Due Diligence and Dynamics in Wealth Management

IPI-Hawkamah-Tharwa Seminar

Dubai International Financial Centre

14 April 2008

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Agenda

- MENA Economic Renaissance: Corporate Governance imperative for achieving the "Great Transformation" of GCC/ME economies
- Families & Business
- Institutionalizing Families in the GCC/ME region

A ME/GCC Economic & Financial Renaissance

- **Above trend average real GDP growth 6.2% over 2004-2007 vs. 3.7% in 1998-2002**
- **Sustained by strong Global growth led by Emerging Markets**
- **Growth resurgence has been investment led with increased infrastructure investment leading to ↑ in absorptive capacity**
- **Positive demographics & migration sustaining low labour costs & output growth; remittances creating new linkages with labour exporting countries**
- **Growth in personal and public wealth: HNWI growing by 20% p.a.;**
- **Strong fundamentals and macroeconomic conditions characterized by large twin current account & fiscal surpluses and declining levels of public debt.**
- **Growth of Shari'a compliant finance**

Historical opportunity for “Great Transformation” of GCC

- Desirable to sever the link between energy revenues and capital spending: finance projects & infrastructure through financial markets
- Channel energy revenues into Future Generation Wealth Funds (FWFs)
- Crucial role of financial markets of channeling resources to the most productive use would be greatly enhanced

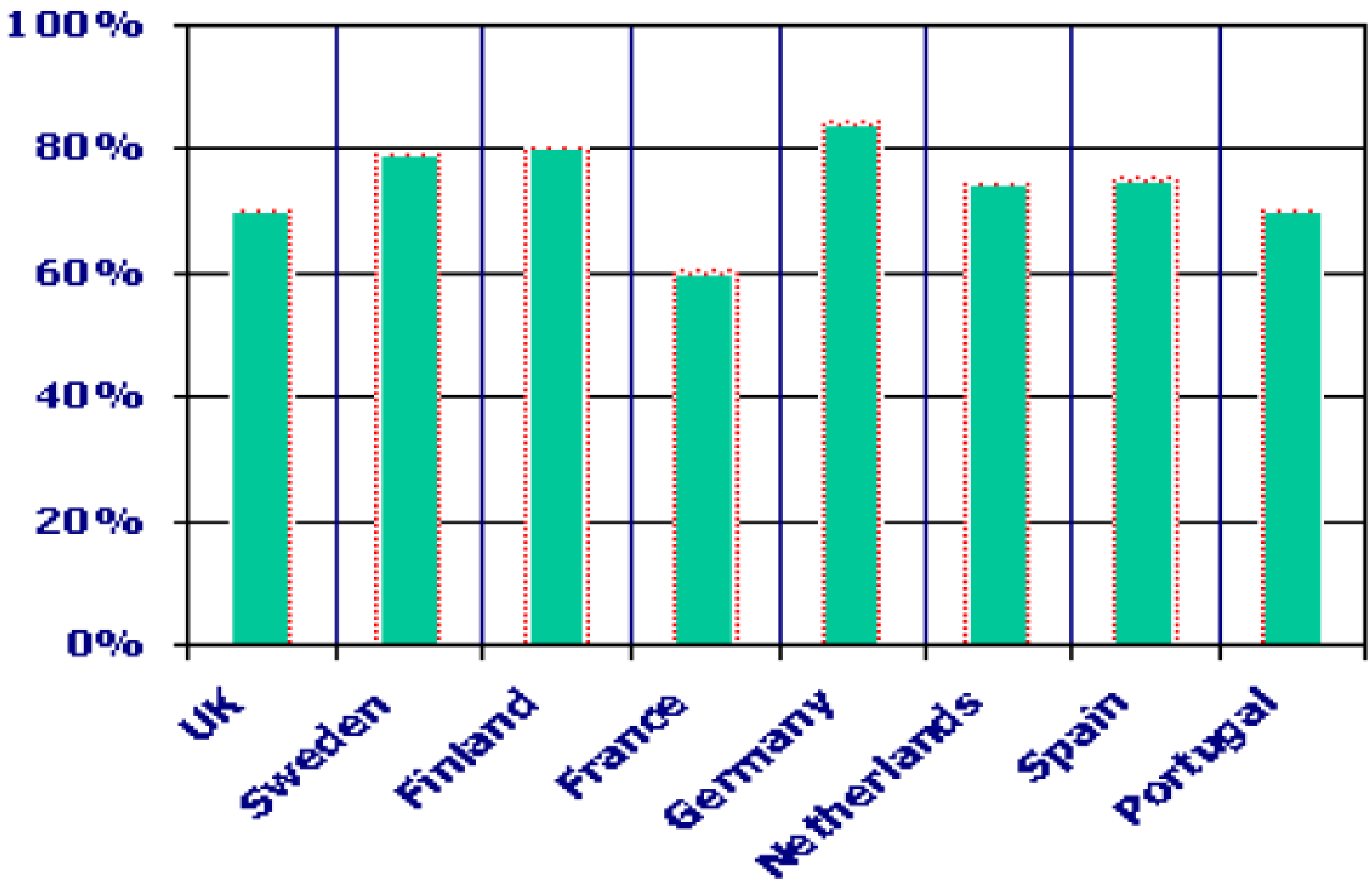
Positive repercussions: strengthen Growth Sustainability

