From family enterprises to institutions

A differentiated journey for Middle East and North Africa family businesses
Ramy Sfeir is a thought leader with Strategy& (part of the PwC network). He is a partner based in Dubai and leads the family business, investments, and real estate practice and the Strategy& deals platform in the Middle East. He works mainly with family conglomerates, investment companies, sovereign wealth funds, and real estate developers. He advises on topics related to corporate and investment strategy, corporate transformation and governance, as well as mergers and acquisitions.

Marc-Albert Hamalian is a partner with Strategy&. He is based in Beirut and is a member of the family business, investments, and real estate practice in the Middle East. He leads the family business and investments offering in the region, working primarily with family conglomerates, investment companies/private equity firms, and sovereign wealth funds. He has broad expertise across corporate and investment strategy, corporate transformation, and governance. He also works on deals and corporate finance matters including commercial due diligence, portfolio rationalization, mergers and acquisitions, and post-merger integration across multiple sectors.

Maria Abou-Sakr is a manager with Strategy&. She is based in Beirut and is a member of the family business, investments, and real estate practice in the Middle East. She works mainly with family conglomerates on their institutionalization journey, advising on topics related to corporate and investment strategy, corporate transformation, and governance.
In the Middle East and North Africa (MENA) region, family businesses face significant common challenges. They are dealing with problems of generation transition, an increasingly challenging business environment, and business models growing in complexity.

Family businesses therefore need to embark on an institutionalization journey that is customized to their particular needs and that seeks: a definitive separation between business and family, with clear mechanisms and appropriate bodies governing the activities of each; an adaptive strategy that ensures competitiveness and includes regional growth and even global diversification beyond the home country; and sustainable and differentiated corporate enablers that shape the company’s identity and endure beyond the founders’ departure from the business.

Although each family business has unique features and will have a different institutionalization starting point, there are four general profiles drawn from actual examples. The first, the “one-man show,” owes its success to one or a few family members. It lacks strong non-family corporate capabilities. The second, the “business–family merger,” possesses a growth strategy and has developed differentiating capabilities. Its family governance is, however, typically weak and does not distinguish between family wealth and corporate assets. The third, the “going concern–going nowhere,” is a legacy organization with large, established businesses and a strong market position. It cannot achieve its growth and profitability objectives because it has not properly defined a corporate strategy nor developed the capabilities to deliver it. The fourth, the “institutionalized family business,” has strong performance because its institutionalization journey is over. It runs the risk of complacency.

To determine their next steps, family businesses must first understand which priorities they need to address most urgently as they progress toward institutionalization. Once they have completed that assessment, they will be able to take action in one or more of the following areas: protect and strengthen their family and business foundations; develop a capabilities-driven growth strategy that will give them the right to win; and reinforce their corporate functions and resources.
Family conglomerates in the MENA region need to focus on becoming institutions. Being professionally run institutions is vital to these companies because they face significant generational, market, financial, and technological challenges, while new generations are rising to leadership positions.

These companies are now operating in a substantially different environment to that in which they were founded. There are significant internal challenges related to the rise of the next generation. Businesses started and once led by one or a few family members over half a century ago now face a dilution of decision-making and wider ownership. The views of the newer generations are often substantially different. This may mean differences over their employment in the business, the need for family services, the level of risk they are willing to take, and the returns they expect. At the same time the founding generation wants younger generations to perpetuate its legacy, enterprise, and achievements.

There are external challenges as well. The market is becoming more competitive, for example from local and international companies entering industrial sectors. Competition has also intensified due to regulatory changes such as more-open trade policies, as exemplified by the entry of MENA states into the World Trade Organization. Car distributors can no longer demand exclusivity, pharmaceutical distributors have to grapple with the fact that the brands they are selling are also available to customers through direct channels. Also, these companies’ increasingly diverse portfolios, with different businesses in a variety of sectors, make it hard to achieve strategic focus and maintain a competitive positioning.

Family companies also have to cope with a much tighter funding environment than in the past. Without strong governance, institutionalization, and strategic focus, family businesses are not attractive to lenders. Indeed, with less to lend, banks are putting first.
such institutions as publicly listed companies, multinationals, and large enterprises. This is because these companies tend to be more transparent and have clear separation between categories of assets. An additional financing problem is the effect of disagreements within a family company about its direction during the generational handover. The result is that some members of the family may refuse to dispose of family assets, put their own money into the business, or borrow against dormant land banks.

