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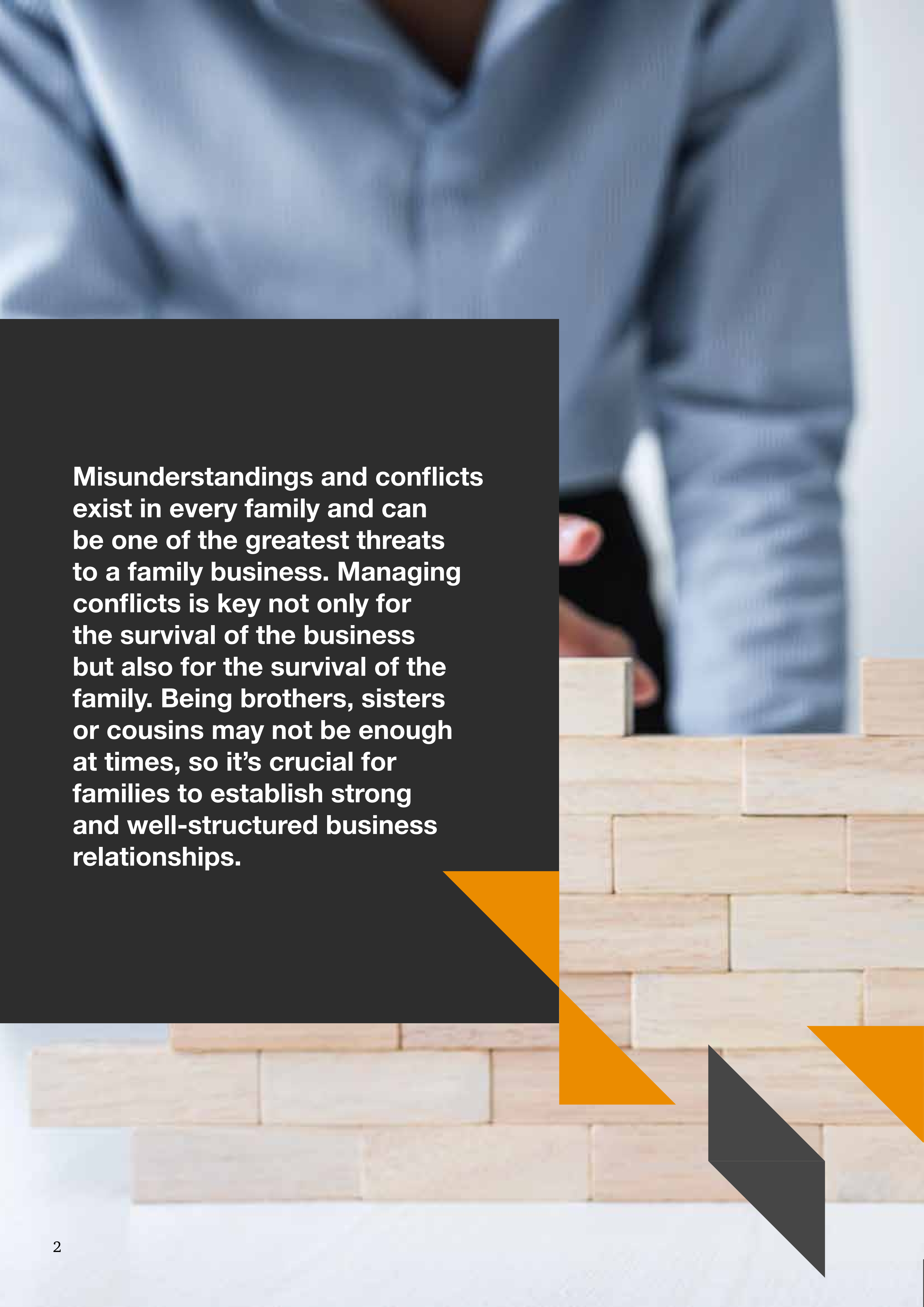
Understanding family dynamics and family conflicts



Misunderstandings and conflicts exist in every family and can be one of the greatest threats to a family business. Managing conflicts is key not only for the survival of the business but also for the survival of the family. Being brothers, sisters or cousins may not be enough at times, so it’s crucial for families to establish strong and well-structured business relationships.

