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Leading the future in the Gulf:

The evolving role of owner managed businesses

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White paper, 2016

The business environment in which Owner Managed Businesses (OMBs) operate within continues to evolve with the emergence of new technology, innovation, changes in financial management, client needs and increased regulation.

Change can often be predicted and thus prepared for, however at times this can be unexpected and unavoidable, requiring robust infrastructure not only externally but internally too, in order to survive the impact that it brings. These changes bring along a range of challenges and opportunities for both businesses within the region as well as external investors.

Often, OMBs have defined strategies which are led by generational change as opposed to generic changes in the ecosystem in which they operate. This at times can be deemed perilous and given the dynamics and influence of OMBs, they must embrace and be ready for change today for a thriving tomorrow. OMBs have played an instrumental part in the development of the GCC as a region and continue to do so, further placing the territory on the global map. As the Gulf economies have strengthened, so too have these businesses which have played a paramount role in aiding economic growth. OMBs account for over 80 percent[1] of the Middle East's non-oil economy, approximately 5,000 medium to large OMBs exist in the Middle East with net assets totalling US $600 billion according to Al Masah Capital's MENA Family Business Report[2]. These companies constitute 75% of the private sector economy and employ 70% of the labour force in the GCC region, highlighting the sheer scale and influence that they currently have.

Some of the largest OMBs were incorporated over 60 years ago, when the region was relatively unknown and operated on its once buoyant oil & gas, pearl and shipping industry. The opportunities and landscape promoted the emergence of OMBs, which have today grown in both footprint and scale to become some of the largest conglomerates in the region who have since, diversified into a number of sectors.

Where once, OMBs had a land of opportunity, the increase in regulation, globalisation and foreign direct investment (FDI) including agency law and 100% foreign ownership law is profoundly changing the business landscape within the Middle East. The introduction of VAT and discussions on other forms of taxation are some of the key initiatives undertaken by Governments towards diversification of income sources, due to the falling oil prices. As a result of such, what does this mean for OMBs? Are new FDI regulations and recent developments set to increase the competitive landscape? Would the introduction of VAT lead to greater governance and compliance? Do they present opportunity or risk? These are some of the questions that we set out to discuss in this white paper as we explore how recent developments and the transformation of the economic system is set to revolutionise the way OMBs operate in the near future within the Middle East and how they can no longer remain stagnant.

1 Family businesses face key challenges in Middle East, Khaleej Times (online)
2 MENA Family Businesses: The Real Power Brokers? Report by Al Masah Capital

Adapting to change in order to lead the future

There is no refute that OMBs in the GCC have done exceptionally well. With research showing the correlation of family connections with enhanced success, the role of OMBs has historically been clearly defined. Fast forward fifty years and we now see businesses operating in an increased global environment, competing with businesses that have stringent policies, enhanced governance and succinct corporate structures to promote consistency and efficiency no matter where in the world they operate.

This has proved to be slightly challenging for local OMBs, who still maintain tradition and generational ownership models. The current period of OMBs is increasingly seeing the first generation founders passing on the business to the second generation, who are met with a challenge that their founders may not have been faced with – how do you adapt to change to continue leading the future? How do you remain locally and now, globally relevant?

Some recent changes have enforced OMBs to think about the notion of relevance. The removal of subsidies and adoption of OECD (Organisation for Economic Co-operation and Development) rules on transfer pricing which have been introduced, are impacting how OMBs approach international taxation and the cost of commodities. The fall in profit margins, operational efficiencies and functional issues raised by wider transparency and regulatory requirements are some of the factors which OMB's need to consider.

The removal of subsidies saw the oil price being deregulated, with the UAE being one of the first countries in the region to link gasoline and oil prices to the global oil markets, thus being the first country in the Gulf to remove transport fuel subsidiaries. Suhail Al Mazrouei, the UAE energy minister said that the change is part of the government's plan "in diversifying sources of income, strengthening the economy and increasing its competitiveness in addition to building a strong economy that is not dependent on government subsidies[3]." Moreover, recently at the previous World Economic Forum in Davos, the minister stated "the UAE will extend its economic diversification strategy by removing further subsidies on energy, in particular subsidies on electricity and gas sold to power generators[4]".

