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للمنشآت العائلية
National Center
For Family Businesses

Succession planning in family businesses

From common to successful practices

April 2023
KPMG Professional Services

Content

Foreword

Since the announcement of Vision 2030, Saudi Arabia has been witnessing unprecedented transformation in various domains. As one of the Vision's main objectives is to achieve a long-term economic diversification, a significant role is placed on the private sector. When we talk about the private sector in Saudi Arabia, we inevitably have to consider family businesses as they make up 63% of the private sector and make significant economic contributions to the economy – whether GDP or employment. For those familiar with research on family businesses, it is known that the rate of survival of family businesses drops significantly as the business transitions from one generation to another. What makes family businesses unique in the Kingdom compared to other countries outside the region, is that majority are fairly young – established during the 1960s – and have either gone through one succession or none yet.

As we do believe in the significance of family businesses for this country's economy, the National Center of Family Business (NCFB) and KPMG continue to be committed to support the family business ecosystem so that family businesses can play an impactful role in their contribution to the economy and to job creation. For these reasons, NCFB and KPMG embarked on this research project, led by two distinguished Saudi researchers and practitioners in the family business field namely Dr. Hanoof Abokhodair and Dr. Dalal Alrubaishi. We hope that family businesses in the Kingdom and beyond do find it useful.

We would like to extend our gratitude and appreciation to all the prominent Saudi Arabian business families who gave us some of their precious time to be part of this publication. Without their contribution, this could not have been possible.

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Introduction

One of the key characteristics that differentiate family business from non-family businesses is the intention to transfer the business from one generation to the next in family businesses. It is through successful succession in each generation that family businesses are able to exist long – at times longer than the lifecycles of the industries in which they operate. There are many examples of family businesses that are centuries old, something not any of them could have achieved without having many successful episodes of succession.

Despite the importance of succession to the sustainability and longevity of family businesses, we observed through our experiences with business families in Saudi Arabia and neighboring countries that succession is a topic less spoken about when compared to governance, for example. Many families are concerned with mitigating the risks of family conflict to the extent that much of their attention, resources, and time is dedicated to finding ways to develop their governance structures and protocols. Having an effective governance framework does help answering some of the succession questions, however, governance structures and protocols, on their own, are not sufficient to take a family and its business through the succession journey.

Rarely did we come across families who explicitly spoke about succession as an important problem to resolve or who had a plan, written or unwritten, that they intend to follow for succession. In most cases, we observed succession taking place reactively and organically without proper analysis, preparation, or planning for either the current or the next generations whether in the family or in the business.

Lack of explicit and organized succession is, understandably, in part due to cultural considerations we have in the Kingdom and the region. Many families in Saudi Arabia find it culturally inappropriate to raise the question of what will happen after the parents' death. In part, though, we also believe that lack of organized succession is caused by unclarity of what succession is, what aspects it should address, and what decisions should be made to ensure a smooth and successful transition from one generation to the next. However, with the pace of changing market dynamics and unforeseen events such as Covid-19, we see that Saudi family businesses in the Kingdom are starting to realize the importance of planning succession in the most suitable manner.

As a result, we were excited to lead this research project, with businesses families in Saudi Arabia on the topic of succession in order to develop a practical guide for business families that would assist them in their succession journeys.

We would like to express our appreciation to all the family-business owners and leaders who participated in this study and to those whose help facilitated gaining access to participants, all of whom made this research possible. We hope that this guide helps you and your family in navigating your generational transition journey.

Methodology, demographics and definitions

To achieve the goal we set for this project, we utilized qualitative research method to gain a thorough insight and understanding into how family businesses undergo succession in the Saudi context. We conducted 19 semi-structured interviews with family business leaders in Riyadh, Jeddah, and the Eastern Province to ask them about their succession journeys. Interviews ranged between 75-120 minutes with an average of 88 minutes. We used the following criteria for sampling. First, businesses identifying themselves as a family business. Second, those that have had a succession. Third, have another succession episode approaching. The sample was purposive in nature and the sample size is based on saturation where no more new themes are emerging.

The businesses families we interviewed operate in a variety of industries including retail, construction, oil and gas, mining, automotive, communication, education, pharmaceuticals, and agriculture. They also range in age; we spoke to families that own companies that are eleven years old and others who own companies that are around 100 years old with an overall average age of 49 years. The businesses were also of different sizes, with some having as little as 30 employees and others as much as 7000, with an average of approximately 1700 employees. The legal structure of more than two third of the companies is closed joint stock, and the rest were limited liability companies LLCs.