Family businesses in the Middle East

A large percentage of the commercial activity in the Middle East is controlled by family business groups across several sectors and they collectively contribute 60% of the gross domestic product (GDP)[1]. Family businesses also employ a substantial percentage of the regional workforce and therefore play a critical role in the region's economy. In fact, one trillion USD[2] is estimated to pass from one generation to the next within the next decade.

A significant number of families started these businesses in the early 1960s. Therefore the groups are considered relatively young – mostly managed by family members of the first or second generation or in a few cases the third generation. They have since diversified their business interests and many have become successful conglomerates with multiple locations or business activities, including retail, automotive, construction, importing, shipping and travel, insurance, agriculture, financial services, real estate, and manufacturing. Some have synergistic operations which have enabled them to participate in the development projects that have shaped the region over the past decade.

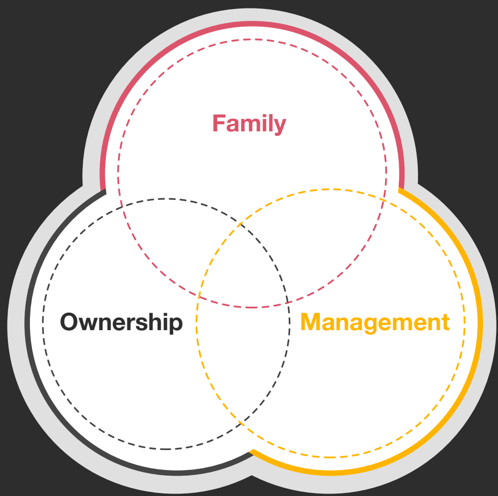
Although strong cultural traditions, including respect for older generations, have to a certain extent protected the families from conflicts, we are beginning to see an increasing number of family disputes in the region.

[1] PwC Middle East Family Business Survey 2016
[2] Family Business Council - Gulf

Why do conflicts occur in family businesses?

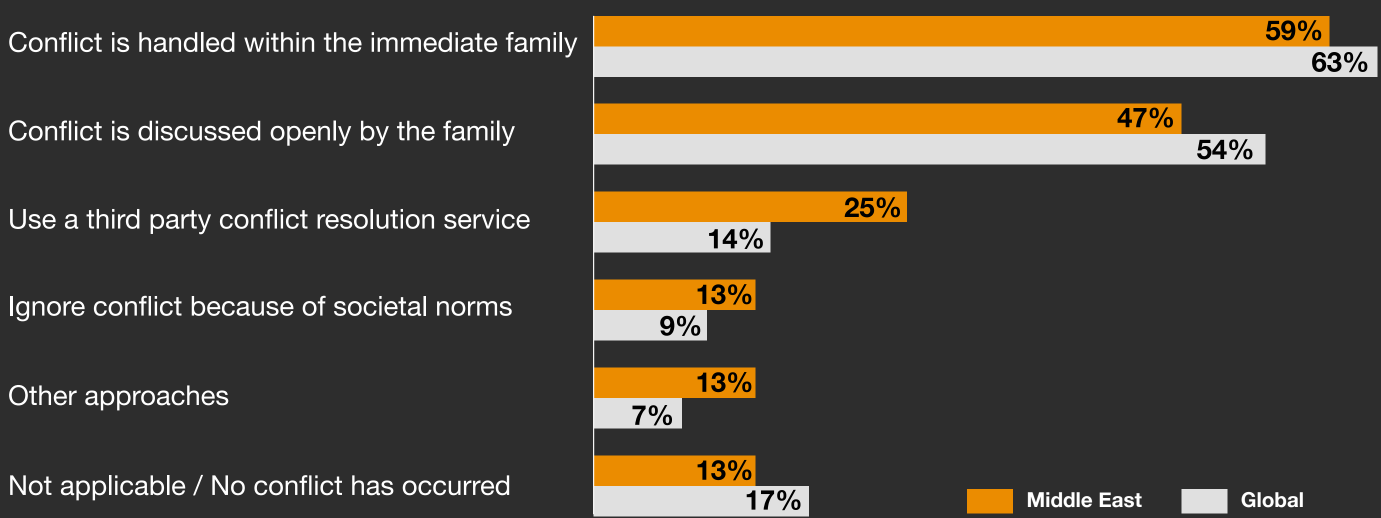
The two greatest threats to successful continuity of family businesses are conflict and succession. Conflicts in family businesses are rarely caused by poor business performance – most arise because family owners feel that their needs are not met. Conflicts also surface when there is a lack of understanding and communication between the three family dimensions – namely the family, owners and management.

