-set

In the global survey, 63% of respondents consider family businesses to be more entrepreneurial than other sectors of the economy, a figure which drops to 58% in the Middle East, though this may be a reflection of the larger size of companies in the Middle East survey. 45% of those in our region believe that family businesses are able to reinvent themselves with each new generation.

A greater commitment to jobs and the community

77% of those who took part in the global survey believe that family firms feel a stronger sense of responsibility to support employment than other companies, but this drops slightly to 72% in the Middle East. Firms in our region do clearly believe, however, that family businesses tend to generate greater loyalty from their staff. 78% agree that community initiatives are important to the family firm, compared with 70% globally. This reflects the very strong commitment Middle Eastern family firms have to charitable giving, in particular, with many donating extremely large sums to good causes in the region.

The characteristics of the family business

A more personal approach to business based on trust

74% of respondents in the Middle East agree that culture and values are stronger in the family firm. As elsewhere in the world, many businesses in our region believe that they win business because they have closer relationships with their customers.

Family firms consider these special characteristics to be a source of real competitive advantage, which are at the heart of their distinctive approach to business. But some other characteristics of the family firm can hinder growth, whether by generating conflict within the family or causing the business to be overly risk-averse, which may mean opportunities are not seized. We will look at some of these issues in more detail in due course, after a brief resumé of the current state of sentiment in the family business sector, both globally and in the Middle East.

"There is a closer interaction with the people whether customers or staff" (Middle East)

"Family businesses tend to have a better relationship with clients" (Middle East)

"A lot of our customers like doing business with us because we have good values. We can adapt more readily to customers' needs because we are flexible" (USA)

The family firm in 2012

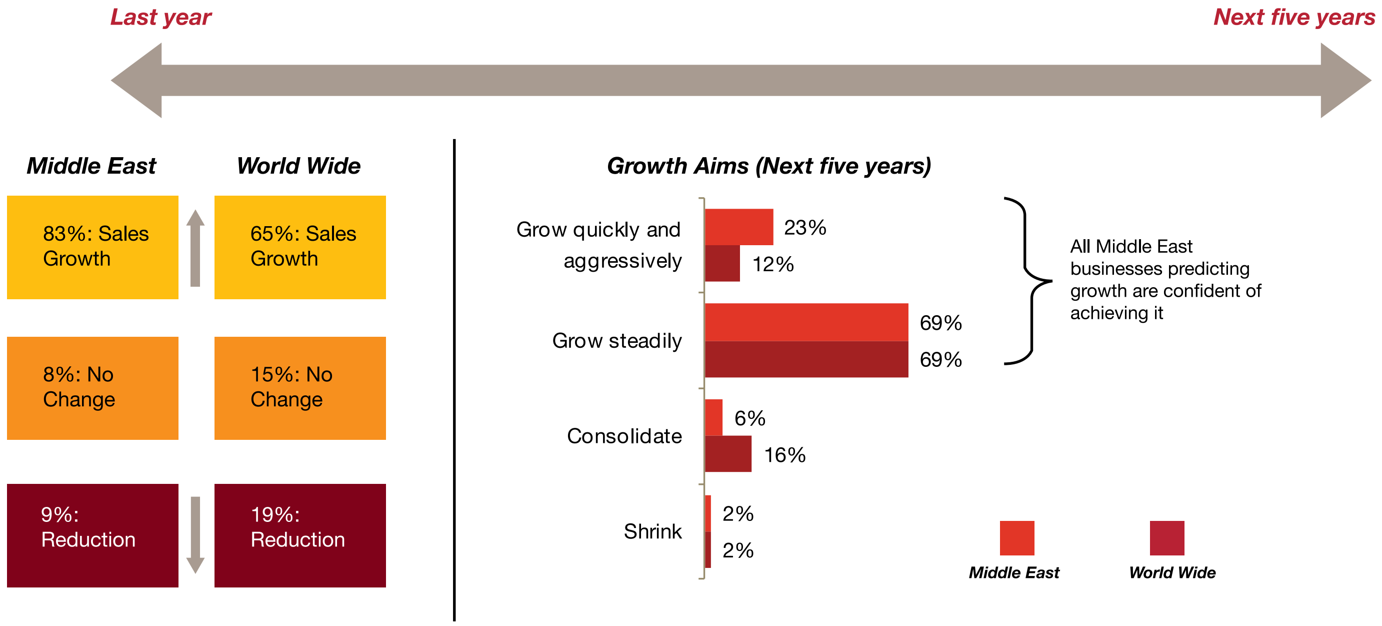
Here are some of the key survey findings:

Family businesses are thriving globally, and even more so locally

An impressive 83% of Middle Eastern family firms have seen growth in sales in the last year, compared with 65% globally. Only 9% of respondents in our region saw a reduction in sales in the last year, as against 19% overall.