In addition, family firms have to deal with the risk of being disrupted by digitization and new business models. All of these challenges are occurring in an uncertain external environment characterized by geopolitical instability and fluctuating oil prices (see Exhibit 1, page 6).

Turning family firms into institutions is also of national importance because of the economic significance of these companies in their home markets. Family conglomerates, in which the majority of ownership or control lies within one or several families, generate around 60 percent to 80 percent of non-oil GDP in some countries.¹ These enterprises are diversified, often owning a mixture of assets across sectors, and typically include significant real estate holdings. They are often dominant players in such sectors as distribution, industrial manufacturing, real estate, and construction. They owe these impressive achievements to a highly entrepreneurial founding generation that had important political and financial connections, and decades of economic growth and development. They also benefited from an initial business environment in which companies could succeed with an entrepreneurial approach to doing business, and in which institutionalization was not an urgent issue. As a new generation takes the reins, it is critical to proceed with transforming these companies so that they can become institutions.
### Exhibit 1
The challenges confronting MENA family firms

<table>
<thead>
<tr>
<th>Dimension</th>
<th>Historical paradigm</th>
<th>New paradigm</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leadership</td>
<td>Business was led by one or a few founding/controlling entrepreneurs with support from close advisors and with the full agreement of all family members</td>
<td>Control and decision-making diluted because of fragmentation of ownership resulting from generational transition and the involvement of family members across business units and functions, with at times different perspectives and opinions on how to conduct business. Significant pressure on the next-generation family members to maintain the founding generation’s legacy, entrepreneurial spirit, and track record.</td>
</tr>
<tr>
<td>Family</td>
<td>Direct family members (typically spouse and children) of the entrepreneur</td>
<td>Involvement of the second and third generations with divergent aspirations on such critical family and business issues as: employment of family members, increasing need for family services such as wealth management and administration, and divergent risk-return and liquidity expectations.</td>
</tr>
<tr>
<td>Business model</td>
<td>Focus was on just a few areas of business with clear competitive advantages</td>
<td>Fragmented portfolio across asset classes, sectors, and geographies, leading to increased difficulty in maintaining competitive advantage across businesses.</td>
</tr>
<tr>
<td>Economy</td>
<td>Exceptional economic development, driven by high population growth, relative political stability, and massive government investment in infrastructure</td>
<td>Economic slowdown, maturing economies, and unstable macroeconomic environment following financial crises, political instability in some countries, and drop in oil prices.</td>
</tr>
<tr>
<td>Industry</td>
<td>Early stage of development across most industries, focus was on first-mover advantage</td>
<td>Disruptive technologies and business models put pressure on legacy businesses to innovate.</td>
</tr>
<tr>
<td>Competition</td>
<td>Relatively closed economies favoring local players</td>
<td>More-open trade agreements (e.g., entry into the World Trade Organization) and increased competition from local and international companies entering home markets.</td>
</tr>
<tr>
<td>Financing and liquidity</td>
<td>Banks’ excess liquidity led to abundant financing options and reputation-based lending to prominent families</td>
<td>Cash flow pressure and more stringent financing conditions following the financial crises. Tighter funding environment than in the past. Lenders favor businesses with the strong governance, institutionalization, and strategic focus that many family firms lack. Disagreements within family companies about direction during the generational handover means that some family members can refuse to get rid of family assets, invest their own money into the business, or borrow against their balance sheet. Difficulty in monetizing illiquid assets such as land in a cyclical real estate market.</td>
</tr>
</tbody>
</table>

Source: Strategy&
The transition to becoming an institution requires family businesses to assess their current position and capabilities and take action in three main areas: governance, strategy, and corporate enablers (see Exhibit 2). Strengthening themselves in these areas means making the transition from a family concern to a professional enterprise run to the highest standards of corporate governance and transparency. The process of institutionalization will separate family matters from corporate affairs, increase professionalism, and maximize value to the owners of the business. Each family business will have a different starting point and will require a customized journey to institutionalization. There is no standard path for becoming an institution.