As businesses continue to operate around the world and OMBs look to enter other key global economic markets where MNEs (multinational enterprises) play a key role, the impact of OECD and BEPS (Base Erosion Profit Shifting) should not be taken lightly. The introduction of these rules will ensure that the taxable profits are not falsely removed from their territory and that the tax levies reported by these enterprises in their countries is parallel to economic activity undertaken in another.

Francesca Lagerberg, Global Head of Tax in Grant Thornton, notes that tax is increasingly becoming a reputational issue and this is raising uncertainty in board rooms. It is essential, of course, that businesses operate within legal and regulatory boundaries, but they also have a responsibility to their investors to keep costs down; and this includes tax. She says *"it's when executives are called up to answer legislative committees' questions or respond to negative press stories, that we see the extent of the shift in public scrutiny around tax issues. It's not whether companies are acting within the law but whether they ought to pay more. Simply telling businesses to pay their 'fair share' is not a viable alternative to a clear set of rules or principles. What constitutes a fair share?"*.

3 UAE removes Fuel Subsidy as Oil Drop Hurts Arab Economies, Bloomberg (online)
4 UAE to cut remaining energy subsidies, minister says, The National (online)

Adapting to change in order to lead the future

Within the GCC region, the government of the Kingdom of Saudi Arabia (KSA) has been actively involved in the BEPS discussions from the onset, given they are a member of the G20. KSA is also a part of the group responsible for approving the final BEPS recommendations and have committed to implement the BEPS package. The UAE too was one of the invitees to the recent gathering in Kyoto, Japan where representatives of more than 80 countries[5] and jurisdictions came together to push forward ongoing efforts to update international tax rules and has shown an inclination to implement BEPS by 2019. Meanwhile, the Ministry of Finance (MoF) signed a MoU with the OECD to extend the jointly established training programmes until 2019[6], facilitating the region to develop a better understanding of the international taxation principles.

In the UAE alongside BEPS, the introduction of corporate tax and value added tax have been in discussion for the past few years. In a report issued by the International Monetary Fund (IMF) in August 2015, it was highlighted that the UAE could generate up to 7.4 per cent in extra revenue by introducing these taxes. There is currently no personal income tax or value added tax (VAT) payable within the UAE which has been known as a tax haven. Following the announcements earlier this year, the GCC countries have finally agreed to introduce VAT at a rate of five per cent in 2018, however, they are yet to finalise their implementation policies. An IMF report suggested that the introduction of VAT is likely to help mitigate the drop in government revenues to an extent, caused by the falling oil prices. The UAE will be the first GCC country to introduce VAT in 2018 and is expected to generate approximately AED 10bn to AED 12bn revenues in its first year of implementation[7]. Also, the Ministry of Finance (MoF) has outlined details about the first phase, under which companies which record annual revenues of over Dhs 3.75m will be required to register under the new system and shall be liable to pay VAT.

The introduction of BEPS and application of VAT across businesses, once the laws have been passed in key economies will lead to increased compliance with new rules and regulations. OMBs will need to absorb new systems and process in order to ensure transparency and embed the changing practices of taxation. This would also include reassessing the overall business strategy and ensuring all parts of the business are aligned to encounter impact of increasing scrutiny. As a result, a more synchronised and transparent local landscape will enable OMBs to leverage the benefits of globalisation and attract investments into the region.