Family businesses in our region are ambitious and planning for growth

23% of Middle Eastern businesses plan to grow quickly and aggressively in the next five years, nearly double the comparable number for the survey as a whole. A further 69% in our region expect steady growth, and only 2% expect to contract.



The family firm in 2012

Here are some of the key survey findings:

Globally, the economy is the key external challenge, but not in the Middle East

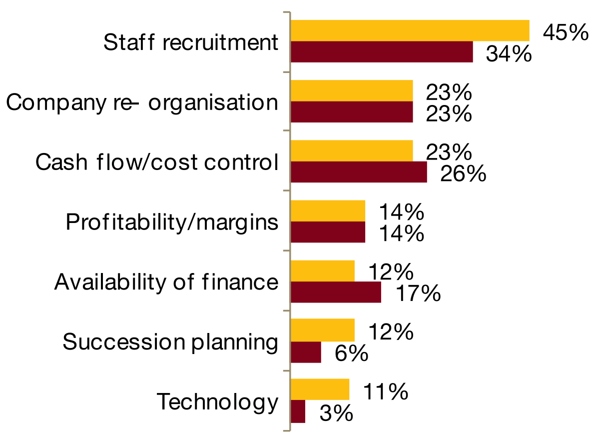
All businesses face difficulties in the current climate, but family firms in the Middle East are significantly less concerned about this in 2012 than they were in 2010, with the number dropping from 71% to 45% this year. The top three external issues identified by global respondents are market conditions (54%), competition (27%), and government policy and regulation (27%). In the Middle East the top three, by contrast, are government policy and regulation (46%), market conditions (45%), and competition (32%).

Internally, skills are the main issue, both globally and in the Middle East

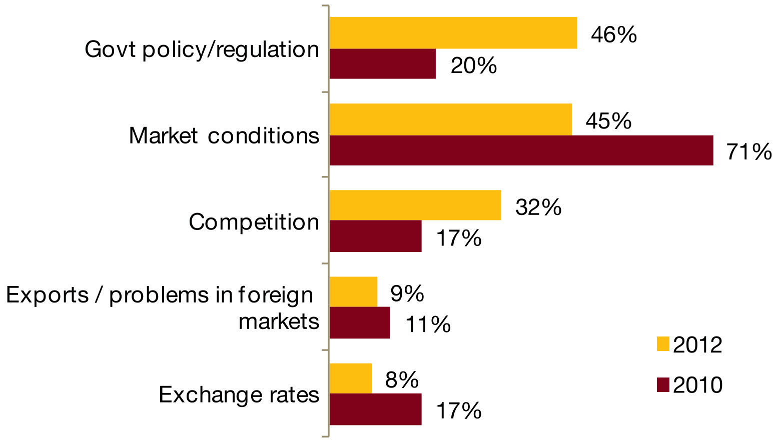
As with the global results, the Middle East findings suggest that the recruitment of skilled staff has become a greater challenge in 2012 than it was in 2010 – the number of Middle East respondents citing this has risen from 34% to 45%.

Globally, the need for corporate restructuring has eased somewhat as an issue, but, perhaps significantly, this number has remained steady in the Middle East. Likewise cashflow and cost control are no longer so important overall, with the global number falling from 30% in 2010 to 17% in 2012, but it remains rather higher in the Middle East at 23%. This may suggest that there is more that family firms in our region could do to streamline their organisations, improve internal processes, and tighten up inventory control and debtors.

Key internal issues in next 12 months



Key external issues in next 12 months



"[The issue is] finding and retaining the right people" (Middle East)

"Getting the right people, especially at middle-management level" (Middle East)

"We need to make sure the business model can cope with change in the market" (Australia)

Looking ahead:

Emerging issues for 2017

Despite their overall confidence about the future, family firms do recognise that there are issues and challenges they need to address.