Exhibit 2
The three elements of institution building

Source: Strategy&
Family and corporate governance

**Family governance**

Every family enterprise has a core set of values that underpins its family governance model and how it is implemented. These values were typically established informally by the founding generation. They determine how the family and the business will function and they form the foundations of the family’s governance model. Family businesses should begin by explicitly acknowledging and articulating these values. How a family states its values will differ. Some, for example, formally sign a morally binding family constitution. Others may hold family councils that allow all generations to informally discuss and pass on the family’s values.

Although the governance model will differ among family businesses, there will be certain common features. All models will provide guidance for all the areas in which the family and the business intersect — such as succession planning, ownership rights, and family employment policies. Similarly, all models should include such features as clear decision-making processes on potentially controversial matters.

The most critical function of the family governance model is to separate family and business matters. An inclusive family council should oversee all family affairs such as philanthropy, wealth management, and the education of younger generations. Meanwhile, a selected shareholder council that represents all family shareholders should supervise business matters through selection of board members and oversight of their performance.

**Corporate governance**

A family firm should have a robust corporate governance structure and exemplary transparency to complement its family governance model. The corporate governance structure should adopt best practices that comply with relevant regulations, account for the specificities of the business (or business requirements), and take into account the preferences of the wider family shareholder audience.

Governance is critical to maintaining oversight of the business, its strategy, its finances, and its management processes and policies. Family businesses need to have governance entities with clearly defined roles, composition, and methods of operation. These structures include a board of directors (typically selected by the shareholder council) with the necessary board and management committees. Good progress is witnessed within some regional family businesses that are increasingly professionalizing their boards by hiring independent directors who are non-family members, non-shareholders, and non-executives who help to maintain a “business-first” perspective at the board level.
Governance plays another equally important role of information sharing and transparency. In the past, family firms were often characterized by a lack of openness about some information. At the same time, not all family members were interested in the business or understood it. That has to change to avoid tensions in the family as family businesses welcome new generations and the number of shareholders increases. Governance needs to ensure the right level of information is channeled back to the family shareholders on a frequent basis to ensure the comfort of shareholders not involved in the business. One successful model has been adopted by Cargill, a family-owned company, and goes beyond what is required in terms of communication to shareholders. The firm acts as if it were a public company, reporting its earnings on a quarterly basis on its website. Cargill’s shareholder council plays an integral role, given its understanding of business performance and issues, and it frequently communicates more detailed information back to the wider shareholder base.

**Strategy**

Core capabilities

Changing market conditions require family-owned companies — just like public companies — to stake out a differentiated position in the market: they have to be better than their competitors in what they do. They therefore need to identify a few core capabilities to focus on. Family firms should ensure that their entire organization and resources are devoted to developing these core capabilities. This will allow them to differentiate themselves from competitors and maintain a right to win. In addition to aligning core capabilities with business objectives in terms of financial returns, risk-return profile, and liquidity (typically defined by the shareholder council), the consistency of the business objectives with these core capabilities is a key criterion for determining the target portfolio composition in terms of asset classes, sectors, and geography, and agreeing on a set of investment characteristics (e.g., development stage, holding period, and ownership stake). The business is able to assess new investment opportunities against these requirements, which ensures portfolio coherence and alignment with the target strategy. Capabilities coherence is strongly correlated with profitability according to a Strategy& study published in the *Harvard Business Review*.²

Some family businesses have taken advantage of their core capabilities to invest in new markets and new sectors. For instance, one large regional company realized that its deep distribution expertise in its core industry could apply to other markets, and it achieved a successful selective geographical expansion. The company has also used its familiarity with its home market to achieve success in related new industries that require similar underlying capabilities.
Management of non-operating investments

One of the most common issues for family firms is how they handle their non-operating investments, including real estate and such financial investments as stocks and bonds. The best option for a company with limited financial management capabilities is to outsource this function. This should, however, happen in a highly controlled manner to ensure that the portfolios that are built fit the risk return profile of individual and/or collective family members. Family conglomerates can, however, keep the management of non-operating investments in-house if they do have the capability to make it worthwhile. For example, family conglomerates with financial management as a core capability typically use a separate family entity to manage non-operating investments. Such a segregated model reduces the family’s risk of contaminating the business’s finances — for instance, by using family wealth to collateralize business loans — and vice versa. One example is the French investment company Wendel, whose success stems from it possessing best-in-class internal financial management capabilities that are difficult to replicate.

