Schumpeter

Succession failure

Family businesses in the Arabian Gulf need to address the problem of succession planning

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The grand mufti of Saudi Arabia recently added a surprising new item to the familiar list of worries plaguing his region. Chess, he pronounced, is “a waste of time and money and a cause for hatred and enmity between players.” Without disputing the mufti’s judgment, Schumpeter would like to add a different worry: succession in family businesses. Like chess, poorly planned succession is a “waste of time and money and a cause for hatred and enmity”; unlike chess, it has the potential to undermine some of the country’s foremost economic institutions.

Succession is a problem for family businesses the world over. The Family Business Institute calculates that only 30% of such businesses survive into the second generation, only 12% into the third generation and only 3% into the fourth. But the problem may be bigger in the Gulf than anywhere else. Around 80% of the companies in the region, producing more than 90% of its non-oil wealth, are family-owned or controlled. The number of relatives clamouring for a job in these firms is surging, partly because the population is so young (the average age of citizens in the Middle East and north Africa is well below the global average) and partly because governments are desperate to shift workers from the public to the private sector (in the United Arab Emirates 90% of employed citizens work for the state).

These family firms are mostly fairly recent creations—the products of the oil and property booms of the 1970s and 1980s that turned people who were lucky or well-connected enough to own prime bits of land into moguls. Over the next decade up to half the region’s business families, controlling assets worth perhaps a trillion dollars, will hand the reins to the next generation.
That is a worrying prospect. A proper succession requires good governance. Yet too many of the region’s businesses blur the line between what belongs to the firm and what belongs to the family: they spend company money as if it were their own and employ family members without subjecting them to proper vetting. And if disputes occur, the region’s courts are not equipped to cope. The World Bank reports that they take an average of 575 days to resolve a commercial dispute. An estimated 70% of Saudi families have at least one succession problem tied up in court.

The two most obvious results of a botched succession are incompetent leaders and feuds. Family tradition often conspires against merit: families routinely favour the eldest son regardless of his ability. Locals say there are examples of incompetents “all around”, though they are reluctant to name names. The scope for feuds is increased by the complexity of family structures, thanks to high fertility rates and occasional polygamy. Abdulaziz Al Ghurair, chairman of the Family Business Network, a regional body, predicts that more than half the businesses will split over succession. A less obvious consequence is what might be called “functioning dysfunction”: companies get around incompetent heads by creating parallel structures so that the real power is held by people with minor titles, or by avoiding naming a CEO at all.

One of the most famous family disputes was reportedly solved by royal intervention. Two relatives, Abdullah and Majid, inherited joint control of Al-Futtaim Group, a Dubai-based empire, part of which now operates the Mall of the Emirates with its famous ski slope. The dispute proved so damaging that Sheikh Mohammed bin Rashid al-Maktoum, then crown prince and now emir, stepped in, locking them in a room and refusing to let them out until they had divided up the empire. But even the most enlightened royal intervention is no substitute for reliable rules.

Badr Jafar, the 36-year-old head of Crescent Enterprises, a conglomerate, is leading a campaign to provide just such rules. He argues that regulators should compel companies to make a clearer distinction between corporate property and family property. But he adds that companies need to change from within. They should borrow mechanisms that are popular with family companies around the world—such as family constitutions, family meetings and family offices—and adapt them to local traditions.

Mr Jafar is the perfect man to make this pitch: his company is based in Sharjah, one of the most conservative emirates, but he was educated at Eton and Cambridge. He has helped establish a pressure group, the Pearl Initiative, to support the case for better corporate governance. He has secured the support of global organisations, including the World Economic Forum.
Capitalism with Gulf characteristics

Mr Jafar can also point to several notable advances in the region, some of which predate his activities. W.J. Towell, an Omani company that employs 150 family members, has introduced regular family gatherings to promote family cohesion. The Zamil Group, a Saudi conglomerate with more than 100 family members on the payroll, demands that both family and non-family executives go through a “future leaders programme”, which uses psychometric tests to assess their abilities. The Abdullatif Alissa Group, another Saudi conglomerate, has gone even further, replacing all family members with professional managers and limiting the family’s role to board membership. A growing number of companies are creating family offices to help make the distinction between family and corporate resources. Ten years ago almost nobody was talking about this subject, says Mr Jafar. Today 50% of business families “have it on their minds, 30% in their mouths and 20% on paper.”

With luck, even more companies will put it on paper soon. Corporate governance might sound like an ineffective way to take on serious problems such as Islamist extremism and state breakdown. But the region has no chance of escaping from these conflagrations without improving its economy and creating jobs for the young. The last thing it needs is for companies to be ruined by incompetent heirs or torn apart by pointless disputes.

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