The economy remains a cause for concern, but less so in the Middle East

66% of the global respondents cite the general economic situation as a key issue going forwards, and those companies who believe their business will contract are likely to see this as the cause. Middle Eastern family firms are more optimistic, with only 42% concerned about the economy over the medium term. Price competition is a slightly more important issue in our region (48%) but again this is lower than the global figure (59%). 34% of Middle Eastern family firms believe regulation will continue to be an issue, and 20% anticipate supply chain issues becoming more important.

"That the economic crisis we are experiencing will restrict liquidity in all enterprises, including family ones." (Mexico)

"We need more international thinking - it's a challenge not to limit the company to the local market" (Belgium)

"International competition is now much more structured, much more professional, but on the other hand, this leaves large market niches that large companies are not attacking, precisely because of the agility of family businesses" (Mexico)

"It is the era of the multinational" (Romania)

"Our short product life cycle means that we need to constantly produce new ideas and new products to stay in the market" (South Korea)

"Some family businesses depending on their size will probably merge with bigger companies to become public companies" (Middle East)

"Potential employees think that within a family business they will not have a future. In order to attract and retain talent we must create an enabling environment for the future" (Singapore)

"Some families may be ready to withstand the storms of the economic crisis but more likely to collapse at the first dispute among family members" (Middle East)

Globalisation is having a major impact

Globalisation emerges more strongly as an issue in five years' time. Taking the survey as a whole, the respondents are concerned that family firms may struggle to compete with major multinationals and global megabrands. However, many businesses are still confident that they have distinct advantages such as local knowledge, and the ability to move quickly, which will help them compete.

Middle Eastern firms are less concerned about innovation, and more about consolidation

Turning to the internal management of the business, the key emerging issues in the Middle East are recruiting the right skills (55%), innovation (45%), and retaining key staff (43%). It's interesting that the comparable figure on innovation for the global survey is much higher (62%). 37% of the global respondents anticipated the need to invest in new technology, compared with 34% in the Middle East. It's important that Middle Eastern businesses do not lose sight of the need for constant innovation, whether in processes and ways of working, or products, services, and new technology.

The issue of market consolidation is more prominent with Middle Eastern firms than elsewhere. Some firms find the prospect of possible acquisition by a larger listed business as a threat, others see a merger with such a firm as an opportunity.

The 'war for talent' is still waging – both generally and in the Middle East

Attracting appropriately skilled staff, and then retaining them, are as much a concern for Middle Eastern family firms as for those in the rest of the world – the numbers are 55% and 43% for the Middle East, and 58% and 46% globally. Across the world, a number of respondents observed that family

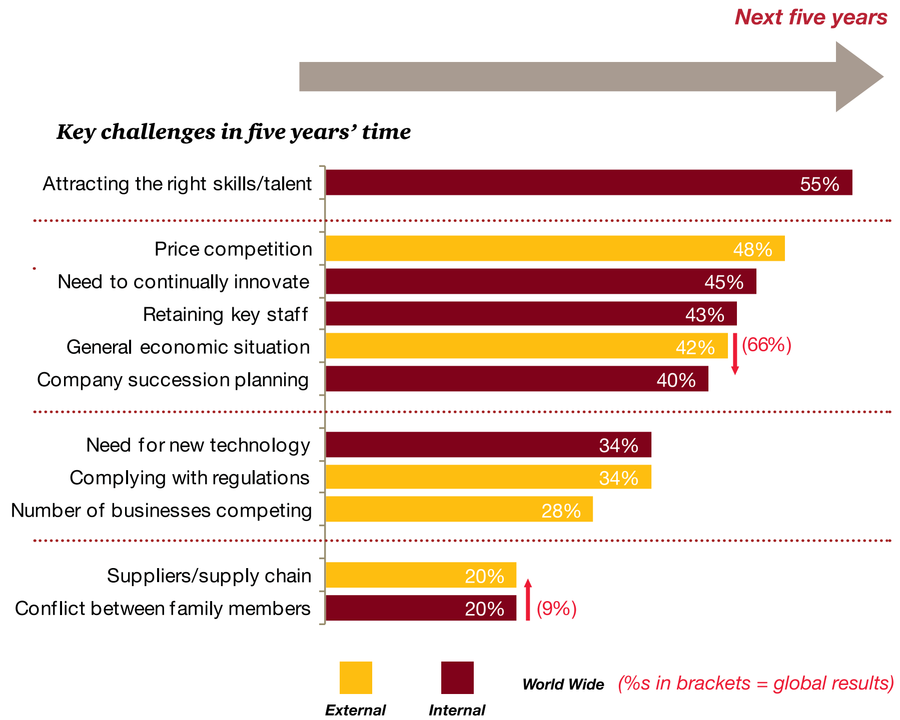
businesses can struggle to attract the most talented employees because the career path at a listed multinational is often clearer, and these companies can offer high-fliers the prospect of an equity stake and share-related bonus schemes. There are also specific issues in the Middle East, centring on problems with hiring skilled workers from overseas, and difficulties with the visa system.

