مجلس الشركات العائلية الخليجية
FAMILY BUSINESS COUNCIL-GULF
Member of FBN عضو في

غرف دبي
DUBAI CHAMBERS

التميمي و مشاركوه
AL TAMIMI & CO

The future of UAE family businesses

Strategies for a successful transition

Contents

Introduction

During the UAE's first 50 years, many family businesses have risen to prominence with corporate and financial success. Established by founders with vision, they have capitalized on and benefited from, and in turn contributed to, the continuing dynamic growth of the UAE.

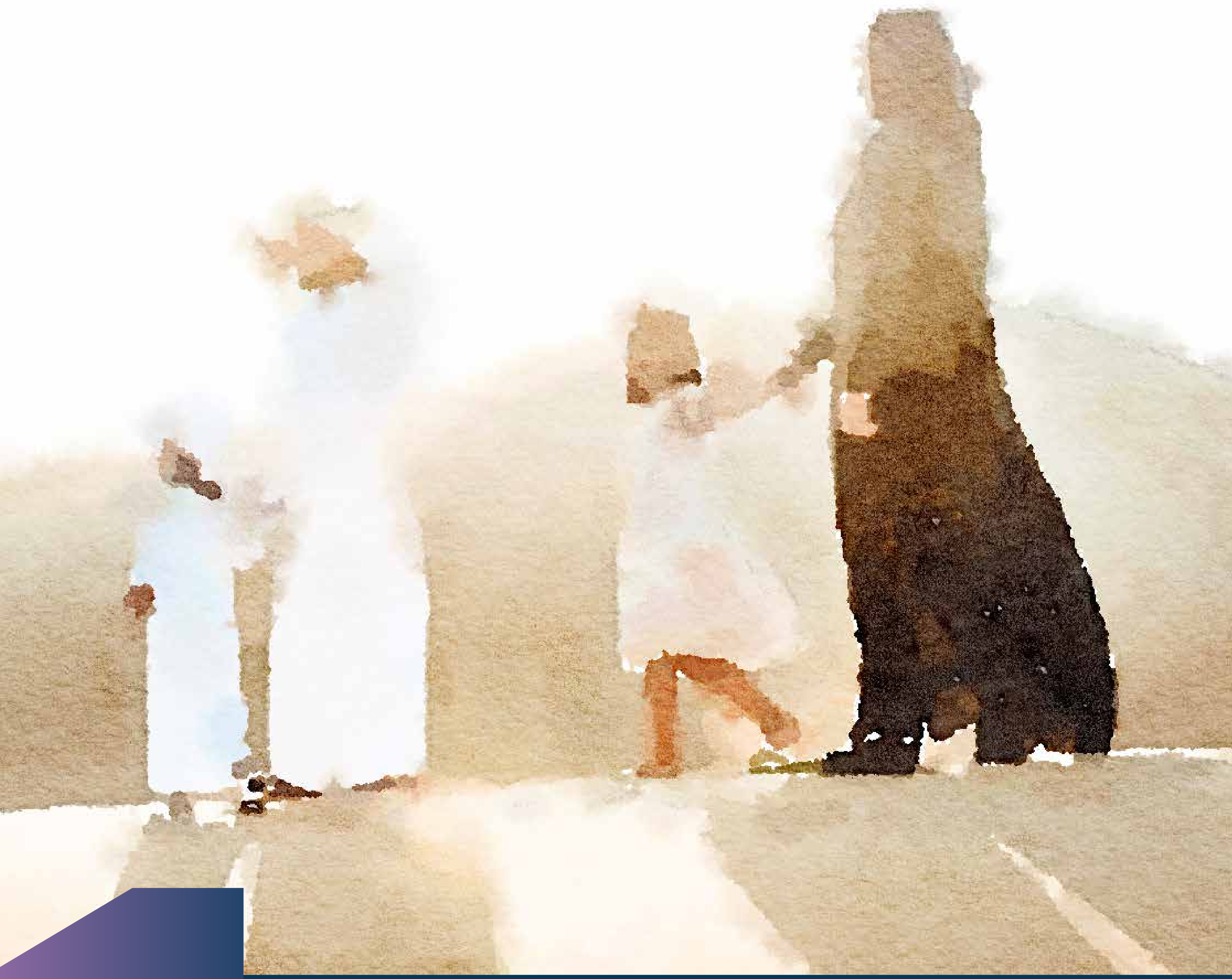
> **The final test of greatness in a CEO is how well he chooses a successor and whether he can step aside and let his successor run the company."[2]**

Now, many are at a crucial inflection point in their own history, with generational change occurring in tandem with technological disruption and intensified competition. The years ahead will be a test of their ability to manage the transfer of ownership and management to a new generation, along with the turbulence that comes with the process. And this goes to heart of our white paper: how to ensure the continued success and sustainability of family businesses in the UAE?

A great succession is one that hardly anybody notices – it is a non-event, but few see the artful planning and management that has gone on behind the scenes over an extended period of time. It requires a lot of family team-work; as Josh Baron, a leading family business expert says, "ownership is a team sport"[1].

Managing a smooth succession also requires enlightened leadership on a personal, family and professional business level. As Peter Drucker, a management expert, stated: "The final test of greatness in a CEO is how well he chooses a successor and whether he can step aside and let his successor run the company"[2]

[1]Et Josh Baron, Partner, Banyan Advisors, Webinar 2021
[2]Family Business Succession: The Final Test of Greatness, Craig E. Arnoff, Stephen L. McClure and John L. Ward, A Family Business Publication (2011)



1 Smarter succession planning for UAE families

Why make a succession plan?

Fundamentally, succession planning provides clarity to stakeholders in a family business about who the decision-makers are, what competencies are required from a successor, and what is the process of succession. A family has a blueprint - known and agreed upon - that they can all refer to when the occasion arises.

While setting a clear intention for succession, and developing a plan around it does not necessarily guarantee the longevity of a family business, research shows it helps in many cases. When a family begins to plan for succession, it automatically leads to a form of self-assessment to understand the family's current business and ownership structure. This process helps to detect any 'blind spots' in the business, enables them to see what aspects should be improved, and provides insight as to how the business can become more future-proof.

The benefits of succession planning

PRESERVES FAMILY UNITY

Succession planning helps to preserve a healthy family dynamic and safeguard family unity in times of uncertainty and crisis. It is common for familial relations to face pressure and tough challenges at different generation stages, if transition is unplanned. See Image 1 for more on how transition phases can impact family dynamics at different generations.

HELPS PROTECT AND GROW WEALTH

Succession planning in the context of transfer of wealth is a critical part of the family's financial strategy and a valuable method to grow the collective family wealth. It prompts the family to think about long-term asset protection, in particular what are the optimal legal structures, jurisdictions and ownership models to safeguard the family wealth. Succession planning will also prompt the family to think of their long-term wealth strategy – who will be making the necessary decisions and who will be the custodian. It can also be a means of raising the financial literacy of the next generation with regards to wealth management and financial markets.

A HEALTH CHECK-UP FOR THE BUSINESS

In the process of planning for the transfer of business ownership and management, the family will need to take stock of their collective assets. This may unearth crucial tax and legal considerations regarding inheritance and the transfer of assets – particularly if assets are spread across different jurisdictions. This process could lead to the establishment of a distinct holding company structure – independent of the trading business or group conglomerate – to optimize tax, diversify risk and sources of income, and allocate capital for philanthropic and entrepreneurial activities, which appeals to the next generation.

SAFEGUARDS BUSINESS CONTINUITY

A succession plan that covers the transfer of management also helps ensure the business to run smoothly, especially if there is an unexpected death or crisis. A company with a well-designed succession plan covering Board and executive management has a far higher chance of surviving and growing. A plan provides transparency, objectivity and allows for enough time to identify and groom future successors. For family businesses with third-party shareholders, it also helps manage investor confidence in the event of any unforeseen circumstances.