Corporate enablers

Professional corporate functions

Family businesses that have become institutions should have the right corporate enablers in place to deliver on their strategy. This need is reinforced in the case of diverse portfolios that contain entities at varying maturity levels, requiring a strong holding entity that can consolidate business assets under one roof and ensure proper oversight and support. This holding entity needs to develop best-in-class centralized corporate functions such as strategy, finance, and human resources that interact with the corresponding functions in the businesses (when available). These corporate functions enable it to oversee business activities and provide subsidiaries with strategic guidance, capital allocation, and talent development. The corporate functions and services, such as strategy, finance, or HR, are selected to support the holding entity’s corporate management role vis-à-vis portfolio companies. They support the company’s integrated value creation strategy, optimize efficiencies and operational synergies, and ensure flexibility for future growth.

Finding and retaining an experienced management bench to drive these functions is critical; professional training programs across all levels of the organization and rotations within the organization or with international partners are common approaches to develop and retain top talent.
Planned financial resources

For family businesses, an important corporate enabler is to define the equity and debt funding required to support short- and long-term growth aspirations. The shareholder council should agree on the optimal level of assets (including financial investments, land, and cash) that should be maintained as part of the business to implement the strategy, while limiting the need to raise new capital from the family, in order to balance business requirements and family wealth expectations. It is important for the business not to have more resources than it needs because this can tempt managers to pursue opportunities that may not fit with the strategy and core capabilities. The ownership structure for family wealth and business assets should therefore be designed to ensure flexibility for future transactions.

The family should also ensure that the business keeps control over assets that were collateralized for business use, as well as personal assets that are used for company purposes — such as office buildings. The remaining assets are thus considered family-owned assets and can be distributed to the family members when the subsequent generation inherits the business and other assets.
Profiles of regional family businesses on the journey to becoming institutions

If at all possible, family businesses should begin the journey from enterprise to institution while the firm’s founders are still active. The first generation, or a second generation with a unified view, has the credibility and influence to make a compelling case for institutionalization and can obtain support from a diverse group of stakeholders. Once the shareholding becomes very fragmented among different generations, it may be difficult for businesses to marshal support for the journey to institutionalization.

The importance of governance, strategy, and corporate enablers can be seen by examining profiles of MENA family businesses as they make the journey toward becoming institutions. Although each family business has unique features, which means a different starting point and a differentiated institutionalization journey, four profiles that draw on actual examples help illustrate the common themes that these firms confront (see Exhibit 3).

Exhibit 3

The four profiles of regional family businesses on the journey to becoming institutions

Source: Strategy&
The “one-man show”
The “one-man show” has succeeded thanks to one family member — or in some cases a few.

Weaknesses:
“One-man show” organizations lack strong non-family corporate capabilities. Such companies struggle to maintain family unity and shield the business from family issues when new generations join the business. The lack of institutionalization means there are open questions as to who should run the business and how. Such issues concerning governance can have a negative impact on the company’s prospects.

Institutionalization status:
**Governance**: Nominal — must be urgently developed
**Strategy**: Insufficiently developed — firm must develop differentiating capabilities to be sustainable through generations and successfully face business environment challenges
**Corporate enablers**: Nominal — must be urgently developed

Institutionalization imperatives:
“One-man show” leaders need to understand that the family business must be about business — not family. The narrow base of the management team and the lack of boundaries between the family and the business mean that although they may have flair, they likely lack professionalism and sustainability. Therefore, “one-man shows” need to put in place the right governance mechanisms (e.g., formal board of directors, clear approval authorities) to formalize decision making and delegate sufficient power across the organization.