As the world becomes more accessible, OMBs also need to embrace the rise of FDI which sees foreign investors coming to territory which was once ‘exclusive’ to them as a local OMBs. Globalisation and the need to generate additional revenue has further put the Middle East under the spotlight and thus Saudi Arabia and more recently the UAE continue to look for alternative revenue sources. One of which, saw Saudi Arabia opening up their stock exchange to foreign investors for the first time in history in a bid to tear away from being an oil dependent economy. Liberalising the stock market in Saudi Arabia was a bold move, which is set to attract substantial investment to the Kingdom, a change which was welcomed given that Saudi Arabia was one of a very few global exchanges that restricted foreign access.

5 First meeting of the new inclusive framework to tackle Base Erosion and Profit Shifting. OECD.org
6 MoF and OECD renew MOU for another three years, Ministry of Finance website
7 UAE introduces VAT threshold for firms in phase 1, Gulf Business (online)

Adapting to change in order to lead the future

"Saudi Arabia's Vision for 2030[8]" envisages to further improve its business environment and provide development opportunities to the private sector. The three pillars of vision include:

1. Position as the heart of the Arab and Islamic worlds
2. Leading investment capabilities, and
3. Strategic geographical position.

The determination to become a global investment powerhouse is one of the key pillars and the Government has introduced a number of programs such as the regulation review, strategic partnerships and privatisation program to name a few. Such initiatives will help build a more conducive environment for foreign investment. This provides a great platform for OMBs to explore local and global partnership opportunities.

Should the other countries in the region introduce similar plans as done so in Saudi Arabia to foster foreign investment including liberalisation of the stock markets, it will considerably change the landscape – with home grown brands and businesses becoming owned by investors around the world.

With the recent slump in the oil and gas sector, six nations in the GCC have stepped up their effort to attract FDI to their capital markets. For example, Nasdaq Dubai has introduced trading in single-stock futures on shares in some of the large companies of the country with intention to draw fresh money[9]. Also, the Securities and Commodities Authority (SCA) has noted an increase in the confidence of local and foreign investors in UAE securities market.

Alongside this, there has been recent speculation that large international brands may soon be in a position where they no longer need to have a local sponsor to operate within the GCC. At present, foreign companies operating in the UAE, must be majority-owned (51 per cent) by a UAE citizen as stipulated in the Agency Law. Businesses wanting to retain full ownership must operate in one of the UAE's many free zones, which may not provide the same level of exposure as they could do so, by operating elsewhere in the country. Currently, OMBs provide access into the GCC market which allows these OMBs to maintain exclusive rights and represent the international brand in the region. As a result, international brands looking to operate in the region must relinquish some elements and management of the brand which they would traditionally maintain when operating in other key international markets.

However, the notion of shared ownership has been probed and more recently saw Apple establish a Middle East headquarters in Dubai which is said to have been done so under a 100% ownership model as reported by Bloomberg[10]. Where once the landscape of the country was semi-owned by local sponsors, similar approaches as taken by Apple could see this element of control and local ownership being removed, which would impact OMBs significantly as the element of shared ownership is relinquished.

8 Vision 2030 – Kingdom of Saudi Arabia website
9 Nasdaq Dubai begins trade in single-stock futures, Arabian business (online)
10 Apple to have 100% ownership and control in the UAE, Techview (online)

Adapting to change in order to lead the future

"According to Bloom and Kotler "the PIMS study shows that businesses with market shares above 40% earn an average ROI of 30%, or three times that of those with shares under 10%[11]." This further pre-empts the notion of the increasing value of 100% ownership which promotes foreign brands to maintain full ownership and control of the brand they represent, no matter where in the world they do business allowing them to maintain a sizeable market share.

International brands who enter the market as such, will bring with them increased governance structures, policies, customer service metrics, global best practices and lead to attracting highly qualified talent. As a result of such, competing against these brands will become increasingly difficult for OMBs and local brands who may not have such stringent and innovative measures in place.

Further endorsing this ownership model in the UAE, Abdullah Al Sale, the Under Secretary for foreign trade and industry said[12] "The foreign direct investment law is now in the final stage. It has been passed from the Ministry and will go to the UAE Cabinet and then to Federal National Council for discussion". He went onto state that "The new law will allow foreign equity ownership up to 100 per cent in certain sectors where we need to attract foreign investment, knowledge and technology".