- Break Oil-induced Boom-Bust Cycle
- Absorb high liquidity growth resulting from energy revenues
- Improved fiscal policy discipline, management & control
- Achieve increased economic diversification
- Increased private sector participation in economic activity
- Greater fluidity of financial flows and deepening of organized financial markets

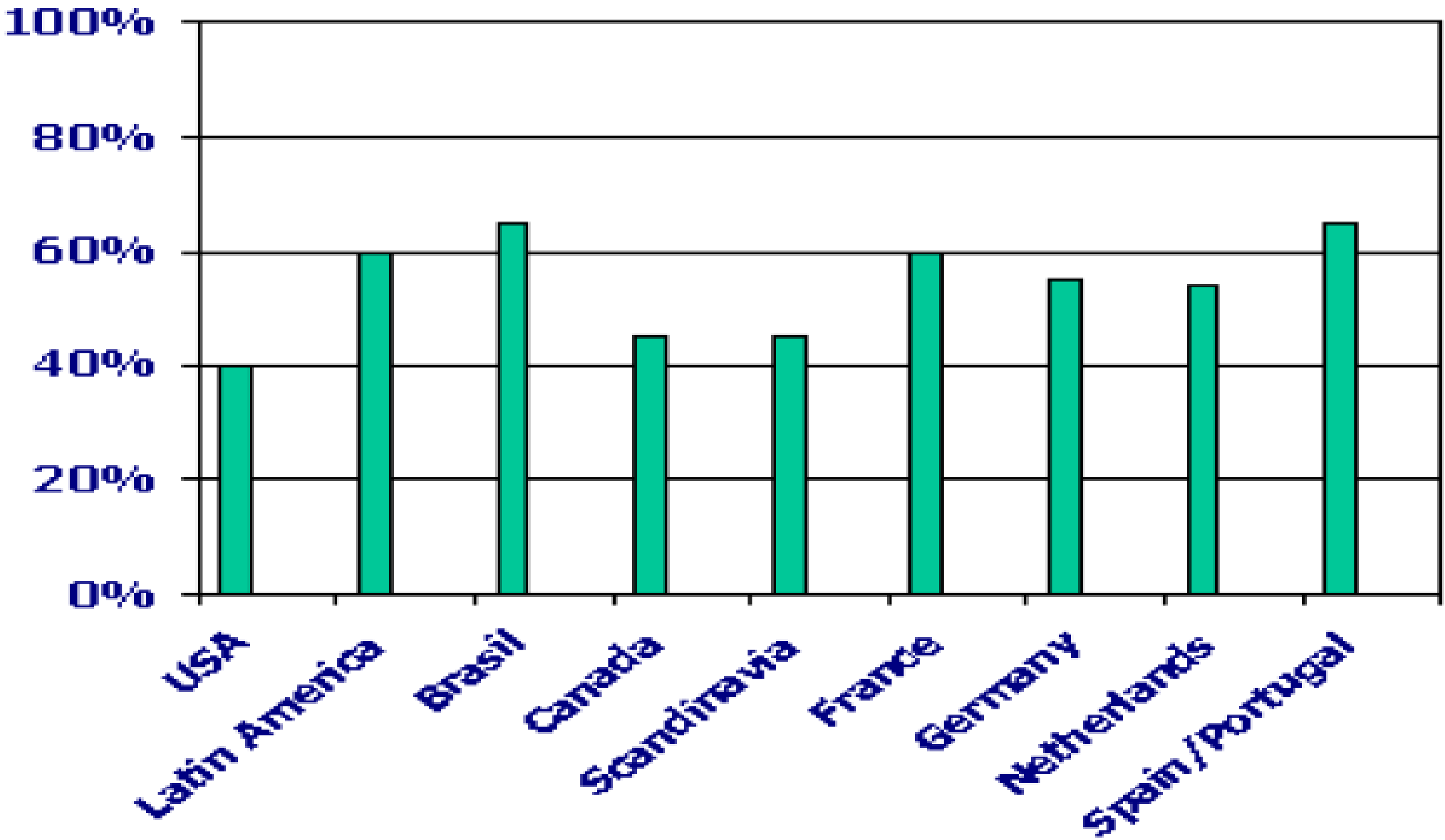
The CG Imperative

- "Good corporate governance" required by both the public sector and the private sector in the MENA
