At the crossroads

Private equity opportunities exist for GCC family businesses, but they must adapt to the changing business environment in order to fully capitalise

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The slowing of the world economy and the restrictive credit environment has pulled back the curtain on many Gulf Cooperation Council (GCC) family firms, revealing structural weaknesses. However, the challenges posed by the economic crisis are not without opportunity.

Indeed, the crisis provides strong impetus to reshape GCC family businesses in ways necessary to ensure firms' long-term survival and success. For many family firms, private equity can provide an effective framework for accomplishing this goal.

As the summer months passed, economists, business people and commentators speculated over the timeline of an economic rebound in the Gulf region. Such discussion looked at a range of economic indicators, including employment, oil demand, budget projections and inflation. In their commentary, one factor – the health of family businesses – seemed to be overlooked.

FAMILY TIES

Family businesses are a vital part of the economic fabric of the GCC economy. Some estimates indicate family businesses conduct more than 90 per cent of commercial activities and employ more than 70 per cent of the workforce in the GCC.

The defaults of the massive Saad Group and Ahmad Hamad Algosaibi and Bros (AHAB) earlier this year made it clear that the family sector would not emerge unscathed from the economic crisis. That controversy marked an end to loose credit practices regionally and exacerbated restrictive credit conditions.

The most obvious benefit of private equity investment is liquidity. There has been much talk of the appeal of family firms' holdings to the many private equity firms operating in the GCC in recent years. Such firms could purchase unproductive units, use sector-specific expertise to retool them and potentially combine them with other units, unlocking synergies. If family firms can make the difficult decisions necessary to part with such business units, private equity could provide them with badly needed cash while making a profitable return.

ABOVE: AHMAD HAMAD ALGOSAIBI

The benefits of private equity, however, may go beyond liquidity. Private equity firms can bring to bear the managerial expertise necessary to reshape family businesses by helping to pare down unproductive business units, boost productivity, raise funds, reform corporate governance, professionalise functions, and institute new systems and processes. These steps can prove crucial to securing the prosperity of the company. If permitted to invest in the company and to influence management, private equity can reshape the business for future growth.

There are a number of steps family firms can take to increase the likelihood that private equity firms will invest in their business. The first of these steps is formalising corporate governance in line with international standards. The process of strengthening internal controls, risk management mechanisms, and monitoring and reporting frameworks can reveal weaknesses and valuation affecting issues while instilling enhanced managerial discipline. Additionally, firms can recruit independent non-executive board members and bolster the influence and accountability of their boards by instituting typical board committees with written charters, policies and procedures in line with international standards.

WHILE OFTEN MAJORITY STAKES CAN'T LEGALLY BE SOLD, FAMILY BUSINESSES SHOULD BE OPEN TO TRANSFERRING MORE CONTROL SO INVESTORS CAN REALISE RETURNS

SEPARATION OF POWERS

Perhaps the most significant governance step that family firms can take is to separate ownership and management. Top management and the board of directors should coordinate with, but be independent of, the family. Such a measure would typically serve to encourage professionalisation of management, avoid succession conflicts, and increase transparency.

The improvement of governance and the professionalisation of management prior to a deal should also facilitate the implementation of new systems and processes after a deal. Further, the implementation of standard practices, including accounting practices, will signal to investors the reliability of a firm's figures and improve the likelihood of a successful transaction and later exit.

Lastly, family businesses in the GCC should be flexible and creative in structuring private equity deals. While often majority and controlling stakes cannot legally be sold, GCC family businesses should be open to transferring larger stakes and more control in order to allow private equity investors to realise expected returns. Structures involving hybrid securities, debt, dividends and warrants can be considered. Family firms may also consider allowing private equity investors the chance to exit through partial IPOs. Nasdaq Dubai has recently decreased its minimum offering requirement to 25 per cent in a bid to encourage this behaviour and entice more family businesses to offer shares for public trading.

Family firms have an honoured legacy in the Gulf for pioneering industries, exploiting new opportunities, and creating wealth. Today, many of these pioneers stand at a crossroads. Will they respond to current pressures by continuing with old ways of doing business, or by embracing change that will enable them to meet the challenges of an increasingly global economy? For many family firms, private equity investment can be an effective catalyst for change helping to meet those challenges. ●

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