Once the law is passed, it will change the landscape of the UAE to be known as the global hub of the Middle East. This in turn will mean that OMBs will need to raise the stake and enhance their resilience in an increasingly global but yet local economic landscape. As revealed before, FDI will not only support in economic diversification but it will also open up new business avenues, promote new business models, increase regulation and internationalisation of doing business in the Middle East.

This in turn will create a complex business environment, with international brands hiring top talent from key economies. Decision making roles within a OMB still tends to be held by family members who may make a decision based on history and emotion hence unknowingly promoting nepotism, with further advantages and disadvantages highlighted in figure 1 and 2 overleaf.

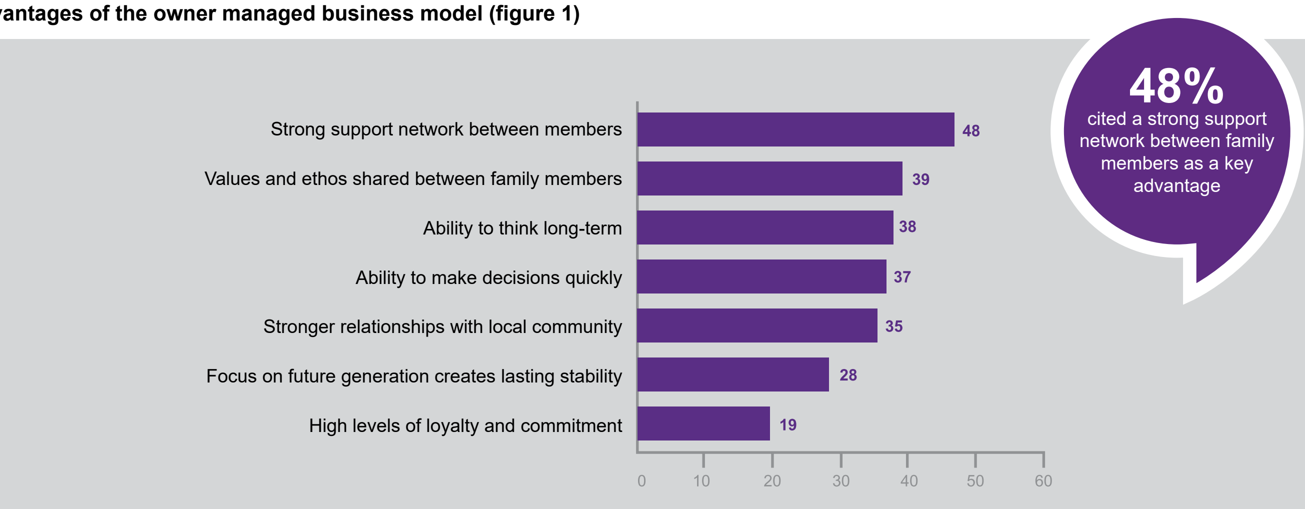
To further compete in the changing environment, OMBs need to embrace a diverse and dynamic board, introduce audit committees and independent advisory boards which will promote 'new ways' of doing business that adapt to global demands and needs, thus further safeguarding the future, allowing them to remain pertinent in a period of change.

11 Strategies for High Market-Share Companies, Bloom & Kotler, Harvard Business Review (online)
12 The UAE investment law to come soon, Ministry of Economy says, Gulf news (online)

Adapting to change in order to lead the future

Research conducted by Barclays Wealth Insights & the Economist Intelligence Unit[13] found that one of the key advantages of an owner managed business (highlighted in figure 1) was that there is a strong support network between family members (48%) which enables businesses to grow, given the increased levels of trust that is instilled. This was followed by the ‘values and ethos’ (39%) shared between family members, which are often aligned to achieve the same objective, along with ‘thinking long term’ (38%), ‘ability to make decisions quickly’ (37%) and ‘stronger relationships with the local community’ (35%), all of which are crucial for successful organisations and promoting long term growth.