- Address CG challenge for Family Owned Enterprises, State Owned Enterprises, banks and listed companies
- Investment in bridging 'CG gap' a priority:
  - Build and grow Capital markets
  - Need to attract FDI, M&A
  - Finance infrastructure and investments
  - Succeed in market liberalization & privatization
- ***Better CG is a key to "Great Transformation" of ME/GCC economies, sustaining growth and developing sound, efficient and resilient financial markets***

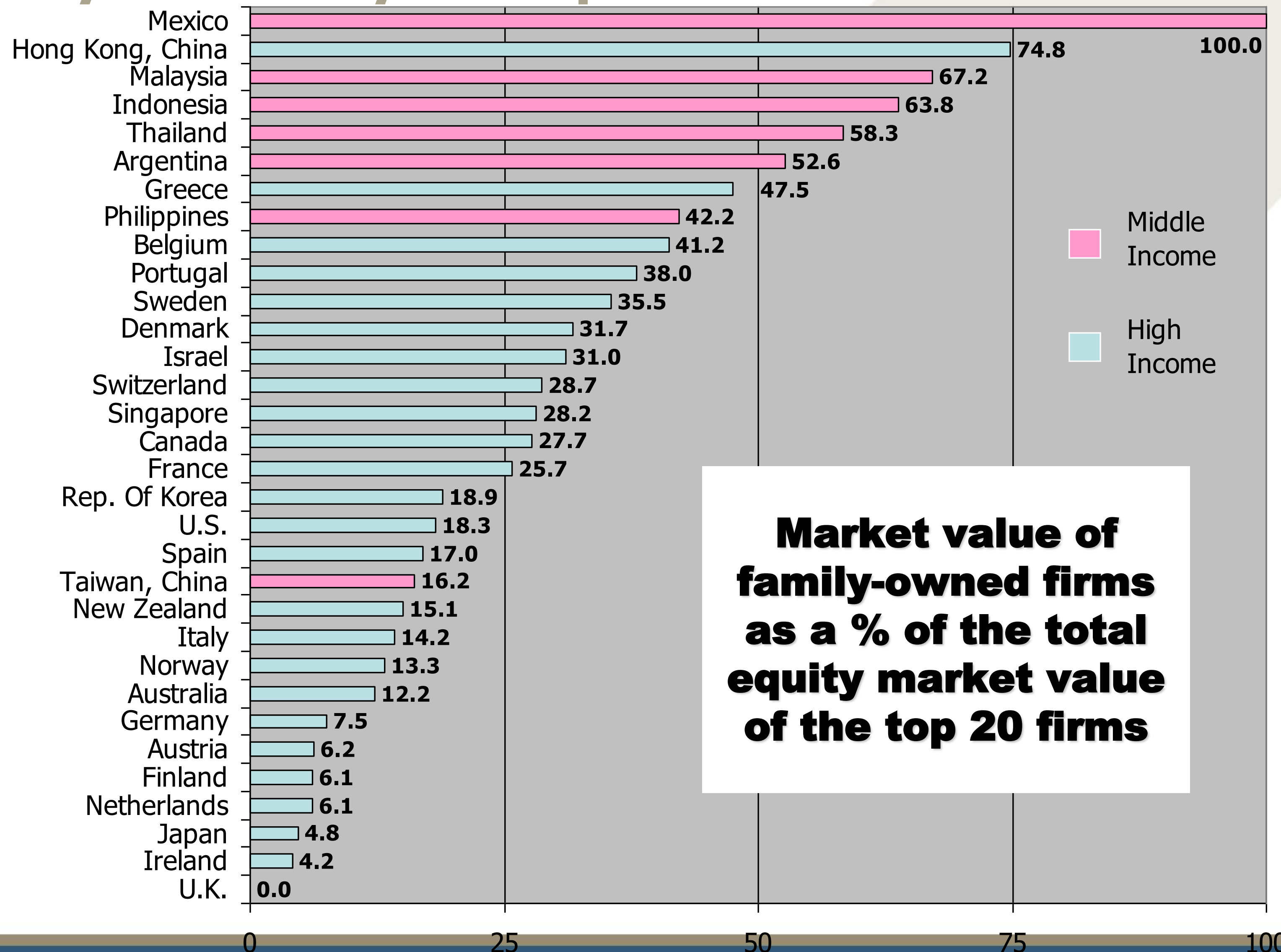
Family Businesses are Dominant: % of all businesses (Source: FBN)