Generation games

The family dynamics involved in the transition of power between different generations can create some unique challenges

Passing from G1 to G2

For some families, the succession from first generation (G1) to second generation (G2) can be the most challenging, because there is no precedent or past example in the history of the family or the business. In many cases, G1 founders find it difficult to step away fully from the business, and emotionally resist giving up the reins. Typically, the G1 is an individual founder and owner, accustomed to full control and unilateral decision-making. This may or may not be sustainable, depending on how many G2 family members there are and their family dynamics. If the business adheres to a solo-leader model, then G2 members might have to compete for the top leadership role; and if they decide to switch to multiple leaders, they have to strike the right balance in the separation and division of power, which may include in-laws. Lastly, the business itself is typically larger and more complex during the time of transition than it was when the G1 founder launched the business, with entirely different external factors.

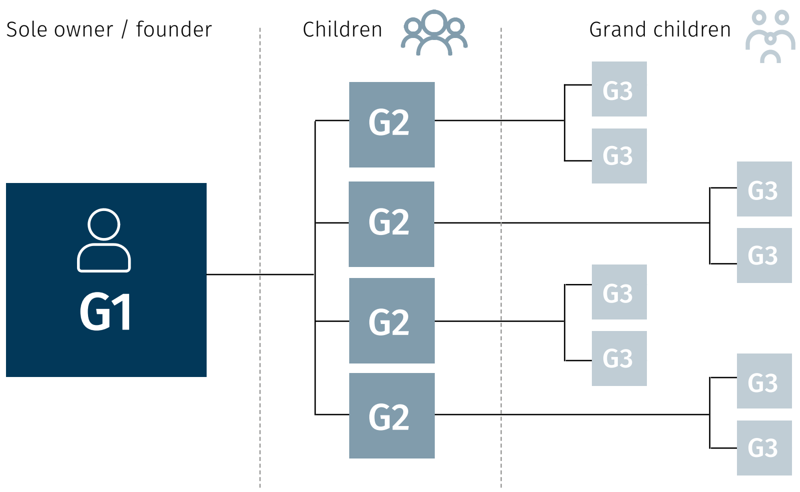


IMAGE 1

Passing from G2 to G3

The next wave of transition from G2 (children of the founder) to G3 (grandchildren of the founder) will also have some unique challenges, although at this juncture the family has the advantage of precedence and past experience in succession. If the family size grows significantly by G3, the complexity also grows with it, in particular with the introduction of branches with many in-laws and great grandchildren. Multiple members will be competing for a limited set of leadership roles. This can lead to unhealthy rivalry and politics in the absence of clear family employment policies and succession plans.

By the G3 stage, some extended family members may also feel removed and disconnected from the family business, and not be invested in its longevity. Rather than get entangled in complex succession planning, they may opt to exit the business completely, or push for fragmentation of the business. Any business entering the G3 stage must be able to grow enough to maintain the same per capita dividend levels enjoyed by G1 and G2 owners.

If a family does manage to transfer to G3, all the challenges from previous generations are amplified, irrespective of a rise or decline in family members. With a large family, all the issues of G2 are exacerbated. If the family is small in members, there are limited leadership options, and one or two individuals may feel burdened to carry the legacy, whilst having to sacrifice their preferred personal career path.

Global context

How policymakers around the world are helping family businesses

Countries around the world have provided institutional and policy support specifically for family businesses. These range from awareness-building and education, to legislation and regulation, and economic programs and incentives designed to facilitate the generational transition and continuity of family businesses.

GERMANY

- Supports its Mittelstand (SMEs) and family businesses to access global markets and human capital
- Centralized family business policies via the Ministry of Economy
- Based on 7 pillars, from facilitating financing to boosting exports

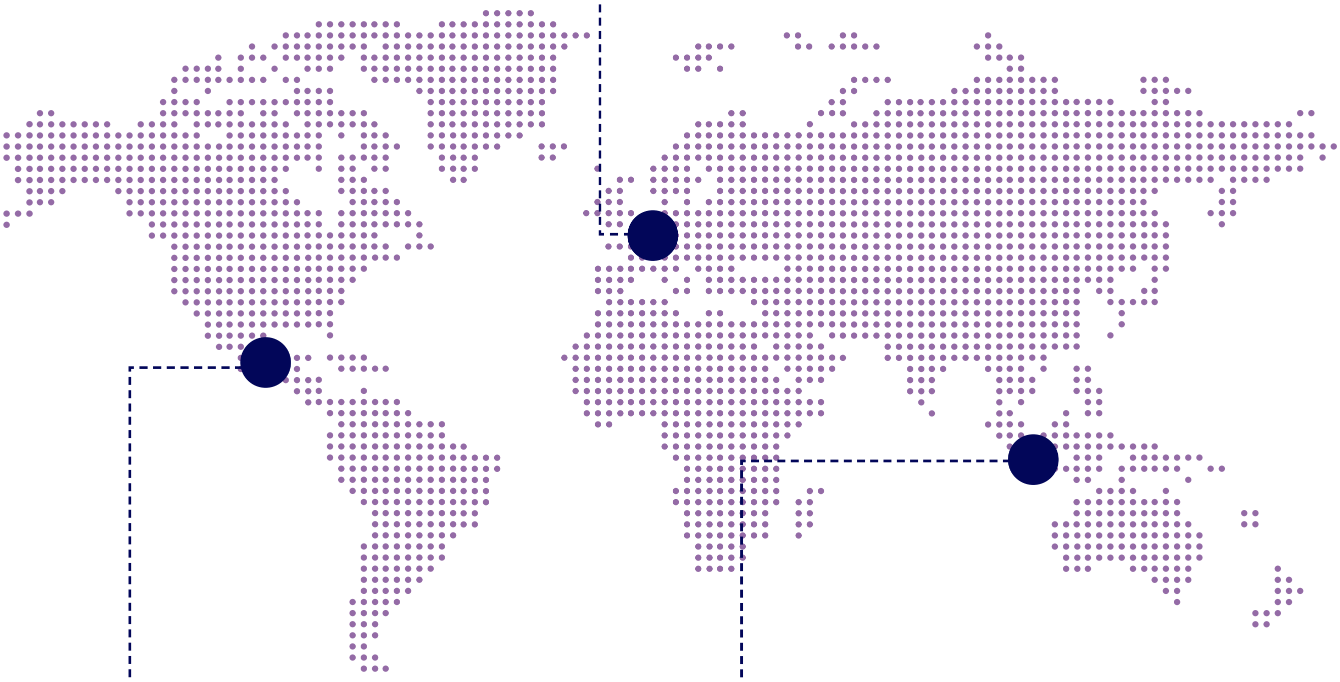


IMAGE 2

MEXICO

- Issued decrees and specific support mechanisms to support family businesses, notably taxation conditions
- Initiatives include financial ones (such as grants and loans), government guides for sector-specific family business and a dedicated online resource bank

SINGAPORE

- Dedicated government agencies to support family businesses and family offices, part of mission to make Singapore a financial hub
- Led by Economic Development Board (EBD) and Monetary Authority of Singapore (MAS)

2 Legal landscape in the UAE

There are a number of corporate structuring options available that can be customised to best suit the requirements of a family business.

Finding the right legal structures

Family businesses in the Gulf region have grown organically, capitalizing on opportunities as they have arisen. As a result they often have complex legal structures, with ownership spread across various family members in different jurisdictions. Therefore the first step towards building a solid foundation for a succession plan is usually to organize and streamline the existing corporate structure by placing all the businesses under the umbrella of a holding company.

For families with significant assets there are many benefits to this:

Shields against unpredictable risks
Companies have perpetual succession and so avoid problems arising from disability or death of the holder. As a consequence they can insulate the underlying businesses against disruption through bypassing probate and inheritance procedures, and their limited liability status can act as a shield for the stakeholders against unpredictable business risks.