Family enterprise as a complex system comprising of three overlapping sub-systems



Understanding and managing these conflicts becomes the key to survival of both the family and the business. Everyone within the family will have their own point of view which will differ based on the individual's personality but also where they are positioned within the family ecosystem. Some family members will be active shareholders involved in running of the business while others may be passive shareholders. When you are actively in the business you understand the challenges the business is facing. On the other hand, when you are not actively involved you might not have the same insights. This divergence in knowledge can easily lead to conflicts.

How do Middle East family businesses manage conflict?



The core issues likely to create tension within a family business include but are not limited to:

- Decisions about the future strategy and direction of the business
- Performance of family members actively involved in the business
- The setting of remuneration levels for family members actively involved in the business
- Decisions around who can and cannot work in the business
- Family members actively involved in the business not consulting the wider family on key matters
- Decisions about the reinvestment of profits, allocation of capital and the payment of dividends
- The role 'in-laws' should or should not play in the business
- How can family shareholders exit?
- Agreeing on the basis of the valuation of shares in the business for those exiting the business
- Choosing the future leaders of the family and business succession

How do conflicts impact family wealth?

Erode successful family businesses

Unresolved conflicts between family members often lead to the destruction of the family business and its value as disintegrating trust results in the creation of smaller less effective units.

Impact family harmony and relationships

Family cohesion and harmony are negatively affected when family members start fighting with each other. Conflicts often end with family members not only leaving the business, but also breaking ties with the family.

Freeze assets and family wealth

In the Middle East, a number of family disputes have ended in court where strict rules are imposed on the management of the disputed assets. In some cases, the assets of the business have been frozen until the satisfactory resolution of the dispute.

6 steps family businesses can take to help minimise conflict

Most family businesses have reasonable governance procedures to deal with the business dimension. However, few have set up formal governance structures for the family and owners dimensions. We have outlined six key steps that family businesses can take to minimise conflict and balance their business priorities with the personal.

01 Agree on a common vision

Without unity of vision it is only a matter of time until the family finds themselves in conflict. Therefore, the crucial first step that families need to take to minimise conflict is to align around a common vision and formulate a strategy for the business.

02 Establish a family council

Families can create family councils or shareholders' assemblies – a separate gathering from the board of directors – for the family owners. This council is a forum which allows family owners to actively engage in a debate surrounding ownership and family issues – it's vital for all family members to be able to participate, regardless of whether they are actively involved in the management of the business. This lessens the threat of family conflict and improves the likelihood of the next generation embracing and supporting the family business.

03 Create family rules

Through the family council or shareholders' assembly, the family can agree on a set of rules which address key ownership issues. These values, often referred to as family protocols or the family constitution, are vital for establishing strong intragenerational business relationships. It is important that such family rules are legally enforceable – new legislation is proposed in this area but it doesn't cover the full range of matters that ought to be covered by a family's framework of rules.

04 Decouple family issues from business issues

Very few family businesses in the Middle East set clear boundaries between family and business activities. This lack of clear separation increases the potential for conflict between family members. Decoupling or separating ownership issues from management issues can help balance personal relationships with contractual obligations and have a more viable family business. Ensuring that operational and management issues are dealt with in the family's governance and legal framework will create transparency and clarity, helping to mitigate the potential loss of trust between family members.

05 Develop a concept of fairness in the family

Divisions and fragmentation between family members can occur if family members suspect others of benefitting at the expense of the family. It is important that the whole family makes a real commitment to fairness, for example by creating a family constitution that outlines the concept of fairness.

06 Agree on a conflict resolution mechanism

Most family businesses have conflicts but only a limited number have tools for dealing with disputes. These mechanisms are critical for family members to air out their differences and resolve any issues in an amicable way. For family businesses, it can be especially beneficial to set up conflict resolution or arbitration committees that include third parties who are trusted and well respected by the family and offer their independent and objective views. This go-between can provide a more structured negotiation and longer lasting results. Another benefit to creating a clear conflict resolution mechanism that falls short of litigation is that conflicts can be kept private, can be resolved quicker and at a lesser cost than by litigious means.