Family Businesses are major contributors to GDP (Source: FBN)



Family Firms Play an Important Role in Markets



Source: OECD Analysis

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Corporate Governance : Performance in Emerging Markets

Better CG correlates with	Firm level CG provisions & practices matters even more wherever	Cross-country differences in laws & enforcement affect
⇨ better operating performance	⇨ weak shareholder rights	⇨ ownership structure
⇨ better market valuation of companies	⇨ weak legal environments & weak public governance	⇨ dividend payouts
		⇨ availability & cost of external finance
		⇨ market valuations

Example: In the UAE listed companies, families are represented on many Boards (257 total seats/37%)

Family name	# of board seats held	% of all board seats	# of seats DFM-listed companies	# of seats ADSM-listed companies
Qassimi	45	6.4%	3	42
Dhahiry	23	3.3%	2	21
Mazrouei	23	3.3%	5	18
Ghurair	16	2.3%	15	1
Suwaidi	15	2.1%	0	15
Shamsi	12	1.7%	1	11
Qubaisi	11	1.6%	0	11
Mansouri	10	1.4%	3	7
Sayegh	9	1.3%	2	7
Muhairi	9	1.3%	0	9
Khoury	8	1.2%	1	7
Yousif	7	1.0%	3	4
Sarri	7	1.0%	5	2
Hosani	6	0.9%	0	6
Badi	6	0.9%	1	5
Essa	6	0.9%	5	1
Jaber	6	0.9%	0	6
Mualla	6	0.9%	0	6
Owais	6	0.9%	4	2
Nahyan	6	0.9%	5	1
Darmaki	5	0.7%	0	5
Lootah	5	0.7%	5	0
Mulla	5	0.7%	5	0
Zaabi	5	0.7%	1	4

Source: ADSM, DFM, TNI Investment Research, Company accounts

Multiple Family Members on the Board of Same Company

National

Table 10: Multiple family members on the board of the same company

Market	# of companies	0 directors from same family	2 directors from same family	3 directors from same family	4 directors from same family	5 directors from same family
ADSM	59	44.1%	42.4%	11.9%	1.7%	1.7%
DFM	34	58.8%	26.5%	14.7%	0.0%	2.9%
UAE-listed	**93**	**49.5%**	**36.6%**	**12.9%**	**1.1%**	**2.2%**

Emirate by Emirate

Table 11: Multiple family members on the board of the same company

Location	# of companies	0 directors from same family	2 directors from same family	3 directors from same family	4 directors from same family	5 directors from same family
Abu Dhabi	29	44.8%	51.7%	3.4%	0.0%	0.0%
Ajman	1	0.0%	100.0%	0.0%	0.0%	0.0%
Dubai	27	55.6%	25.9%	14.8%	0.0%	3.7%
Foreign-based	12	66.7%	33.3%	8.3%	0.0%	0.0%
Fujairah	2	100.0%	0.0%	0.0%	0.0%	0.0%
RAK	11	45.5%	18.2%	27.3%	9.1%	0.0%
Sharjah	9	33.3%	33.3%	22.2%	0.0%	11.1%
Umm Al Qaiwain	2	0.0%	100.0%	50.0%	0.0%	0.0%