Makes it easier to change asset ownership
Changes to the ownership of the assets are much easier to implement through the transfer or issue of shares rather than changing ownership of the underlying business assets such as real estate, trademarks, agency rights and business licenses (particularly in Middle Eastern countries).

It is possible to separate management from ownership
Companies permit separation of management and ownership through boards of directors.

Trusts

The use of trusts in succession and wealth planning is commonplace and brings significant advantages. Trust structures have evolved to capture all the benefits of corporate ownership, achieved through the use of corporate trustees and (in some cases) subsidiary companies.

At its heart, a trust is a separation of the legal and beneficial ownership of an asset, and this separation of interests allows control and ownership rights to be split between trustee and beneficiaries. The Trustee controls the assets, the beneficiaries are entitled to the fruits of the assets. For family businesses this important characteristic is the key to putting in place an arrangement which can protect the many interests of a widened family ownership, whilst at the same time insulating the governance of the business by incorporating a management structure that is distinct from ownership.

Within a trust, through either a discretionary arrangement or the ownership of fixed interests in the beneficial interest in the trust, family members can hold an entitlement to income and capital from the underlying businesses and assets held. This is within the consolidated ownership structure held in its entirety by the trustee.

While there is some additional complexity and expense involved in establishing and operating these corporate trust structures, they come with additional features that would not be available from a purely corporate structure:

The founder's wishes can be embedded in the company's future governance

The founder or 'settlor' of the trust can lay down and embed enduring rules covering the family assets, including rules as to management, use of assets, governance of the family business and entitlements of particular beneficiaries and succession.

There is greater flexibility in terms of assets and entitlements

Trusts can enhance flexibility in dealings with assets and with entitlements to economic benefits, including changes in allocation of capital and income to stakeholders from time to time; in contrast, capital payments out of companies are often subject to significant regulatory requirements (e.g., share buy backs, capital reductions).

Entitlements can vary from year to year

Trusts can give rise to "floating" ownership or entitlement to assets; for example, the controllers of the trust may retain year-to-year discretion as to how trust entitlements and economic benefits will be distributed amongst a potentially wide class of stakeholders.

Family assets are protected against any liabilities of individual beneficiaries

Such "floating" ownership can preserve family assets from attack by creditors of beneficiaries because the terms of the trust may confer no right of ownership, merely a right to be "considered" by the controllers of the trust at their discretion; until a discretion is exercised in the beneficiary's favour, the debtor beneficiary 'owns' no share of the trust assets.

Within the UAE, the free zones of DIFC in Dubai, ADGM in Abu Dhabi and ICC in RAK provide for the establishment of trusts and foundations.

Corporatised Trust Arrangements

To complement a structure designed to preserve wealth for the long term, corporatised asset holding structures provide the opportunity to establish governance frameworks, which help ensure that suitable decision making is in place for the future.

One sophisticated methodology for family ownership is the establishment of a private trust company ("PTC") as the holder of trust assets, which can be structured, managed and controlled in accordance with the settlor's wishes through a board of directors.

In establishing a dedicated PTC, the board of directors ("Board") and shareholders of that entity can be selected from amongst family, close friends and trusted colleagues and advisers.

In some jurisdictions it is necessary to engage a company licensed as a professional trust business to administer the trust and act as the trustee, but this is not the case in either the DIFC or ADGM, where the PTC can be closely held by family members or their trusted advisors.

The question of board and shareholder composition requires consideration of the present and likely future family circumstances, particularly succession plans. In some families, participation on the board can fuel disagreements. In other families, exclusion from the board and management can lead to the same outcome.

A particular attribute of trust structures is the potential for the founder to retain a level of control for life. Founders can even embed rules and policies that apply well beyond their lifetime. These rules can be applied regardless of the contrary views of shareholders / directors, by giving powers to the trustees or the trust protector (an office holder under the Trust) who can enforce them.

Foundations

One further additional structure that is finding increasing popularity in the region is the Foundation, which is available in both ADGM and DIFC. This is a corporate body with a legal personality separate from that of its Founder or any person with an interest in the Foundation, which can have many of the attributes of a trust arrangement. It does not have shareholders or members.

Internationally Foundations are often associated with charitable or philanthropic undertakings, but private interest Foundations are different. They are typically used to assist multi-generational families with asset protection; high-net-worth individuals and families with geographically diverse assets; and individuals, companies or family offices wishing to restructure, typically for succession planning purposes.

A Foundation is a perpetual concept, allowing arrangements to continue through time. This provides certainty after a founder's death. Foundations can be formed for an unlimited period, or may continue only until their objectives have been fulfilled. A Foundation requires no owner, so provision is not required for transmission of a Foundation in succession planning.

Foundations further provide flexibility as they permit beneficial class(es) to be changed, make it possible to impose obligations on a recipient as a condition of receipt of any amount from the Foundation, or even make any right of receipt liable to termination or restriction.

After the creation of a Foundation, the Founder/s has/have no more rights to the Foundation or its property. However, they have the option to retain (but not bequeath) significant powers in the by-laws. The Founder/s may reserve the right to change the charter and the by-laws or terminate the Foundation, which gives them significant control over the Foundation during their lifetime.

A Foundation is managed by a council (similar to a board of directors), which could be composed of family members, professional advisors, or a combination of both.

The council administers the Foundation's assets and carries out its objects. The council must have at least two members. The members of the council must conduct the Foundation's affairs in accordance with its charter and by-laws and the law. The council must act honestly and in good faith and must exercise the care and diligence that a reasonably prudent person would do in comparable circumstances.

Foundations have the following advantages:

i. **The management, governance and control of the Foundation can be tailor-made** to reflect the arrangements desired, via a combination of provisions set out in the charter, by-laws and by the control of the council.
ii. **The Foundation structure establishes checks and balances and creates an ownership structure** where stakeholders cannot sell or dismember the underlying assets of the Foundation or be incentivized to do so whilst permitting exit rights in the family equity in a managed and orderly way.
iii. **The Foundation ensures that the management and governance arrangements stipulated cannot be overridden or amended easily**. So in effect, there will be no disruption to the management and business at the transition and the arrangements put in place will continue to apply.
iv. **As orphan entities there are no individuals who are ultimate legal owners** so no changes in individual stakeholders through death or incapacity can disturb the foundation's legal status; and
v. **They enjoy utmost flexibility in achieving the objectives desired** so long as the same has been provided for in the charter and by-laws of the Foundation.

Sharia'h in focus:
Islamic Jurisprudence and Shari'ah compliant structures

In most common law or civil jurisdictions, succession planning as a legal process is reasonably straightforward, but in Middle Eastern countries such as the UAE, where there is the added complexity of Shari'ah principles, things take an interesting turn.

Islamic Jurisprudence

The terms Shari'ah, Islamic Shari'ah, Shari'ah Law or Shari'ah Principles typically refer to the established guidelines that form the basis of Islamic Jurisprudence. Islamic Jurisprudence comprises the rules stipulated by the Quran and the teaching of Prophet "Mohamed" (PBUH) relating to practicing the religion of Islam in every aspect of a life of a Muslim, which includes possession, inheritance, finance etc. There are various schools of Islamic Jurisprudence (e.g. Maliki, Hanafi, Shafi'I, Hanbali) and accordingly slight differences between these schools in the interpretation of the rules of Quran and the teachings of the prophet. Courts in Muslim countries typically use the interpretation followed by the country's government or the interpretation followed by the parties to the claim.

Islamic Shari'ah addresses, in a general manner, every aspect of an individual's life and provides strict guidelines with respect to areas of life that are not viewed as subject to change over time. Inheritance is amongst the areas where no change is contemplated by Islam.

The Holy Quran in many instances addresses the rules of inheritance in a very specific manner, leaving no room for differing interpretation. Fundamentally, there should be no differences between the four schools of Shari'ah jurisprudence when it comes to basic questions, for example, which individuals will inherit and in what proportions will they inherit.