The narrow base of these firms means that institutionalization should happen gradually. Family members need to delegate some matters to the next generation. One way to achieve this can be to hire appropriately selected external advisors to attend board meetings during the early stages of institutionalization. At a later stage these advisors can become independent directors. “One-man shows” need to move from being driven by the founder’s insights to formulating and applying a capabilities-driven strategy. These businesses also need to make a conscious effort to professionalize their functions. They need to revise their business structure, consider setting up a holding entity with key corporate functions (e.g., finance, HR), and build management capabilities among staff who are not family members.
The “business–family merger”
The “business–family merger” has a strategy to grow the business, and has developed its differentiating capabilities. To a lesser extent it has developed its corporate enablers, but family governance is weak.

Weaknesses:
The “business–family merger” makes little or no distinction between family wealth and corporate assets, services, and rights. The result is conflict between the business’s priorities and family members’ desire to maintain liquidity for personal requirements. Family members rely on the business for income (e.g., demanding high dividends), employment (e.g., taking key positions away from capable managers), and other personal use (e.g., using corporate resources for personal services).

Example of a “one-man show” profile

Family business overview:

**Industries:** Hospitality, healthcare, and real estate  
**Ownership:** 100% family owned  
**Founder:** Two, one of whom is still involved in the business  
**Generations:** Currently witnessing ownership transition from the first to the second generation and management transition from the second to the third generation  
**Number of family members:** Around 100

Characteristics:

- Complex dual-entity ownership in which the business is owned by two legal entities, which could lead to conflicts of interest in the future (all members are shareholders of one entity and some are shareholders of the other entity).
- No separation between oversight, governance, and management; an executive committee composed of four family members from the second generation plays a dual governance and management role for both legal entities. All business decisions are taken by the executive committee.
- Limited transparency of the activities and performance of the business; family members who are not a member of the executive committee do not receive any update on the performance of the business.
- Family tension created because only select members are involved in the business, which is leading to a decrease in the level of commitment of others in the family.

Key recommendations:

- Reduce the family ownership to one entity, while ensuring that family members’ stakes are maintained fairly.
- Develop a corporate governance model that clarifies the roles and responsibilities and separates management from oversight.
- Define the family employment policy clarifying the eligibility of family members to be involved in the business at the management or the board level.
Institutionalization status:
**Governance:** Nominal — must be urgently addressed
**Strategy:** Developed — no need for action beyond continuous improvement
**Corporate enablers:** Insufficiently developed — needs more attention

Institutionalization imperatives:
Governance should be a top priority. Family members should agree on a family governance model that sets the boundaries in areas where the family and business overlap, such as ownership rights, asset categorization (family wealth versus business assets), liquidity principles, family council setup, and family employment policies. They should agree on a family constitution or set of agreed principles that can maintain family unity. The governance model should be simple and fair to appeal to all family members across generations. Family members could also agree to set up a family office that provides a range of services such as philanthropy and concierge services without using company resources, and align on a fair charging mechanism. The family/business separation will help develop the corporate enablers that have been neglected. A resilient family governance model also reinforces the capabilities-driven strategy by making decision-making more focused, especially as the family grows larger with successive generations.

**Example of a “business–family merger” profile**

Family business overview:

*Industries:* Heavy machinery, trading  
*Ownership:* 100% family owned  
*Founder:* One, who is not involved in the business anymore  
*Generations:* Currently undergoing ownership transition from the first to the second generation. Business managed by the second generation, third generation not yet involved.  
*Number of family members:* Around 80

**Characteristics:**
- Lack of clarity on the categorization of assets, i.e., what belongs to the family and what is a business asset.  
- Difference in the liquidity requirements of family members, and hence disagreement on whether portfolio assets should be consolidated or distributed.

**Key recommendations:**
- Review current portfolio composition and determine action to be taken on each asset: whether to manage under the family group (based on the group strategy and business needs), to liquidate and redeploy capital, or to distribute to family shareholders.  
- For the liquid active investments (e.g., shares in a listed bank), coordinate at the very least their management in order to maintain control and influence (e.g., board seat).  
- Agree on the principles and policies governing the family business.
The “going concern–going nowhere”
The “going concern–going nowhere” is a legacy organization with large, established businesses and a strong market position, but which can no longer achieve its growth and profitability objectives.