Firm age

Between

11-100 years

Average

49 years

Number of employees

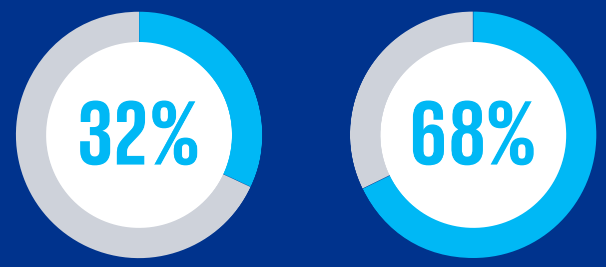
Between

30-7000 employees

Average

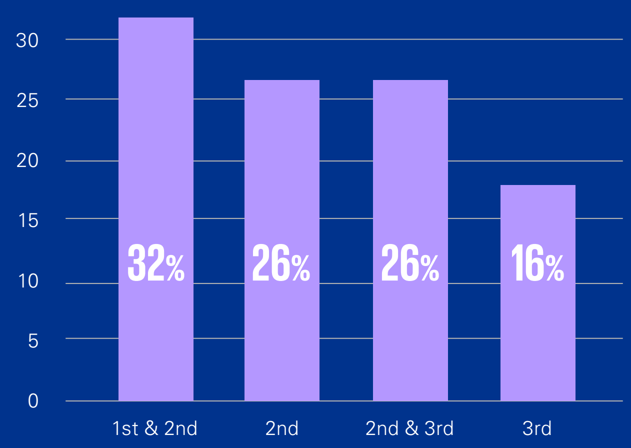
1697 employees

Legal structure

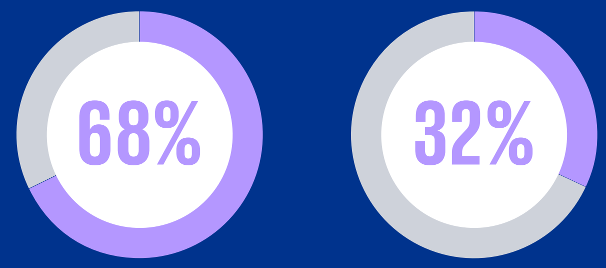


We also ensured that we learn about succession in business families at different generations. Thirty-two percent of those we interviewed were in companies that are run by first and second generation, 26 percent by second generation, 26 percent by second and third generation, and 16 percent by third generation. Around two-thirds of the companies were managed by family members while the rest assigned a non-family CEO.

Generation managing the business



CEO family member



In terms of governance, all family businesses we interviewed have a board of directors (BOD) or board of managers except for one. Out of those with a board, 39% have an all-family members board, while the remaining 61% have a mix of family and non-family board members. One third of the family businesses we interviewed have a family charter, one third do not have one, and one third are in the process of developing one.

All family members board

Presence of family charter

We believe the diversity of the families and companies we engaged with allowed us to deepen our learning about common succession processes in business families in Saudi Arabia and how they support or hinder successful successions.

We organize this paper based on the main decision areas that business families need to consider as they undergo generational transition. Within each decision area, we ask some of the most important questions business families should answer. For each question, we report the common practices that we found through our research along with our recommendations, based on our long experience working with business families.

What do we mean by succession?

Succession in family businesses is often understood as the transfer of ownership and management of the family business to the next generation. Moreover, it is typically viewed as an event that takes place the moment when the business leadership is handed over from the incumbent to the successor.

We believe that succession is better thought of as the process of transitioning the family enterprise from one generation to the next. This view means that the transition involves more than just the succession of ownership and management. At the same time, it indicates that transition is a long process over several fronts, some of which start in family members' early childhood and upbringing.

What are the main decision areas that business families need to consider in the process of generational transitions?

Each business family is different and there is never a "one size" which "fits all." This is true not only in generational transition decisions but also in all decisions a business family makes. As the topic of our paper is succession, each family should find the right arrangement for a generational transition that suits their particular situation and conditions.

There are different areas that need to be addressed in the generational transition process of business families. These involve both ownership and management succession as well as next generation development and the preservation of the family values and legacy. However, the most central of all, and the ones often overlooked, is to revisit the family's objectives as they approach a generational transition and also assess their objectives for the business.