Resolving an existing family conflict

When conflict resolution with the help of committees and arbitration fails, there are additional measures that can be taken to help the family reach a suitable and formal resolution which will prevent business fragmentation and maximise value preservation.

Tracing of assets

When family members don't have visibility of all aspects of the business and questions arise about mismanagement of the business, for example nepotism, suspicious activity or syphoning of funds, it can be helpful to trace all the assets both locally and globally.

These assets can include:

- Companies
- Real estate
- Plant, machinery and vehicles
- Stock investments and bonds
- Bank accounts, trust funds and other forms of monetary funds
- Debts and tied banking facilities
- Other assets

Performing independent and evidenced asset tracing procedures is the critical first step in dispute resolution and can help all family members continue the discussion from a common standpoint. It is also important to mention that asset tracing can be completed without the knowledge of the family members involved in order to avoid any further conflicts.

The asset tracing procedures can also reveal any changes that have been made to those assets in the past, for example transfers or changes in ownership – changes that are often a concern and can be related to syphoning of funds or the sale of assets without the knowledge of other family members. Asset tracing activities can be carried out alongside legal due diligence exercises to verify ownership, understand the history of an asset or asset class and identify encumbrances or liabilities affecting assets.

Establishing the facts to address concerns

The other critical step in conflict resolution is establishing the facts to address the concerns raised by all parties. It is important to present factual information to enable the parties to reach an amicable conclusion on contentious matters that might have caused conflicts among the family members.

This can be done by gathering information and intelligence through several resources, including interviews with relevant people who may know about these concerns, review of financial records, review of electronic records and other sources that may have information in relation to the allegations or concerns.

Valuation

Once there is clarity about the assets, the next step in the dispute resolution process is often agreeing on the market value of the assets. This can be accomplished with the help of an independent third party provider of valuation advisory services.

During this process, discussions are conducted with the Board of Directors, senior management and key employees. Historical and projected financial and operational data is analysed to highlight the financial risks related to the business and to establish an appropriate value for the relevant assets.

Where there might be concerns of any mismanagement by the owners or the key management team, or particular financial risks that need to be considered, a detailed review of the historical financial performance of an existing business might be carried out as part of the broader valuation exercise. As part of the valuation and financial review, areas such as related party transactions, the sustainability of the earnings, the cashflow generation and understanding actual net debt (including all debt-like and off balance sheet items) will typically be considered to help determine the valuation.

In addition to financial matters, there are a number of additional factors (both qualitative and quantitative) that might need to be considered in the analysis. These include, for example, the following:

- Is an influential shareholder planning to depart?
- How are business operations impacted by decision-making at the group or shareholder level?
- Are there corporate governance processes in place?
- Are the interests of shareholders and management team aligned?
- In the case of conglomerates, are parts of the business kept in the portfolio due to historic or sentimental reasons?
- If the group is split up, will there be any destruction of value due to inter-relationships between group companies?
- Are the interests between any incoming external shareholders and the family aligned?