Managing the succession process is crucial – and a key issue locally

40% of Middle Eastern respondents are concerned that the transfer of the business to the next generation might cause problems, compared to 32% globally. 20% of local firms saw the possibility of family conflict as a consequence, which is considerably higher than the overall figure of 9%.

Across the world, many family businesses are planning to bring in external non-family managers, either to strengthen the business, or as part of the transition when the current family directors retire. Taken overall, 64% of family businesses have non-family members on the board, a figure which increases to 75% for firms with turnover of more than $100m. 63% of Middle Eastern businesses have non-family directors (executive or non-executive), compared with 49% in the UK and North America, and 74% in the Asia Pacific region, where a high proportion of family businesses are listed, and are therefore required to have independent Board members.

In our experience, family firms in the Middle East are increasingly looking to strengthen their boards. They want board-level discussions to be about business, global challenges, growth, strategy, and profitability, rather than family issues or conflicts.



Scale, skills, and succession
Tipping points for the family firm

The global survey proves that family firms across the world – and in the Middle East – are successful, ambitious, and entrepreneurial. But these businesses face specific challenges which might stand in the way of their ambitious growth plans if they are not effectively addressed. Some of these are unique to their particular business model, but others are issues which every company will face, but which can create particular difficulties for a family business. In addition, there are specific cultural and historical factors in the Middle East, which can create particular challenges for firms in our region.

The global survey identified several key 'tipping points' for the family business: moments in the firm's evolution where key decisions have to be made, and the future direction of the business is determined. PwC's Middle Eastern practice is particularly experienced in dealing with these transitional moments, especially in relation to continuity planning, succession planning, and conflict management.

"[The greatest challenge is] consolidation through globalisation. Customers are getting bigger, which will put greater pressure on size of the family businesses as against large multinational or publicly owned corporates. In other words, scale" (Australia)

"[The issues are] experience relevant to these countries. Cultural differences with customers" (Middle East)

Tipping point 1: Scale

The first of the key tipping points is scale: the moment when a business achieves a certain size but can only progress further by making a significant step change. This may take the form of a new opportunity in the domestic market, prompted by the actions of a competitor or the introduction of a new product or innovation, or by the decision to become an international business.

It's notable than the average proportion of sales that family firms make internationally is significantly lower in the Middle East than it is elsewhere in the world – 15% as against 25% globally. This disparity widens ever further when it comes to family firms' plans over the next five years: on a global basis, the average level of exports is predicted to rise to 30% by that time, but only 18% in our region. As many as 32% expect to have no new international markets at all in that time.

When they were questioned about the challenges of becoming an international business, the global respondents cited understanding the business culture overseas (20%), competition (19%), local regulations (19%), exchange rate fluctuations (16%), and local economic conditions (16%) as the main ones. A number also referred to the complexities of an international supply chain. In the Middle East, by contrast, the top issues were the political situation in overseas markets (18%), local regulations (13%), and understanding customers overseas (13%).

Finding the finance for expansion - whether international or domestic - can be a particularly difficult challenge, because family businesses do not usually have access to the public capital markets, and prefer not to leverage their balance sheets or sell off family assets. As the family business passes from one generation to the next the number of family members grows (especially in the Middle East where families tend to be larger), which means that the income from the business is distributed more thinly, and there are likely to be fewer family members who are able or willing to invest the significant resources required for a major capital investment. The only practical option, in these circumstances, is bank finance, but this has become more difficult since the economic slowdown.