Objectives of the family

Many families assume that what was the case in the past will persist in the future when it comes to family members and their priorities. However, this is rarely the situation. Every generation has its own times and conditions, and members in different generations often have dissimilar priorities to pursue.

When a family is undergoing generational transition, one of the most critical issues to consider is what the family wishes to achieve on the family side and to what extent members share the same objectives. Understanding what the family wishes to achieve for the family highly influences decisions on the generational transition journey.

Our interviews show that the families we spoke to had different objectives on the family side, and accordingly, have followed different paths in their ownership and management transition decisions. We spoke to families whose objective is for the family to stay together. We also spoke to families who were mostly concerned with preventing conflicts, growing the family's wealth, and/ or continuing the family's legacy. Some families clearly stated that family objectives were something they never thought about.

> **We want to continue working together. There is a strong bond between us and we want it to continue.**

> **Business should remain in operation regardless of who leads it. I'm opposed to it only being a family-owned business.**

Investing time in identifying what the family wishes to achieve on the family side is a very important building block that influences succession decisions. A family that wishes for the family to remain together will have to make decisions which facilitate achieving that particular objective. On the other hand, the family that places more emphasis on business continuity regardless of ownership will have a different path to take.

Another area of importance when families approach a generational transition is to find out who in the family is interested to continue in the family business. This is particularly a question for the next generation of owners. Before moving to decisions related to how ownership and leadership of the family enterprise should be handled, it is very important to first understand whether the next generation is interested in taking over the family business, whether collectively or individually.

We have observed that many families assume that next generation members are by default interested in taking over the family business. However, they do realize that the matter is not as straightforward when the next generation actually reaches the point of taking over. There are many cases where next generation members are either not interested all together or are partially interested to take over the family business.

We have come across several scenarios in our discussions with business families during the interviews. There were families with uninterested next generation members where the current generation decided to exit them as part of organizing ownership transfer during the founders' or incumbent's life. We also spoke to families where next generation members from different family branches did not wish to continue owning the family enterprise together, thus, bought each other out in different parts of the family enterprise. There were also cases where families who have decided to pass the business ownership to interested family members and other assets to uninterested ones.

> **The company was established by my father and uncle. When they passed away, we bought out our cousins in one part of the business and they bought us out in another part.**

> **Most of the third generation are not in our field of business. Some of them are not interested to work with us at all.**

These views confirm that as business families approach a generational transition, they should attempt to answer this question and identify whether and who of their next generation is interested and committed to co-owning the family enterprise with other family members.

Objectives of the business

Those who decided to stay in the business should check if they are aligned on the objectives of the business. A frank and open discussion around the business objectives, the portfolio of assets, and involvement of family members in the business at all levels should be conducted to achieve clear and transparent understanding of the "rules of the game" going forward.

Nonetheless, some family members might have aspirations for the future of the business that are not aligned with other family members' aspirations. Some might be risk averse, while others are risk takers, etc. Having a unified vision for the business enables the family to direct its resources towards achieving their vision. It is also an important factor in ensuring a smooth transition and buy in from the rising generation.

Through our interviews with business families for this research, we learned that change in business focus is more of a norm than an exception during generational transitions. Many families have reflected on whether the current portfolio they have aligns with the interests and conditions of their next generation of owners. Some families took the involvement of their next generation in the business as an opportunity to introduce new ideas and explore other areas than the traditional ones in which they have always operated.

> **When the third generation joined, they suggested to leverage, and I agree with them.**

Defining the objectives that current and future shareholders would like to achieve for their businesses informs what they should do to get there.

> **We have always provided the local market with diversified products and services, today we aim at the global market.**

> **Our business objectives keep evolving. First it was to make money, then to go public in order to mitigate risk, and now we prioritize our reputation and charitable work.**

Ownership transition

Deciding how ownership transition will happen is not as straightforward as people tend to think. There are often choices that families have to make when approaching ownership transition. On one hand, they need to decide who to include and exclude from ownership going forward. On the other hand, they need to make a choice about the legal means through which owners will own their shares in the family enterprise. Additionally, they need to come to decision on the process of share transfer.