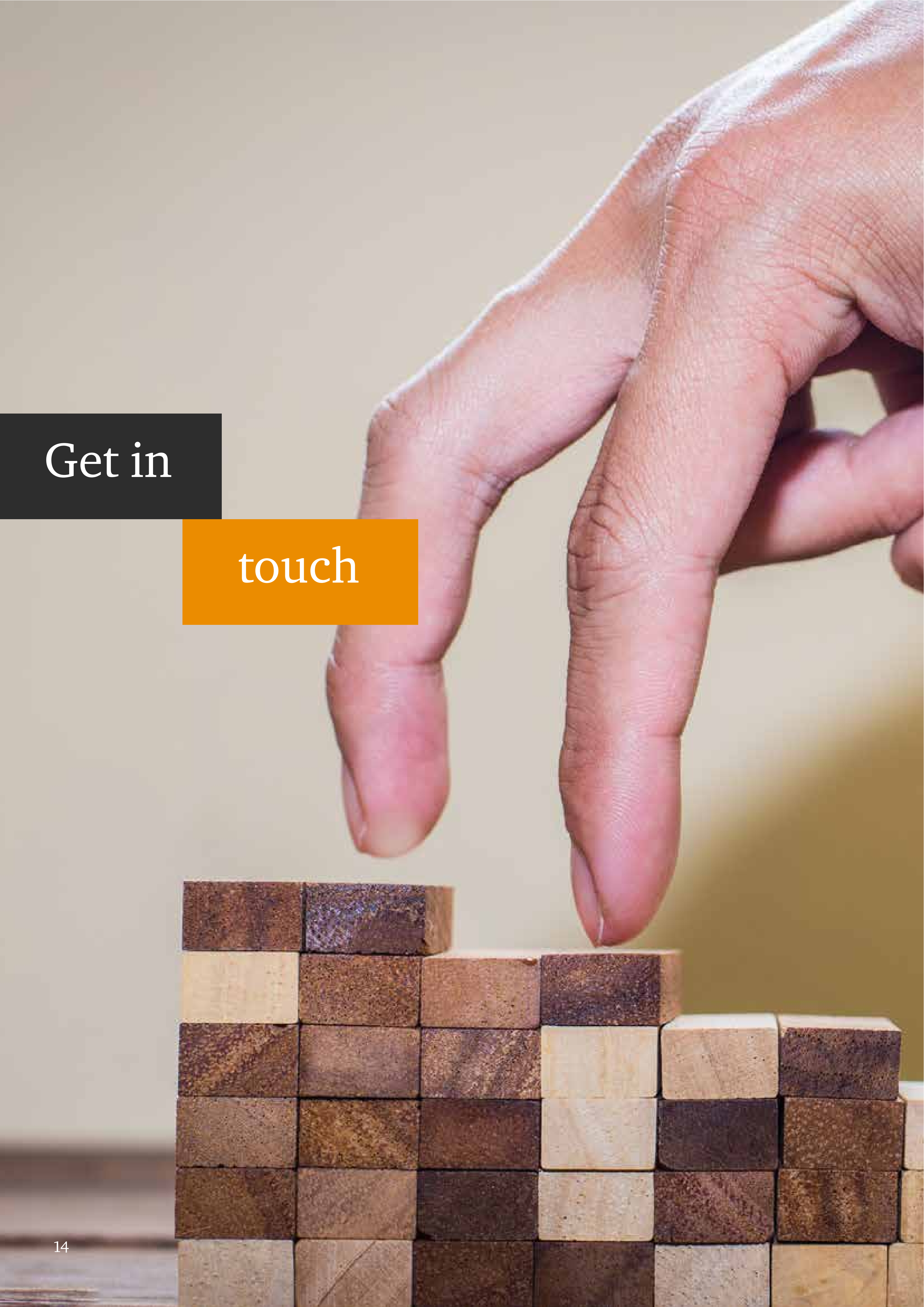
Reconciliation options to resolve the conflict

Once the valuation is complete, the family members have a number of options for resolving the dispute amicably. These reconciliation options will depend on the relationship between the family members and their alignment with the results of the valuation and other steps taken.

Options for reconciliation are as follows:

- The first option, and relatively the easiest, is an agreement between the family members to distribute the assets, such as real estate and operating companies, amongst themselves based on existing ownership portions. This can be achieved without needing to strip off any assets and can help preserve value. A legally enforceable agreement between the family will help inform the process of distributing the assets.
- If the members of the family remain in conflict over the distribution of the assets or part of the assets, they can agree to become partners in the assets based on the existing ownership portions outlined for each family member.
- Another option that can decrease the chance of fragmentation is for family members who share a similar vision and interests to form groupings.
- The final option is to sell the assets and distribute the proceeds as set out by existing ownership portions. It is important to mention that it's permitted for the family to conduct any such sale in private and restrict it to only the members of the family. This can prove helpful should one or more of the members wish to buy the assets under dispute from other family members who wish to sell.

Get in touch



PwC has been advising entrepreneurs and their families for more than 160 years. Today, we provide services to 84% of the top 750 family-owned companies globally,[3] including a number of family businesses in the Middle East. Our Global Family Business Network includes more than 3,000 experts and partners specialising in advising and auditing family-owned companies. In the Middle East, PwC is also the only professional services provider that has an established and unique legal services offering for family businesses.

We understand that while every family-owned company is unique, they all share some common characteristics that make them successful. We have analysed these characteristics and developed our "Owner's Agenda" methodology which addresses both family and business challenges.

To find out more about how we can help your family business, please visit us at www.pwc.com/me or get in touch.

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3 Family Capital's Global Family Business Ranking

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Established in the Middle East for 40 years, PwC has 22 offices across 12 countries in the region with around 6000 people. (www.pwc.com/me).