In the past, family firms in the Middle East have been able to access finance through their strong long-term relationships with the banks, but since the credit crunch the financial institutions have become much more cautious. They have also become more demanding, both in terms of the criteria they impose, the collateral they demand, and the information they require, which might range from details of the corporate strategy to succession and continuity plans. PwC has helped many firms in the region to prepare a successful business case for a bank loan.

The challenges of obtaining investment funding may explain why there is a marked tendency for family firms in general to focus their export efforts only on neighbouring countries, or those with historical ties to their home market. In this year's survey, those Middle Eastern firms which are planning to increase their exports are focusing mainly on other countries in our own region (32%), rather than on regions further afield such as the Americas (16%), or Europe (8%).

Tipping point 2: Skills

Some family businesses are wary of exporting because family members are reluctant to relocate, or because they lack the specific skills and experience they need to do this, but there are also other skills that these businesses can find it hard to develop, because they draw their management team only from within their own family. Risk management – in its broadest sense - is one of these, and others include innovation, Intellectual Property, and IT, as well as broader management and business skills. Dealing with regulatory requirements and changes are another common concern.

Some family firms struggle to fill their 'skills gap' because they are not clear, themselves, exactly what skills their business lacks: in some cases the titles of the senior people are not an accurate reflection of the role they actually play. This results in a lack of clarity about responsibilities in the business, and an inaccurate picture of what skills the business may need to recruit.

One way to address the skills gap is to bring in managers to either supplement or replace family members in specific positions. This can be an extremely positive step, and a source of new energy and new ideas, but it's a process that needs careful management, and flexibility from both the family and the incoming executive. It is not surprising, for example, that some first-generation entrepreneurs can find it particularly difficult to 'let go', and allow the incoming executive to do the job they were recruited to perform.

The cultural norms of Middle Eastern society can make it even harder for companies here to take this step: they are often very reluctant to give executive power to non-family members, or even discuss family affairs with outsiders. Even where they are prepared to do so, it is difficult to find the right candidates for these positions. PwC has worked with a number of Middle Eastern family firms to help them recruit appropriately-qualified outsiders.

If an outsider is brought in as CEO, the challenge for the family will be to learn how to 'manage their manager', so that the performance of the business can be maximised for the benefit of all concerned. The skills of a good CEO are not the same as the skills of a good shareholder, and PwC has worked with a number of firms in the Middle East to assist the owners in developing positive and productive working relationships with those who are managing their interests.

A perceived lack of skills in the younger generation can be one reason why the founders of family business find it difficult to relinquish their management role. Conversely, there can be difficulties if a younger family member is educated abroad and returns to the family firm with new ideas that may conflict with their parents'. It can also be the case that younger family members who have played no active role in the firm may lack the experience they need to be effective shareholders in the future. That's why PwC has designed a special course for family firm directors, covering issues such as accountability, delegation, and transparency.

Tipping point 3: Succession

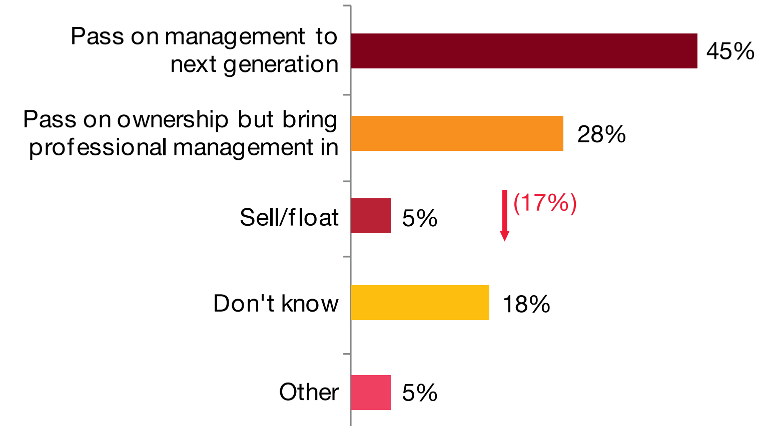
The single most obvious point about a family business is, of course, the fact that has been passed from one generation to the next, but the moment of transition is vital to the firm's future success – or failure. For a mainstream firm, succession planning is about preparing for the moment when a CEO retires or steps down; for a family firm that moment of transition is more complex and more challenging because it involves not just the management of the business, but its ownership as well.