**Weaknesses:**
The “going concern–going nowhere” has not adequately defined a corporate strategy nor developed the capabilities to deliver it. Such businesses have often diversified their activities across various sectors and geographies after their core market reached saturation or through opportunistic expansions. In doing so, these businesses limited the potential value they could add to the operations of companies in their portfolio. These family businesses often find that they are not nimble enough to respond to changing market conditions.

**Institutionalization status:**
**Governance:** Developed — already addressed
**Strategy:** Insufficiently developed — the business strategy lacks a capabilities focus
**Corporate enablers:** Nominal — must be urgently addressed

**Institutionalization imperatives:**
The “going concern–going nowhere” has yet to identify its core capabilities and focus on them. It can do so by building on the fact that it already has proper family governance. The shareholder council, aided by solid reporting systems, should play a critical role in this exercise. It should then set the business objectives and define the target portfolio composition, based on the core capabilities. As part of this process, the firm should review existing businesses in its portfolio and identify the ones to divest, hold, fix, grow, or integrate. It may find that certain business units that were either early acquisitions, important to the founder, or sentimental favorites have consistently underperformed the market and generated significant losses. In such cases, it should consider disposing of them or shutting them down.
Example of a “going concern–going nowhere” profile

Family business overview:

Industries: Food, construction, real estate
Ownership: 100% family owned
Founder: Two, still involved in the business
Generations: Currently witnessing ownership transition from the first to the second generation and management transition from the second to the third generation
Number of family members: Around 100

Characteristics:

- Rapidly growing family size putting pressure on wealth creation.
- Business slowdown in local market creating the necessity for the family business to invest in different regional and global markets.
- Management of future growth (new sectors, geographies, and asset classes) not compatible with current structure and resources.

Key recommendations:

- Define the core capabilities of the family business and articulate the stakeholders’ growth aspirations and strategic priorities.
- Develop the strategy of the business by leveraging current core capabilities to expand into new geographies in emerging markets that have a different risk-return profile to markets the firm is currently in; expand in adjacent sectors and geographies.
- Reorganize operations around the core market and form country units that report to the CEO to leverage centralized capabilities.

The “institutionalized family business”
The “institutionalized family business” delivers strong results because it has completed the institutionalization journey; it has proper governance, a capabilities-driven strategy, and well-developed corporate enablers.

Weaknesses:
The “institutionalized family business” can be complacent. It can struggle to dispose of underperforming assets, especially ones the family is emotionally attached to.

Institutionalization status:
Governance: Developed — already addressed
Strategy: Developed — already addressed, must be revised frequently
Corporate enablers: Developed — already addressed, must be revised frequently

Institutionalization imperatives:
Such businesses must maintain a dynamic strategy and continuously grow their differentiating capabilities, in order to avoid backsliding. This involves monitoring performance to ensure it is in line with the set targets and initiate corrective actions if needed. They should also analyze recent market developments (e.g., competition, technology, disruptions) and assess those developments’ impact on the business. Finally, they should regularly review and update their strategy, performance targets, and capabilities requirements to account for market changes.
Many family businesses have already begun the transition to a fully institutionalized model. Each journey should be distinct, sensitive to the different needs and starting points of family conglomerates. Some have even addressed the majority of their internal challenges and are focused on a disciplined execution of their investment strategy. As MENA family conglomerates look beyond their institutionalization journey, they need to take a step back and reflect on their long-term expectations in terms of wealth creation, growth, and liquidity. Ultimately, family businesses should recognize that beyond any required governance and ownership initiatives, their only sustainable source of value creation comes from ensuring they have a solid growth strategy for the business, and the ability to execute their defined initiatives, irrespective of ownership type and control.

Strategy& is a global team of practical strategists committed to helping you seize essential advantage.

We do that by working alongside you to solve your toughest problems and helping you capture your greatest opportunities.

These are complex and high-stakes undertakings — often game-changing transformations. We bring 100 years of strategy consulting experience and the unrivaled industry and functional capabilities of the PwC network to the task. Whether you’re charting your corporate strategy, transforming a function or business unit, or building critical capabilities, we’ll help you create the value you’re looking for with speed, confidence, and impact.

We are part of the PwC network of firms in 157 countries with more than 223,000 people committed to delivering quality in assurance, tax, and advisory services. Tell us what matters to you and find out more by visiting us at strategyand.pwc.com/me.