Source: *It's A Family Affair* The National Investor Market Insight, April 25, 2007

Challenges for Family Business Owners

Challenge	Issues
Access Capital	Finance growth Balance debt/equity
Diversify wealth	Manage risk Provide liquidity
Manage succession	Appoint competent directors/managers Adjust shareholdings pursuant to inter-generational hand-over Finance share transfers Balance jobs/compensation for family employees with returns to family shareholders

These challenges and issues exist for all closely controlled firms

Source: OECD Analysis

Top 10 Questions Facing Family Business Boards: I

- **Why should my family business have a board (advisory or statutory)?**
- **What are the critical issues that my board must address?**
- **What techniques can you suggest for developing a more professional board?**
- **How do I manage communications between the board and the family?**
- **Should I let my outside directors push for ideas that are not supported by the family?**

Source: NACD Family Business Survey, 2004

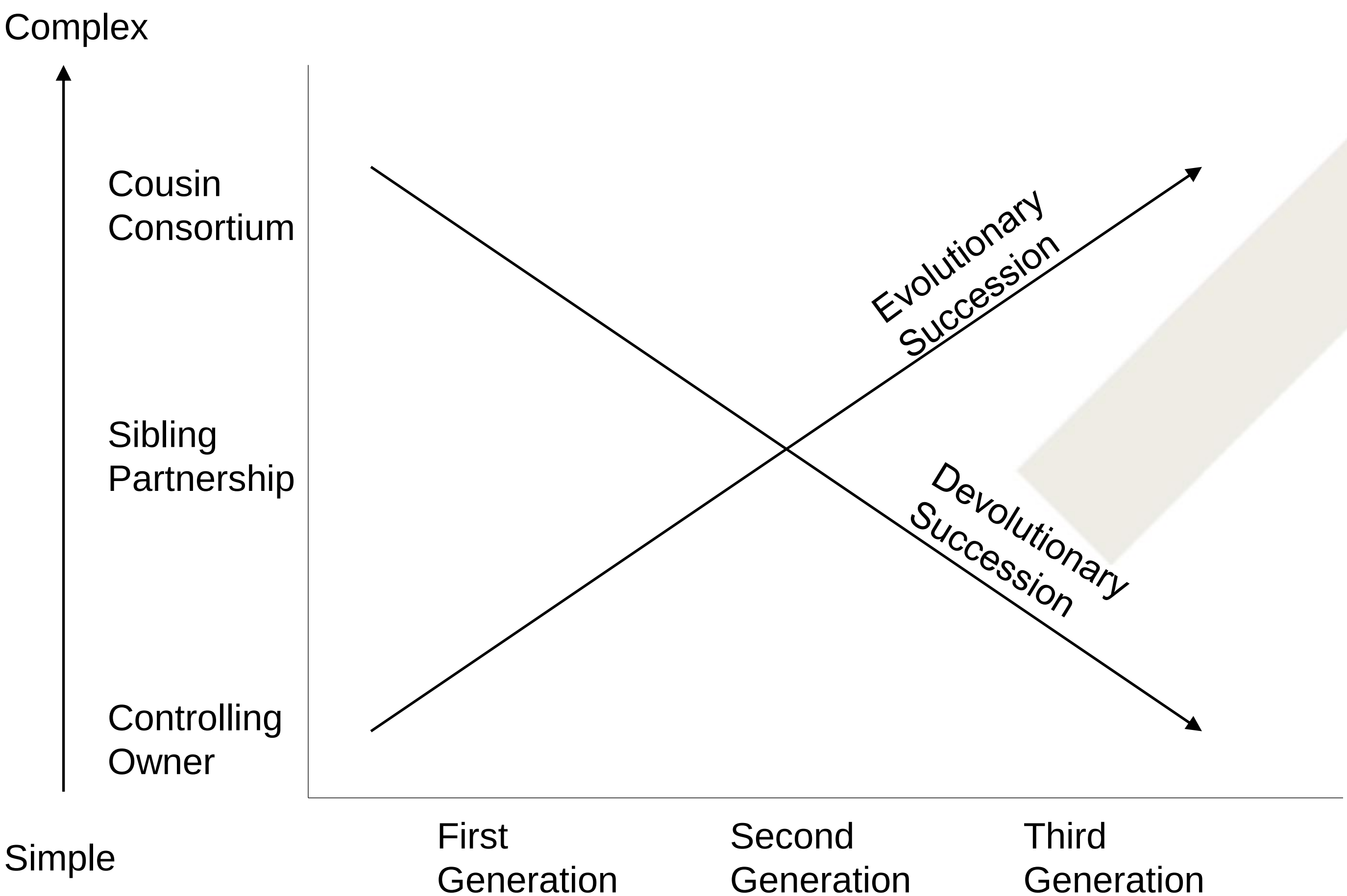
Top 10 Questions Facing Family Business Boards: II