Designing a Shari'ah compliant structure

It is important for any succession plan to ensure that the structure and arrangements selected comply with the spirit of the Shari'ah and do not aim to circumvent the principles thereof. These challenges may be mitigated by designing a Shari'ah compliant structure that accommodates large and complex business holdings, yet respects and implements the principles and spirit of Shari'ah.

Any succession planning will, in principle, require the disposition and restructuring of the family assets. The assessment of the Shari'ah implications of the disposition and settlement of the assets under a proposed structure, and the potential characterization of the disposition made by the person/founder under such structure - in addition to the time and mechanism of such disposition - are all key factors.

Waqfs

A disposition of assets during the lifetime of a founder may be characterized as a waqf or a Hiba. A waqf is an endowment of certain assets or property to the benefit of a specific purpose and/or people. Once the waqf is established, it has its own legal identity and the assets are no longer those of the creator of the waqf. Most waqfs are religious or charitable in nature, such as designating a house as waqf for the use of orphans. However, some waqfs can be created for the benefit of oneself and/or family. Further, some Waqfs are created for both: charitable and family. Legally, once a waqf is created, it cannot be extinguished except by a court order and usually only in extreme cases where the waqf cannot possibly continue. This limits the usefulness of owning business assets through waqf structure because flexibility to restructure or dispose of assets is constrained.

Hiba

The other relevant concept is Hiba, which is a lifetime gift given by the donor to the donee. The donee must accept and receive the gift during the lifetime of the donor in order for valid Hiba to come into effect. To be considered a true Hiba it must not be possible for the transaction to be reversed, and the assets affected must leave the possession or control of the donor. Only where a valid Hiba is made and completed will the gifted assets cease to form part of the estate of the donor requiring distribution under the inheritance rules. It is perhaps worth noting that there are further restrictions under UAE law with regard to gifts made within a family, which include the requirement for the donor to equally gift to all his/her children and spouse/s and not favour one of the children above the others, as well as relinquishing control over the gifted assets, etc

Additional factors to consider

A key factor to take into consideration in the context of a disposition of assets is the legal capacity of the person/founder making the disposition. In principle, any person of sound mind and not suffering from an illness that is the operative cause of death within 12 months of the time of the disposition (death illness) has the capacity to make any disposition of his assets. A disposition by a person with full capacity shall be valid even if it is made for no consideration (i.e., a gift).

Another vital consideration is the purposes and intentions of the person who creates the structure and disposes the assets. The true intention of the person who created a structure is always a material consideration when it comes to the spirit of Islamic Shari'ah.

In summary, several Islamic principles should be taken into account by families for their succession planning, so as to ensure sophisticated and binding arrangements continue to apply whilst respecting the principles of Islamic Shari'ah and mitigating challenges.

Sharia'h in focus: Islamic Jurisprudence and Shari'ah compliant structures

HEIRSHIP RULES

Mandated heirship rules under Shari'ah principles make succession planning much more complex. In Shari'ah compliant jurisdictions the concept of a will or 'Wasia' is not generally recognized, particularly when the beneficiaries are the direct heirs of the deceased. Challenges raised by disgruntled heirs are key risks for any family wishing to provide for its succession planning. Any heir or interested person may challenge any structure or succession plan under Islamic Shari'ah; however, the question is whether such a challenge is likely to succeed in the relevant case.

LEGAL AND REGULATORY CHALLENGES

In the UAE, the UAE Personal Affairs Law (Federal Law No. 28 of 2005) prescribes a formula for division of assets derived from Shari'ah principles of Islamic jurisprudence.

The object of Shari'ah principles is the fair division of wealth across the deceased's heirs whilst protecting the rights of minors and other vulnerable family members.

For a family business, the challenge arises when Shari'ah allocation leads to division of a business' assets, causing fragmented ownership and control. A sudden increase in the number of stakeholders can render governance and decision-making almost impossible, given the potential for disagreement and for shareholder factions to form.

It is not uncommon on a transition, especially in a business unused to a multiplicity of voices, for the result to be total paralysis of decision-making and even hindrances on the running of the business on a day-to-day basis.

UAE LEGISLATION AND LEGAL STRUCTURES THAT CAN AID SUCCESSION PLANNING

Fortuitously many of the challenges to succession planning can be mitigated through structures that respect Shari'ah principles and yet accommodate the flexibility and customized governance arrangements a robust succession plan requires.

The legal regime in the UAE has undergone some dynamic changes to make family wealth planning a much easier and more practical exercise for family businesses.

UAE FREE ZONES: DIFC, ADGM and RAK

The introduction of Trust and Foundation law regimes in the free zones of Dubai International Financial Centre (DIFC), Abu Dhabi Global Markets (ADGM) and the RAK International Corporate Centre (RAK ICC), have made tremendous inroads in overcoming the legal and structural challenges presented by Shari'ah forced heirship rules. Family businesses can now ring-fence their assets in these free zones through multi-layered (typically two-layer) structures and embed customized governance arrangements that are aligned with the founder's vision for the future of the business after he or she has passed on. The structure can be vetted by a reputed Islamic scholar to ensure that it does not fall foul of Islamic inheritance rules.

Such approval goes some way in adding credibility to the legitimacy of these arrangements. Of course, given the vagaries of litigation, scholarly approval does not definitively guarantee that a local court will uphold these arrangements in the event of any challenge, but is indicative of a structure that would likely be regarded as valid from a Sharia'h heirship perspective.

Regulatory authorities, including the various land authorities such as the Dubai Land Department,

Sharia'h in focus:
Islamic Jurisprudence and Shari'ah compliant structures

have made progress in their approach to structures of this nature. These authorities are keen on supporting family businesses and have demonstrated their support by being open to dialogue and, upon satisfaction of their concerns in terms of applicable laws, have provided suitable exemptions to facilitate the ownership of assets by such structures where required.

DUBAI FAMILY OWNERSHIP LAW

Dubai Law No.9 of 2020 regulating family-owned businesses in Dubaiaims to introduce structure to family businesses and is voluntarily applicable to new or existing family businesses, with certain exemptions (such as shares in public joint stock companies).

Under this law, family members can enter into legally binding and notarized family contracts that allow for the collective ownership and management of family-owned assets for the benefit of the family members who are party to the "family contract", as well as their successors. They can customize the terms on which these assets can be managed, including providing for specific proportionate allocation of interests in the assets, including income.

Any dispute arising in connection with the family contract would be settled by a special judicial committee composed of industry experts in the field of law, finance and private wealth management, who would ensure the confidentiality of any dispute was upheld. The law also helpfully addresses issues such as management powers and their limitations, as well as board responsibilities and eligibility.

UAE TRUSTS LAW

Federal Law No 19 of 2020 Concerning Trusts is a unique law that allows trust structures to be established in mainland UAE i.e., outside the financial free zones. Accordingly, it grants recognition to similar trust arrangements but within the onshore UAE legal system and thus provides an effective option for families and companies in structuring their businesses, companies and assets within a flexible legal framework. The law imposes certain conditions for the establishment of a trust and refers to the issuance of ministerial resolutions to regulate and facilitate the implementation of the law. Currently not all implementing resolutions have been passed yet to establish a valid trust under the law.

Sharia'h in focus:
Islamic Jurisprudence and Shari'ah compliant structures

UAE FAMILY BUSINESS LAW

Federal Decree-Law No. 37 of 2022 in relation to Family Companies has been issued and will come into force three months after its publication in the official gazette. The Federal Decree-Law provides families in the UAE with another tool to organize their affairs and provide for succession planning. The new Federal Decree-Law applies to any Family Company in which the owners of the majority of its capital, which should be belonging to the same family, agree to register their company in a unified Register of Family Companies established under this Decree-Law.