In this year's survey, 41% of the global respondents intend to pass on both the ownership and management of their business to the next generation, though more than half of them are unsure whether the next generation will have the skills and enthusiasm to do this successfully. In the Middle East the comparable number is 45%. 25% of the global respondents plan to pass on their shares but bring in professional managers, and here the comparable number for our region is 28%. The majority of the remaining 34% of the global respondents have either not yet decided what to do with their business when they retire (11%), or are planning to sell or float it (17%). In the Middle East these numbers are 18% and 5%, making the number of possible flotations or sales in our region significantly lower.

In the Middle East, family businesses are large and successful corporations, mostly managed by family members of the first or second generation. Many were established in the 1960s, and are facing the crucial moment of transition in the next 5-10 years. Some are still managed by the founder, others have passed down at least one generation and are managed now by a consortium of cousins. Although the culture of respect for older generations remains strong, and families traditionally prefer to keep their affairs private, we have seen an increasing number of disputes ending up in the courts in recent years. In some cases this has led to the assets of the entire firm being frozen until the case could be resolved.

This is why it's so important to plan for the moment of succession as early as possible. Those who own and run the business need to make important, and often difficult, decisions about such questions as the needs and skills of the next generation, the best way to ensure the long-term success of the business, and whether the use of trusts or holding companies might be a more effective ownership vehicle.

Future plans



"Rules and regulations relating to taxation. Audit procedures. Understanding the market in different countries" (Middle East)

"Family businesses tend to finance their growth from their profits, so you need to be more careful. Family businesses have to compete with global companies or public companies where resources tend to be much bigger" (Middle East)

"There is lack of sources for funding" (Middle East)

"[The risk is you have] a narrow vision in terms of experience, and need to inject new blood to get a different perspective. You can get complacent with a stable mind-set and it would be better to be open or receptive to change" (UK)

"A family business can be hampered by an insistence on continuing with a low-performing line of business. Emotions can dominate, and founders can become obsessive about control" (Turkey)

"There can be a lack of stability for professionals brought into the company. The decision-making process can be difficult due to the interference of family members" (Middle East)

"We want our family boardrooms to be dynamic and not end up discussing family issues" (Middle East)

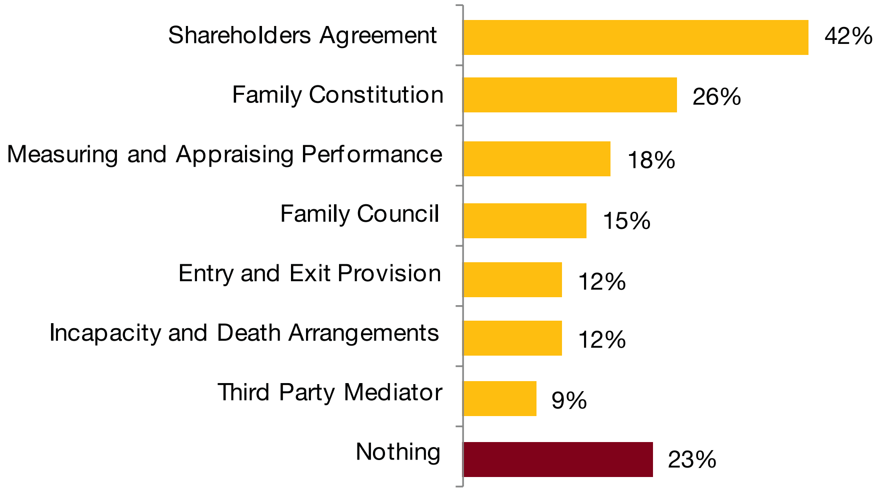
"[We need to] bring outsiders onto the board of the company, and learn how to deal with that. Also the organization of internal processes to streamline our operations. In other words, the professionalization of management" (Brazil)

"Mentoring and developing the next generation family members is crucial to the success of the family business" (Middle East)

"My grandchildren are our soldiers for tomorrow – We must give them the tools to help them fight the battle" (Middle East)

"Succession planning is an issue. Different family members may want different things" (Middle East)

Procedures in place



Family firms around the world are putting formal procedures in place to mitigate or manage potential problems associated with succession, but there is evidence that the Middle East is lagging in this respect. According to the survey results, Middle East firms are less likely to have instituted measures such as entry and exit provisions (12% as against 28% globally), performance appraisal mechanisms (18% as against 32%), or provision for a third party mediator (9% as against 24%).