- What role should my board play in transitioning the company to the next generation?
- Should my board be led by a non-executive, non family chairperson?
- Should I be worried about complying with the Sarbanes-Oxley legislation?
- Should I have an audit committee composed solely of independent directors?
- How can I get my board to work together, when they represent different interests?

Source: NACD Family Business Survey, 2004

Dealing with Succession is Key to Longevity of Family Firms

Succession in Family-Run Firms



Good corporate governance becomes necessary to run the business and to preserve family harmony

Source: Paul Westhead and Carole Howorth, “A Comparison of Ownership and Management Practices in First and Multi-Generational Family Firms,” 24th ISBA National Small Firms Conference, 2001

Corporate Governance and Access to Capital

"Good" corporate governance is essential for:

- safeguarding company assets
- maintaining and enhancing investor confidence
- reducing the potential of fraud

"Poor" corporate governance companies

- will find it harder to access external capital
- will face higher financing costs
- will see their credit ratings downgraded
- will have weak investor confidence

Transition & Succession Issues & Evidence

Centre for Economic Performance at LSE and McKinsey & Company have jointly conducted a major survey of the management practices of over 730 medium sized manufacturing firms in the UK, France, Germany and the United States.

- Analysis of the data reveals that firms that are family-owned but not managed by family members are typically well managed. An example is Wal-Mart, which is still largely owned by the Walton family but which has had a professional (non-family) CEO since the retirement of Sam Walton, the firm's founder.

- While family ownership seems to improve management practices modestly, family management by the children of founders is typically less good. When the CEO is selected by 'primogeniture' – that is, selecting the eldest son – the management practices of the firm tend to be extremely bad.

Choosing CEOs for Family firms

First, selecting the CEO from among the small group of potential family members severely restricts the available pool of managerial ability.

Second, letting family members know that they will get to manage the firm later in life can lead to a ‘Carnegie effect’, in which family members work less hard at school and early in their careers safe in the knowledge of a guaranteed family job.

How do Family Ownership, Control and Management Affect Firm Value?

Survey of data of Fortune 500 firms (1994-2000) establish that:

- Family ownership creates value only when the founder serves as CEO of the family firm or as its Chairman with a hired CEO
- Control mechanisms including dual class share classes, pyramids, and voting agreements reduce the founder's premium.
- When descendants serve as CEOs, firm value is destroyed.
- Owner-manager conflict in non-family firms is more costly than the conflict between family and non family shareholders in founder-CEO firms.
- But conflict between family and non-family shareholders in descendant-CEO firms is more costly than the owner-manager conflict in nonfamily firms.

Source: Amit, Raphael and Belen Villalonga: *How do Family Ownership, Control and Management Affect Firm Value*, December 2004

Families and Finance in MENA

- Families represent more than 90% of MENA businesses

- Major source of job creation in coming decade

- Families/entrepreneurs should actively promote development of financial markets:
  - Meet challenge of increased economic openness and globalization
  - Reduce risk through diversification and divestment of family assets
  - Exit strategy: solution to successor problem and equity in family inheritance

- Families must become ‘institutions’

Family Business Forum Initiative

- Aim is to identify challenges faced by the region's family businesses through research, workshops and seminars, and support the development of a regionally-relevant framework to institutionalize families
- Activities will include:
  - Commissioning regionally relevant research
  - Facilitating dialogue among regional families to share and learn from experiences of other markets
  - Housing a library on family business issues

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