The Decree-Law did not create a new form of companies but rather considered that a Family Company can take the form of any company recognized by the UAE Federal Commercial Companies Law (with the exception of public joint stock companies and general partnerships) or under the laws in force in the Free Zones.

The Federal Decree-Law introduces new and innovative concepts that may be utilized by family businesses in the UAE and wider region as it provides for flexible useful tools and concepts to family businesses in regulating their affairs, such as permitting classes of shares where holders may enjoy different rights and enabling the buy-back of up to 30% of the Family Company's shares to facilitate the exit of family members, further the Decree-Law now abolishes the restriction on the number of shareholders in a Family Company which is a key consideration for families as they grow in number with time.

The Decree-Law also permits the entry into Family Constitutions to regulate the affairs of the family and the Family Company. It provides flexibility in terms of the management of a Family

Company and enables the family to design their own arrangements. In particular the family can establish different governance bodies such as a family assembly, family council, family office, and other committees under this Decree-Law.

The Decree-Law also allows families to select the appropriate mechanisms for dispute resolution where they can resolve any dispute by reference to the courts of the financial free zones, arbitration or by a special Committee in each Emirate, to be established by this Decree-Law which provides utmost flexibility to families in selecting the most appropriate dispute resolution mechanism.

It is expected that Family Companies regulated under the Decree-Law will also benefit from incentives and concessions that may be provided at the discretion of the Cabinet. The precise type and nature of these incentives is not currently set out in the Decree-law.

Another key aspect addressed under the Decree-Law relates to protection of succession planning and regulations of a Family Company under the Decree-Law or the laws applicable in the Free Zones from being considered to be a violation of the Personal Status Law.

Legislation revolution: How the UAE has adapted its laws to help family businesses

"Over the past 10 years there has been a legislation revolution in the UAE to promote succession planning and the continuity of family businesses."[3]

2014

Issuance of the trust and foundations legislations and enactment of the system of wills for non-Muslims in financial free zones

Namely Dubai International Financial Centre (DIFC) and Abu Dhabi Global Market (ADGM).

2017-18

Issuance of Waqf [endowment] laws in the Emirates of Dubai in 2017 and Sharjah in 2018.

2018

The federal Waqf Law No. 5 was promulgated

Containing for the first time specific modern provisions organising waqfs for family businesses.

Federal company law No. 2/2015

Included provisions reducing the minimum shares to be floated by promoters to only 30 per cent of capital, thereby encouraging more family firms to float.

2020

Amendments to the federal commercial agency laws

Allows listed family firms to register and manage commercial agencies in the UAE, even where they are not 100 per cent owned by UAE nationals .

First-of-its-kind landmark law of Dubai Law No. 9 of 2020 (Family Ownership Law)

Under this law, family members can enter legally binding family contracts that allow for the collective ownership and management of family-owned assets for the benefit of those family members, as well as their successors.

Federal Law No 19 of 2020 Concerning Trusts

This unique law allows trust structures to be established in mainland UAE i.e., outside the financial free zones.

.

2021

Abu Dhabi Law No. 10 of 2021|
(Governance of Family Businesses in the Emirate of Abu Dhabi)

This law empowers family-business owners to prevent the selling of shares or dividends to individuals or companies outside the family, and introduces various other flexible solutions to family businesses.

2022

Federal Decree Law No. 37 of 2022 on family companies

The law introduces flexibility to the current onshore corporate framework.

[3] Quote from Fadi Hammadeh, FBCG circular, New Family Ownership Law in Dubai, page 1-2 (2020)

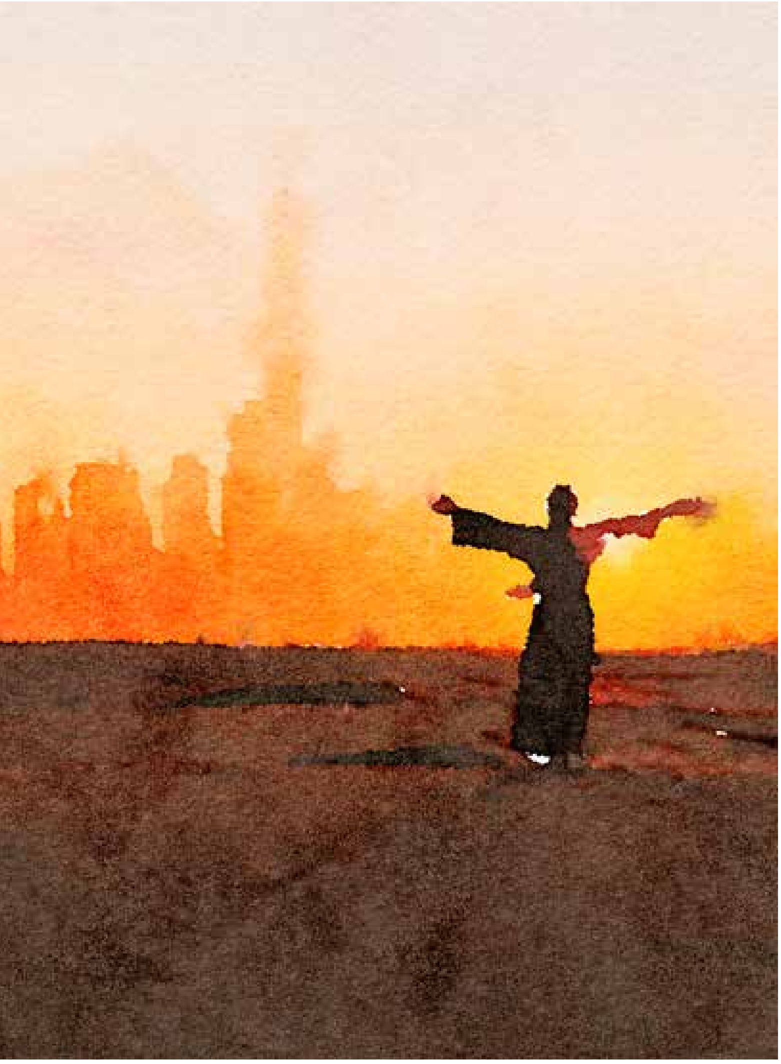
3 Navigating family dynamics and getting started

Common challenges of succession planning

Family business succession is the 'final test of greatness' and a core part of family business continuity.

There are different aspects of succession. It can entail transfer of management, ownership and even leadership of the family business or family wealth. Although these aspects of succession are often intertwined, they also need to be considered separately.

For all these aspects the best succession transitions are organised as a process (not an event), supported by intergenerational teamwork.[4] It is crucial to involve the family and canvas their opinion, with a strong, determined leadership.



Family dynamics: Succession plan sticking points

There are aspects of family businesses in general that can pose a challenge to getting started with a succession plan. Common issues include:

Succession can be a taboo topic

The founder will often avoid choosing a successor for fear that it will undermine his leadership if the founder designates an 'understudy' being groomed to take his or her place. Also, there may be concern that any such designation might have the potential to disrupt family relations if the person selected is not assured of the whole family's support.

Controlling behaviour patterns

Some founders are intense micro-managers, given that they have nurtured the business from its inception. This level of supervision and control often alienates family members and employees alike and leads to conflict.

Absence of formal structures and boundaries

It is common in the region for family businesses to be managed like sole proprietorships with no demarcation of personal and business assets and no clear allocation of professional responsibilities between family stakeholders, resulting in a muddled web of business relationships.

Family conflict

Feelings of frustration and neglect on a professional level can develop between family members working in the business. The proximity of working and socializing together can create a 'pressure cooker' environment that upon the founder's demise can erupt, leading to litigation and embarrassment for the family.

[4] IFB Research Foundation, Family Business Challenges, No. Planning Succession

How to start the conversation

Ideally, a family member with strong leadership skills – be it the founder(s) or someone from the next generation – would take the lead in starting the conversation with the family about succession.