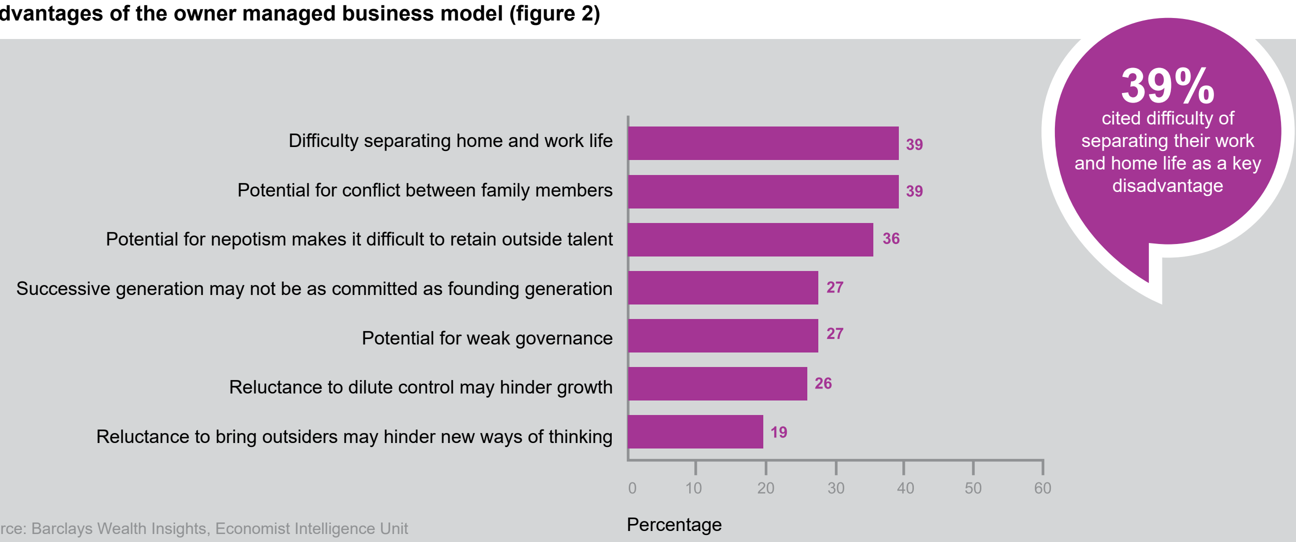
Advantages of the owner managed business model (figure 1)



Source: Barclays Wealth Insights, Economist Intelligence Unit

In contrast, the research found that one of the key disadvantages of an owner managed business was that family members found it difficult to separate their work and home life (39%), thus finding it difficult to maintain a work life balance. This was followed by ‘potential for conflict between family members’ (39%) which is often inevitable given the generational challenge that can occur, along with ‘potential for nepotism’ (36%) and the successive generation showing not as much commitment as the founders (27%) along with the ‘potential for weak governance’ (27%) which still remains a key challenge for family owned businesses.

Disadvantages of the owner managed business model (figure 2)



Source: Barclays Wealth Insights, Economist Intelligence Unit

13 Barclays Wealth Insights in association with the Economist Intelligence Unit, ‘Family Business Insights’

Given the level of change that is being introduced which continues to alter the way in which OMBs operate, it is important that they remain cautious and willing to adapt to the level of change required. If approved, the change will inevitably have a significant impact on their business and their level of competiveness, therefore change must be prepared for and embraced. It is deemed prudent that OMBs adopt corporate governance to secure the future and approach succession planning and generational transition both effectively and efficiently. The initial GCC Family Business survey[14] further endorses this and found that although 66% of OMBs in the Middle East said they are starting to embrace the principle of corporate governance, only 33% of these businesses actually have a coherent corporate governance system in place.