As this suggests, family firms in our region could benefit from strengthening the provisions they have in place to deal with potential conflict, ideally as part of a more comprehensive review of their corporate governance framework. The questions that would need to be addressed as part of this process would include the mechanism for allotting shares, the representation of the family on the board, decision-making procedures, any rights the family may have to be employed in the firm, exit provisions, reward and remuneration policies, performance appraisal, recruitment, the establishment and role of board committees in areas such as audit, and the approach to dividends and reserves. PwC has extensive experience in all of these areas.

"The potential for conflicts is detrimental to the business" (Middle East)

"Sibling rivalry, as well as irreconcilable differences in vision, often leads to splitting up of the family businesses" (Middle East)

"The best time to plan for the future is when the family is harmonious" (Middle East)

"Family businesses do not place enough importance on proper procedures and governance" (Middle East)

"In the event that someone is not pulling their weight, it is much more difficult to make a business decision that you should make- there can be a conflict between the head and the heart" (Ireland)

One popular governance mechanism with family firms is the family council - 29% of the respondents to this year's survey have these, but only 15% in our region. However, a family council could be an especially effective framework for firms in the Middle East, where families tend to be larger than in Europe and North America, and few family businesses have a clear line of demarcation between 'the family' and 'the business', which increases the potential for damaging disputes.

Likewise the conglomerate structure of many Middle Eastern firms means that the businesses within the firm are often run by different family members, but only the owner has a clear idea of what is going on in all these very diverse operations. When he steps down and passes control to the rest of the family, the managers of the different businesses will need to understand the issues and opportunities faced by the firm as a whole, and not just the ones that they themselves are running. The clear danger, at this point, is that decisions can start to be made for emotional rather than commercial or strategic reasons, and conflict can arise between different 'fiefdoms'. If this is not addressed, there can be a danger that some businesses within the firm can start absorbing cash, and destroying rather than creating value.

A family council can be a good way to provide a forum for all family members to participate in discussions about the whole business, and achieve a shared vision for its future, whether they play an active role on the day-to-day management of the firm or not. In other words, it can function as a mechanism for separating ownership (which may involve the whole family), from management (which usually involves only a few). Such a forum also makes it much easier to manage the succession process smoothly and successfully, and can be invaluable if the firm is bringing in non-family executives, or establishing an independent advisory board.

PwC has helped many Middle Eastern family firms establish family councils like this, and has also designed transitional structures specifically tailored to address the challenges of succession by reserving the right of veto to the founder for a specified period, while giving all the relevant members of the next generation a voice in decision-making during that time.

Are governments supporting family firms?

As part of the global survey, PwC asked family businesses whether they feel valued by their governments, and what more they think should be done to support them.

Family firms feel under-valued in general – but not in the Middle East

At a global level family firms feel that the economic contribution they make is overlooked or underrated by their own governments. Middle Eastern firms are by far the most positive in this respect, with a 34% net agreement that their governments value them (compared, for example, to disagreement levels of 31% in the USA, 42% in the UK, and 48% in France). This may reflect the significant political influence large family firms wield in our region, and the fact that they often have access to decision-makers at the very highest level.