For smooth transitions, seniors and the next generation should collaborate amicably to build a methodical approach. One benefit of letting the next generation take the lead, in consultation with and with approval from the owners, is that it empowers those who will be running the business in the future to take charge of the management and ownership succession process.

Communicating with family members

Fundamental to succession planning is communication with the family members. "All family members need to know and understand the guiding principles that will steer the overall succession processes. They also need to understand their family members' expectations as they relate to the current and future management and ownership of the family business. All family members are and will be planning their lives, and they need information to make informed decisions. Recognizing that these succession guiding principles and family member expectations will no doubt change over time, it is essential that family members be kept abreast of their evolution. Providing the family with a dedicated communication forum to address the succession issues is the single most important step in the family business succession process. Achieving this important step is directly dependent on your ability and willingness to communicate."[5]

In the beginning, it may be easier and more productive to discuss succession issues with family members who are active in the business, because they are the ones who experience the full impact of balancing family and business relationships.

Kick-starting the succession conversation can begin with a family meeting with a clear agenda for the family shareholders, family members active in the business, and the next generation inheritors.

[5]KPMG Enterprise, Succession Planning

When to start the process?

It's never too late to start, and it's never too early to begin. In fact, the sooner the family begins the conversation around succession, the better. The conversation can begin with open questions (no concrete, set-in-stone answers required) to help both generations to increase their mutual understanding.

Questions to ask when starting a succession plan

Strategic

- Do we have shared family goals and vision?
- If so, what are those goals? And what is the vision?
- Given our family goals and aspirations, do we want our business to stay family-owned and/or family-managed?
- How do we want the business to serve us, and vice-versa, how do we want to serve the business?

Business and Ownership

- Does our preferred model work best for the business too?
- Do we have lessons learned from how our family identified and prepared past leaders?
- What would happen and who would take over if our family business leader was incapacitated tomorrow? Do we have contingency plans?
- How would any transition impact key non-family employees?
- Are members of the next generation ready, willing and able to take over ownership and management?
- Are there appropriate training, development and transition programmes in place for next generation leader/s?

Individual[6]

- What do I enjoy about my current stage of life and career?
- What do I find tough or dislike?
- What would I like to ask the other family members?
- What do I think the other family members are concerned about, given their age and stage?
- How do I think they feel about the succession process?

[6]Ken McCracken, Head of Family Business Consulting, KPMG LLP (2016) The Succession Conversation – adapted from a presentation at the IFB National Conference, London, 9–10 June.

Who should be involved?

A key point within the succession planning process is getting support and assistance from various sources.

1. **From within the business, a Board of Directors, that includes family and non-family members, can play a crucial role in continuity planning. A proactive, involved and empowered Board of Directors can help ensure succession and retirement is not overlooked.**

2. **Are the trusted advisors and executives working in the business who are respected by all family stakeholders; and who can bring deep knowledge of the business and the employees (in particular the impact of succession choices on them). These advisors can also provide mentorship to the senior and next generations during the succession process, helping improve mutual understanding and mitigate potential conflict among family members.**

3. **Are peer groups – seeking the counsel and experiences of other family businesses who have charted this succession journey can bring fresh perspective for ideas, strategies and support.**

4. **Most important, is engaging professional advisors such as consultants, lawyers and coaches. In particular, seek out experts with a proven track-record of succession planning. They can offer useful advice and support on how to manage the process and making the key decisions.**

The role of external advisors

Family businesses will usually engage external advisors to help them build a succession plan. These may be family business experts, lawyers, accountants, mediators, coaches, and wealth advisors. The role of the advisor is to ensure that the family understands all the options available to them and can make an informed decision that meets the needs of the family and family business. It is important that these advisors remain independent and neutral; they should not push a particular agenda of one family member but rather support and guide the whole family.

Often it can be challenging for family members to express their feelings, so having an external advisor to facilitate the discussion and gauge family sentiment can support the process and ensure that family members feel comfortable and open with the process.

Today, trust and other private wealth functions are carried out by an industry of private wealth managers, private bankers and fiduciaries to ensure that their structures are run efficiently and in accordance with the relevant rules and regulations of the jurisdictions in which it is incorporated, especially in a world with increasing international regulation and reporting requirements.

Fiduciaries can:

» **Administer** the trust or foundation or other structure in accordance with its constitutional documents;

» **Undertake** the necessary compliance function and ensure appropriate regulatory reporting is undertaken;

» **Provide** necessary economic substance requirements if necessary;

» **Deal** with beneficiary requests for information;

» **Manage** the process of accounting and distribution of funds to beneficiaries;

» **Make** investment decisions and deal with all other contractual arrangements for the investment or management of the trust assets;

» **Centralise** administration: the appointment of a professional trustee can remove any doubt as to where the mind and management of the trustee lies, which can be very important when considering the implications of potential exposure to tax.

Wealth management and the role of the family office

In recent years the professional fiduciary/beneficiary relationship has expanded to include the provision of services that a professionally run family office can provide. In addition to the services set out above, a family office can now be staffed with any number of different professionals to deal with all aspects of a family's arrangements, encompassing everything from investment management to concierge services.

When deciding which type of structure to implement as a family, it is also an opportune time for a family to consider whether the involvement of professionals could assist in running the structure and in doing so help save time and resources, which can be very beneficial for a busy family.

For the family that does not necessarily want, or feel the need, to completely divest themselves of responsibility for the management of their assets, the different available structures allow for a varying level of responsibility and control of the family's private wealth and affairs.

In particular, the Private Trust Company and Foundation structures enable family members to sit on the board of directors or council of the foundation.

This provides the following benefits:

» **Retention of control:** family members sitting on the board/council can be involved in trustee decisions and can direct the investment and distribution of family money through the structure.

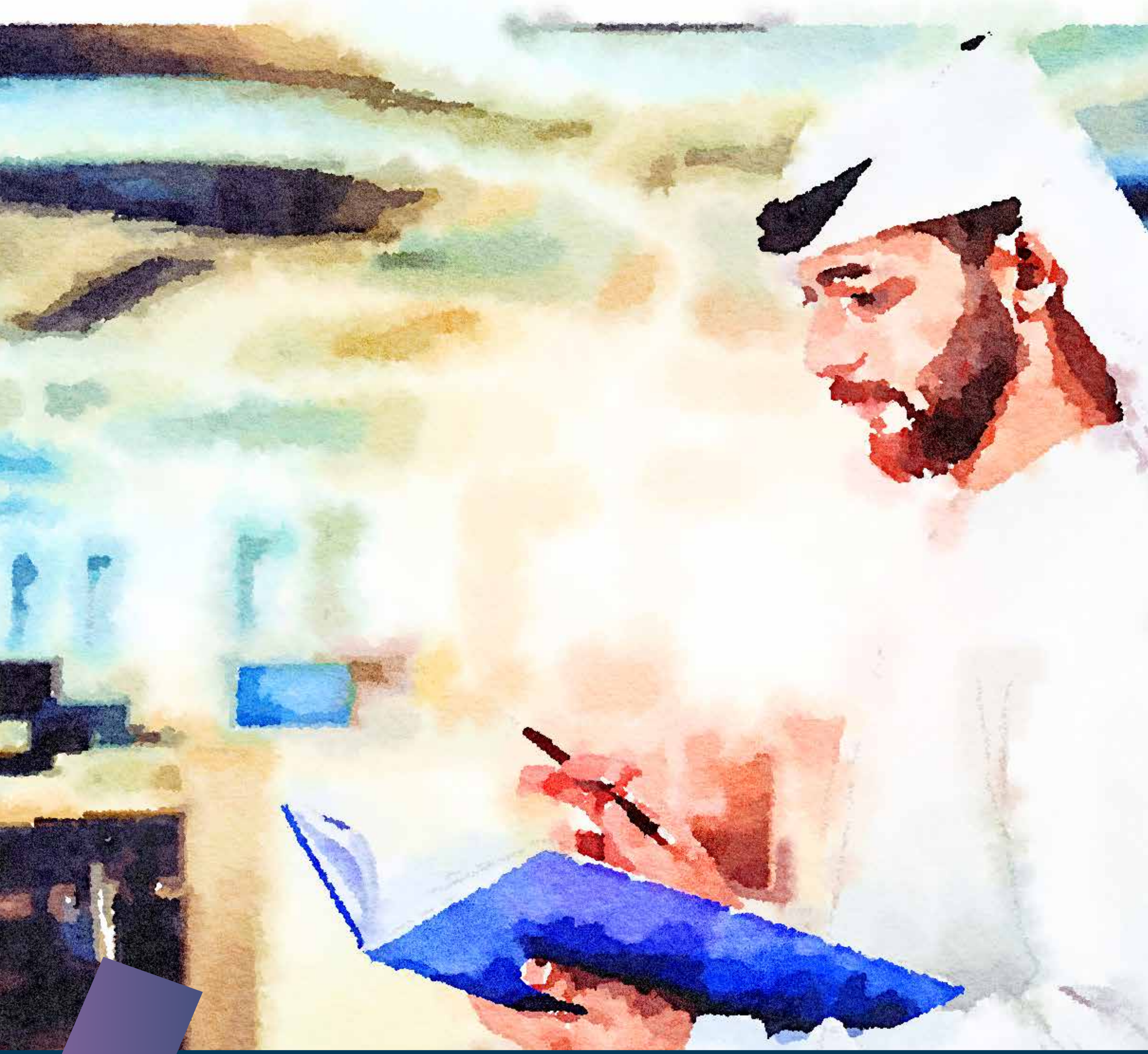
» **Less risk-averse:** a privately held structure may be used in circumstances where the underlying assets of a trust will be speculative or high-risk. A service provider may be less likely to accept such assets.