In line with the above, the regional association of Family Business Network International has recently introduced the concept of a voluntary governance code with the intent to enable efficient succession planning[15]. The code includes a checklist of activities which businesses should consider and plan for. Abdul Aziz Al Ghurair, the chairman of the Family Business Council-Gulf, in recent interview stated that they have adopted the best practices from across the globe and integrated it with the local GCC insights to develop a governance code which is more relevant for the region.

With Middle Eastern OMBs said to be looking to expand to South Asia and hence expanding beyond borders[16], it is imperative that they embrace globalisation and prepare to take part to compete in changing times. Whilst the Middle East has become much more accessible to global investors, so too has the rest of the world (with the likes of India, Iran and Egypt being on the radar) for Middle Eastern investors and OMBs, giving them greater access to the world and the wider region.

The Middle East economy benefits from a youthful society and with increased emphasis on innovation, leading the future and socialisation with global counterparts; it will continue to benefit the wider economy for generations to come. Governmental initiatives, increased investment and access to foreign markets have aided in firmly putting the Middle East on the global map. Embracing change now and promoting enhanced measures, regulation, processes, governance and competitiveness, will in turn reap reward for the region's future leaders.

As Groysberg and Bell state in their Harvard Business Review article,

"family-owned business boards need to become better at governing by implementing best practices and processes because good governance may lead to higher survival rates and smoother generational transitions," especially with globalisation and increased external competition[17] and hence, the time for change within OMBs has never been more so pertinent than now.

14 GCC family businesses need to double down on governance, Gulf news (online)
15 Family Business Council issues governance code, The National (online)
16 Arab family businesses eye East Asia for expansion, Shanghai Daily (online)
17 Generation to Generation: How to Save the Family Business by Groysberg and Bell, Harvard Business Review

The Author: Hisham Farouk

Strategic advisor to family owned businesses, mentor to a number of leading regional entrepreneurs, board member and second generation dynamic leader.

Hisham is the CEO of Grant Thornton in the United Arab Emirates, as a dynamic leader who has a professional and academic footprint in the United States, United Kingdom and across the Middle East region, he is known to be the driving force behind many private and public organisations growth strategies, who today continue to mature under his mentorship and strategic input. With over eighteen years of professional and commercial experience he has led high profile advisory engagements for some of the largest groups in the region.

Known as a key influencer in the UAE for OMBs, he has advised a number of well established and reputable businesses, supporting them to invest and grow effectively across the region.

Hisham also works closely with numerous financial institutions in the UAE, mainly advising them on regulatory and compliance matters. He sits on various boards including a renowned regional investment firm and is a patron and avid mentor for dynamic SME's and entrepreneurial businesses. Hisham also mentors a number of start-ups and works closely as an entrepreneur with REACH and Endeavour, a global not for profit organisation who support multi-million dollar SMEs.

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He is also a committee member for Elevate Dubai and regularly provides strategic advice to the GCC chapter of the 30% club. He actively supports the young leaders of tomorrow through various initiatives including working with the government sector to support emiratization and develop UAE nationals.

He regularly publishes thought leading content and articles in a number of established global and regional magazines including Arabian Business, Global Citizen and cfi.co, to name a few. Hisham was cited by the National Newspaper as being “the right hand man for Dubai families” and is well known within the region as being a specialist within this business arena. He has published a related white paper on “Leading the future in the Middle East: The evolving role of owner managed businesses” and regularly writes a blog sharing his perspective on relevant owner managed business issues.

Along with actively writing about key issues and topics, Hisham is also an active media spokesperson. Hisham has delivered a number of thematic and topical presentations around the world, along with being a key panelists for a number of large international brands.

He has presented to a diverse audience ranging from the leaders of tomorrow to senior C-suite professionals who represent some of the largest companies in the world. A selection of his presentations have been on the topic of Innovation, Macroeconomic Overview, Regulatory changes and Elements impacting family owned businesses.

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