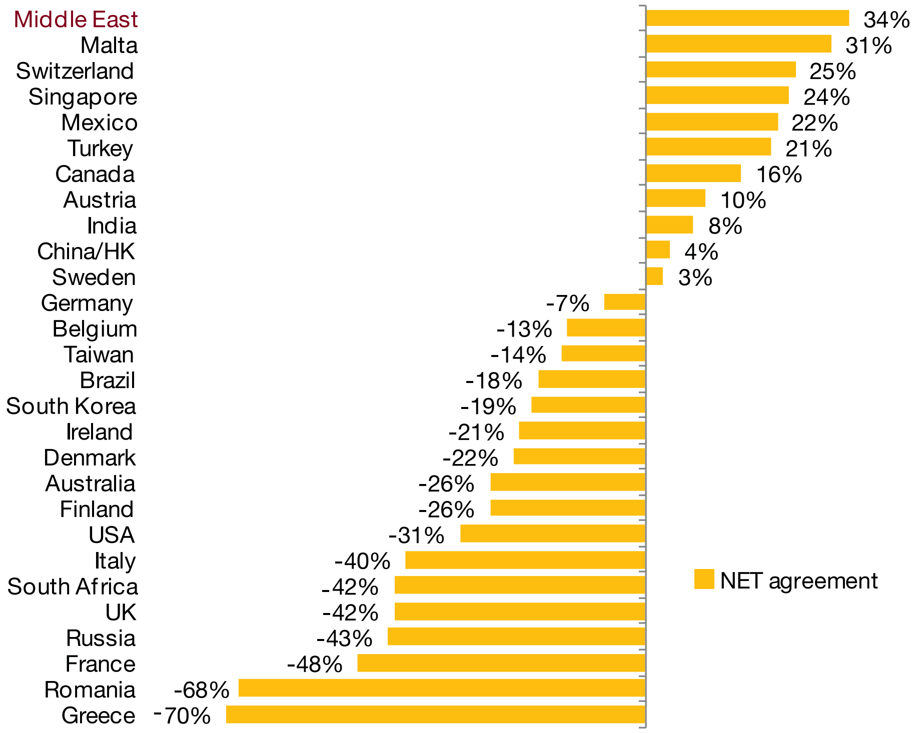
All the same, family firms in the Middle East do believe there's more their governments could do to help them.

So what are family businesses in the Middle East looking for?

The top issue for family firms in the Middle East is access to finance, and 57% would like governments to help more with this. Other than that, there was general agreement on such measures as improving education, training and vocational skills, and reducing bureaucracy, all of which are echoed in the global findings. One obvious area of difference was tax: cutting taxation is a major concern for family firms around the world, but it is not an issue at all in our region, given the favourable tax regime they (and other businesses) enjoy here.

There were some issues which are specific to our region – such as making it easier to hire skilled immigrant workers – and others specific to family businesses in particular. These included helping family firms through the process of succession, flotation, or merger; assisting with conflict resolution; and providing more guidance and – if necessary – regulatory support for stronger corporate governance.

***Net agreement that Government recognises the importance of family businesses**



"[Government should] put policies and procedures in place in terms of corporate governance within family businesses" (Middle East)

"[We need] more facilities in terms of access to finance" (Middle East)

"Government should be involved in the succession planning to avoid conflicts or have guidelines so it can be easily followed" (Middle East)

"[We need] an easier process for the recruitment of expats to work in this region" (Middle East)

Conclusion

"In the future family businesses will operate more like multinational corporations. Although the decision-making will still be in the hands of the family, a family business will have to behave more like a global corporate company. I am already following this model. Family and global businesses will converge going forward and this will be a big change" (Middle East)

Family firms in the Middle East are successful, diversified, agile, and professionally-managed, and their greater size compared with other family firms could mean that they are better-placed to compete with the challenges of globalisation.

There is no other region where family firms are more vital to the local economy, or more integral to business life. However, there are some areas where family firms in our region could benefit from more formalised processes and procedures, and it's vital that they continue to attach a high importance to innovation and the development of new ideas.

Governments across the region recognise and support the family firm, but there is still more they could do to help this vibrant and vigorous sector achieve its full potential.

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Definitions
For the purposes of this survey, a 'family business' is defined as a business where

1. The majority of votes are held by the person who established or acquired the firm (or their spouses, parents, child, or child's direct heirs);
2. At least one representative of the family is involved in the management or administration of the firm;
3. In the case of a listed company, the person who established or acquired the firm (or their families) possess 25% of the right to vote through their share capital and there is at least one family member on the board of the company.

Survey methodology
1,952 semi-structured telephone interviews were conducted via Kudos Research in London with key decision makers in family businesses more than 30 countries worldwide between 7th June and 18th September 2012. The interviews were conducted in the local language by native speakers and tended to average between 20 and 35 minutes. The results were then analysed by Jigsaw Research.

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