» **Reaction time:** a privately held structure may be "nimbler" and quicker in its decision-making processes than a professional fiduciary.

Balancing family control and external expertise

A hybrid model is also possible where any board of trustees or council of a foundation can combine both the services of independent non-executive directors and family members. This provides a suitable level of professionalism and expertise to any private wealth ownership structure, whilst allowing certain family members to represent the interests of the wider family beneficiaries and ensuring that the business retains its essential family character and culture.

Best practice suggests that a family appoints a succession working party, consisting of the owner(s)/founder(s), selected family members, trusted advisors/employees and independent non-executive directors. This group can be responsible for developing the succession plan and monitoring its implementation.



4 Best practice checklist for succession readiness

How to go from now to then: The key steps

While the succession planning journey will vary for each family depending on their generation cycle, number of shareholders and family dynamics, below are some key steps for any succession process:

1 TAKE STOCK OF THE CURRENT CONTEXT

Before planning for the future it is advisable to understand any legacy events that have shaped the family business and to understand the existing circumstances around family management and ownership.

It may also help to conduct a complete financial appraisal of all outstanding assets and debts; and to self-assess vis-à-vis global and regional peers how your family is doing on the transition planning – is it succession-ready compared to its peers? This can be a structured self-assessment or a rigorous audit that evaluates whether you are prepared and positioned for transition.

Questions to explore:

Are there legacy events that need to be considered?

What are the crucial business objectives and needs today?

What is the current financial position of the business, assets and activities?

What is the current business structure?

Who and how many shareholders?

How many family members involved on the Board and management?

Which family members will have stakes in the future of the business, assets and activities?

Do we have a succession plan in place? Is it future-proof?

How does it stack up relative to best-practice and peers?

Helpful references include:

FBCG GCC Governance Code

FBCG Governance Checklist

FBCG Conflict Management Checklist

FBCG Engaging a Mediator

2 START THE CONVERSATION

"Whenever two people meet, there are really six people present. There is each man as he sees himself, each man as the other person sees him, and each as he really is" William James, American Philosopher & Psychologist

It is important to understand all family member aspirations, needs and core values.

With a clear understanding of the present context, the family can begin to engage in a series of conversations that require facing uncomfortable and uncertain topics. The purpose of these conversations is to understand where all family members stand vis-à-vis the family business and personal objectives. Depending on the family size and dynamics, the process can include all family members at a dinner table from the start, or first with principal owner(s) and then expanding to include other members of the family in stages. The process is crucial here.

3 CREATE ALIGNMENT

"Families are like branches on a tree. We grow in different directions, yet our roots remain as one." Unknown

An essential step in the succession planning process is to capture, discuss and define the family's core values and shared vision.

The family should create alignment through exploring questions such as:

What are the core values of our family business?

What is our collective purpose?

What is our vision for the future?

4 DETECT YOUR BLIND SPOTS

Do a gap analysis based on where you are and where you want to be.

Part of the journey is being honest about where the succession planning process is currently effective and where there are gaps.

Families can use the Checklist in Appendix A to audit and keep track of their succession planning.

5 IMPLEMENT THE PROJECT

Take professional advice, establish a plan and ensure that it is implemented effectively. This would incorporate the following points:

a Optimise the corporate structure in place

The first step is to organize and streamline the existing corporate structure (see Section 2: Finding the right legal structure).

b Prepare the founder's vision statement.

A founder's statement provides insight into the vision of the founder for the business. Through this statement, the founder provides guiding principles for those managing the business currently and in the future.

c Choose a successor

This is one of the toughest decisions for the founder of a family business. There may be an inherent bias towards one child. It is advisable to have two or three viable candidates and professional advisors can help narrow it down. An alternative route is to have qualified industry experts on the boards of the trustee companies or as foundation council members and have them manage business operations using industry expertise.

d Formalising internal policies and procedures

To manage family relationships at work, it is useful to implement a formal hiring policy. This would involve determining subjective criteria for appointments and would help in managing family expectations with respect to securing employment at top positions in the business.

e Develop or adopt a code of corporate governance

To formalize the way in which business is conducted, to ensure accountability and improve standards of communication and transparency, it is advisable to develop or adopt a code of corporate governance. This code will ensure clear decision making and transparency and can assist in avoiding disputes.

[See Appendix: The importance of good corporate governance].

6 CONTINUOUSLY ENGAGE AND REFRESH

By its very nature, a family business is a living, breathing construct which needs to be flexible enough to deal with the vicissitudes that family life can bring. Families need to know when it is appropriate to be introspective: often the demands of modern life means that the opportunity to pause and reflect is missed. But regular sessions and audits to determine how the family dynamic is operating can be beneficial and at times cathartic.

In addition, the judgement call as to when to ask for help outside the family cannot be overlooked. Clearly matters should be kept private when possible, but the benefit of an impartial eye can often help expose difficult issues that have arisen or suggest amendments to working practices that might otherwise go unaddressed.

Good Governance
The key to succession readinesss

Once a family business reaches a certain level of maturity and complexity in terms of the number of stakeholders – whether resulting from inheritance or business diversification - decision making becomes extremely challenging and can result in an upsurge of conflicts. This is when creating an effective and tailor-made governance structure for the corporation and the family becomes an inevitable step for ensuring business performance and family harmony.

Although there is no unique model of corporate governance applicable to all family businesses, all governance structures aim to set a guidance for future generations in terms of how the business should be directed, managed and controlled. Good corporate governance regulates the interaction between the beneficiaries, organs of administration and of executive management, and draws a line between family and business.

WHY IS GOOD CORPORATE GOVERNANCE VITAL FOR FAMILY BUSINESSES?

Keep up with economic trends

The absence of a clear decision-making process can result in a continuous chain of lost opportunities. Family businesses with a well-functioning board of directors can more appropriately shoulder the responsibility for making such major decisions and brings in creative and strategic thinking, valuable insights and diversity to the business.

Overcome Conflicts

The use of family governance tools increases the sense of harmony and ownership with the business. Family members feel responsible and part of the business success. Governance tools help the family members and the executive management communicate, interact and exchange ideas and perspectives. A shared vision helps mitigate the risk of intense and irremediable conflicts. Whilst disagreements, conflicts and fights cannot be completely eliminated, putting in place a resolution mechanism can contain a conflict by setting clear and immediate procedures for dispute resolution and the avoidance of prolonged and dramatic conflicts.

However, merely having a set of listed structures and policies in place does not necessarily amount to a good governance practice, as reaching a positive impact through governance requires governance to be "lived and breathed" every day. Belief in the family values, respect and proper integration are essential pillars to good governance. An important element which can make or break the process of implementation is careful analysis of whether the adopted governance strategy is really fit for this particular family or its business. Each family business should look at its own needs and objectives and, based on this consideration, choose workable governance bodies, policies and procedures.

Overcome Vulnerability

The business is most vulnerable during succession. The absence of a clear succession plan and adequate tools to enable the smooth transition from one generation to the other can lead to family members threatening the survival of the business. A governance manual will provide future generations with guidance to a reliable path for succession.

A good corporate governance is a protection for the family and the business, for current and future shareholders by maintaining the balance of power between the different corporate bodies, promoting cooperation, generating jobs and achieving financially sustainable enterprises; and, ensuring adequate and timely disclosure of issues as they arise.

Depersonalizing Issues

Good corporate governance can provide for robust and impartial dispute mechanics and decision-making processes that help disentangle matters from its family characteristic while keeping an eye on the family's shared vision, by having a multilayered governing structure and engaging experts to ensure effectiveness, fairness and excellence. This also eliminates sensitivity and awkwardness between family members as any decision which might be viewed as disadvantageous for a family member is not the product of one person or a family branch but the product of a collective decision by a consortium of accountable experts appointed to the governing body in accordance with an approved recruitment policy.

Ensuring Business Sustainability

Effective operations and governance policies implemented by family business ensure business sustainability. Businesses can and do survive even if no family member is ready to step up and lead the business, as often there is no suitable successor in the family. A good governance manual should provide for these scenarios and specify the eligibility criteria for undertaking management roles, who can take part in the business and who approves appointments.

Clear Roles and Responsibilities

It is important to define the role and responsibilities of each governing body. A functional governance structure accommodates shifts in responsibility from family members to outside individuals on the basis of qualification and merit, and the interdependence of both.

Solidarity

Good governance does not mean having ruthless business-first policies with no consideration to family members' hardships. It is important that the business governance provide for committees dealing with family members' financial difficulties, by setting up a fund granting financial assistance to family members facing hardships subject to certain eligibility criteria.

The governance structure should allow family members to feel that the business is the backbone of each one of them.

Sense of Ownership

A good governance integrates family members in the business and the decision making creating a sense of ownership and belonging to the business. They feel part of this success and responsible for ensuring its continuity. They are not distant from the business and its difficulties, and thus, they develop a sense of solidarity with the business.

No favouritism

Good governance does not entertain favouritism and eliminates any sense of entitlement by family members. It creates a business environment and culture driven by principles of merit and equal opportunities. The internal policies and the decision-making processes are impartial and fair, the same for family members and non-family members with no exceptions.

Involving family members in the business is not necessarily a harmful decision, the important thing is to ensure that people who are put in managerial positions have the necessary grounding in business, skills and education to assume the responsibilities associated with these positions. When family members realize that there is no room for favouritism, only family members who are really keen on the business start gaining the required education and expertise to be eligible to get involved in the business.

How to achieve good governance

There is no unique model of corporate governance applicable to all family businesses. Corporate governance gives families the tools for effective business operation and conflicts resolution. Accordingly, as a first step that families need to study and understand the uniqueness of their business and family to put in place tailor-made governance policies suitable for their business and family dynamics.

An unsuitable governance structure is as bad as no governance at all. Each family must undergo a thorough analysis of its dynamics, needs and goals, with the involvement of the right expertise, prior to setting up a governance structure for the business.

About Us

FBCG

The Family Business Council is a private, non-profit membership organisation that aims to facilitate the continuity of GCC family businesses across generations by strengthening family business governance and next generation leaders. Through peer learning, education, impact-driven family business research, events, and networking, we seek to identify and address issues that are unique to this region.

The council is governed by a Board of Directors, representing leading GCC family businesses, which steers and builds the organisation. FBCG's board shares a common view that the continuity and prosperity of family businesses is vital not only for their families' legacy but also for the economic sustainability of the region.

FBCG is a member of a worldwide organisation - the Family Business Network International (FBN) - which is the largest global network "by families, for families across generations" representing leading family businesses all over the world.

For more information visit **www.fbc-gulf.org** or email us on **info@fbc-gulf.org**

AL TAMIMI & COMPANY

Al Tamimi & Company is the leading law firm in the Middle East and North Africa (MENA) with 17 offices across 10 countries. The firm has unrivalled experience, having operated in the region for over 30 years. Our lawyers combine international experience and qualifications with expert regional knowledge and understanding.

We are a full-service firm, specialising in advising and supporting major international corporations, banks and financial institutions, government organisations and local, regional and international companies. Our main areas of expertise include arbitration and litigation, banking and finance, corporate and commercial, intellectual property, real estate, construction and infrastructure, and technology, media and telecommunications. Our lawyers provide quality legal advice and support to clients across all of our practice areas.

Our business and regional footprint continues to grow, and we seek to expand further in line with our commitment to meet the needs of clients doing business across the MENA region.

DUBAI CHAMBER

Dubai Chambers aim to be a catalyst for Dubai's economic transformation and underline its credentials as the world's most dynamic and attractive business hub. The organisation fosters the adoption of new business models that enable Dubai and its business community to capitalise on rapidly emerging opportunities and drive sustainable economic growth and development in line with Dubai's ambitious vision and the UAE's 50-year development strategy.

Three chambers operate under Dubai Chambers, namely Dubai Chamber of Commerce, Dubai International Chamber and Dubai Chamber of Digital Economy – each of which have their own individual brands, strategies and specialised approach.

Mohammed Khalid Bin Sulaiman
Director - Business Relations
Dubai Chamber of Commerce
mohammed.binsulaiman@dubaichamber.com

Sara Boomsma
Manager
FBCG
sara.boomsma@fbc-gulf.org

Essam Al Tamimi
Chairman
Al Tamimi & Company
https://www.tamimi.com/find-a-lawyer/essam-al-tamimi/

Richard Catling
Partner
Corporate Commercial
Al Tamimi & Company
https://www.tamimi.com/find-a-lawyer/richard-catling/

Nawal Abdel Hadi
Senior Counsel
Corporate Commercial
Al Tamimi & Company
https://www.tamimi.com/find-a-lawyer/nawal-abdel-hadi/

References

Important References

Family Business Council Gulf Resources

- GCC Governance Code
- GCC Governance Checklist
- Toolkit - Family Constitution
- Toolkit - Family Council
- Knowledge Snapshot – Definition of a Family Business
- Dispute Resolution for Family Businesses in the GCC
- Family Business Conflict Management: Family Case & Guidebook
- Family Business Shareholder Exit Strategies and Valuation Principles

Additional References

- Business Succession Planning Cultivating Enduring Value, Deloitte Development LLC, 2015
- Do Most Family Businesses Really Fail by the Third Generation? Josh Baron and Rob Lachenauer, Harvard Business Review Press, 2021
- Family Business Succession, Managing the All-Important, Family Component, KPMG Enterprise, 2011
- Family Business the Essentials, Peter Leach, Profile Books Ltd, Second Edition, 2011
- GCC Governance Code for Family Businesses, Family Business Council Gulf, Second Edition, 2020
- Family Business Handbook: How to Build and Sustain a Successful, Enduring Enterprise, Harvard Business Review, 2021

The future of UAE family businesses

Strategies for a successful transition