In terms of ownership, our research indicates a variety of choices that families made. For example, three of the families we spoke to had an informal rule that restricts in-laws from being owners in order to keep the business in the family bloodline and to avoid conflicts. Some bought out female family members to prevent in-laws from joining as owners in the future. In other families, the co-founding siblings were bought out by one sibling when transferring ownership to the second generation, either due to misalignment in business objective or to keep the business in one branch of the family. We also encountered founders who distributed their wealth evenly among their children during their lifetime, giving the company to some and real estate assets to others.

“

We wanted to buy out our sisters because we did not trust their husbands to join the business. We were right with our decision because later on we discovered that one of our sisters' husband had bad intentions.

“

We did not allow in-laws to join, but I will amend this policy when we go public. It is not appropriate to include in-laws if the business is family-owned. It is also not recommended because in-laws cause many problems.

Business families should carefully consider what is generally perceived as fair by family members when making a decision about who becomes a shareholder in the future, and to balance family and business requirements. When ownership decisions are perceived as unfair by some family members, this scars family relationships and increases the likelihood of conflict among family members when those who made the decisions are gone.

On the other hand, deciding the legal structure through which the family owns the family enterprise is important. Different legal structures bring different advantages and disadvantages relative to the objectives the family wishes to achieve.

Our research reveals a strong pattern among the families we interviewed when it comes to their legal structure. Generally, family businesses started as sole proprietorships or partnerships between siblings. As the business grows and the founder's family join ownership, they convert to a limited liability company (LLC) to accommodate the increased number of shareholders. As families grow in size, and subsequently the number of owners increases and later generations join, many families lean towards converting the legal structure to closed joint stock.

The majority of the families we interviewed have either already converted to closed joint stock or are in the process of doing so. Closed joint stock suits larger families as it introduces good governance practices that are needed to organize the interaction and decision making of a large group of owners and it also facilitates a smother transfer of shares which is likely to be more frequent in larger groups of owners, either due to inheritance or sale. Closed joint stock clearly serves families whose primary objective is to minimize conflict among shareholders. We found this pattern to be consistent regardless of generation. We found families in the founder generation as well as the second and third generations who have chosen closed joint stock as their legal structure. What they had in common are large growing families. We also found some families who maintained their legal structure as LLCs. Most of those families are still in their nuclear family stage with small number of owners.

“

Our business is now a closed joint stock, which is great. There is a shareholders register, which is subject to change at any time. For example, when my aunt passed away, we moved ownership very fast.

“

I advise family businesses to make sure that all their companies are joint stock, whether their children are owners or not.

Our interviews also show that the initial public offering (IPO) is gaining traction among business families in Saudi Arabia. Four of the families we interviewed have already listed some of their businesses, two are in the process of listing, and three families are considering to list some of their businesses. The reasons to list vary from one family to another. Some families consider listing a mean to the continuity of the business, some wish to cash out, and others see it as a way to reduce family conflicts through subjecting the business to the rigid governance requirements of listed companies. Listing a family business is often an exit route as businesses often stop being family businesses over time after listing. Families need to be clear about what objectives they would like to achieve through listing. If keeping their family enterprise in the family is a priority, then listing some companies and keeping some is a good option. Otherwise, the business will stop being a family business in the long-run through sell-out.

“ No one agreed with my worry about succession in our company. One main reason for my worry is that each of the uncles believes their son to be the best.

“ We decided to list our company in order for it to be more organized and have rules.

Additionally, we found that business families whose objective is to grow the family wealth and provide another source of income for family members to create a separate family office to manage their assets and the accumulation of their dividends. Others created holding companies with the role of managing the family portfolio. These holdings operate as investment offices.

Similarly, some business families have created waqfs as part of their family enterprise. We found this in five of the families we interviewed although the objectives they wanted to achieve by creating waqfs were different. Some set up waqf to perform charity work, others to keep the family legacy alive through the waqf, regardless of who owns the business besides the waqf. Some families believe that a waqf structure prevents conflict, and some set up waqfs to support the family's future generations in terms of income, education or healthcare expenses.

Waqf in particular rendered mixed results based on our research. Often times, when a waqf is set up as a solution to conflict due to poor family relations, it intensifies family conflict as it locks in unhappy owners in one space that they cannot leave. Waqfs lead to positive outcomes when family relations are healthy and the waqfs are set up for social giving or to support next generations of the family. In many cases though, when a waqf is introduced as an owner in the family's operating businesses, it often brings complexities because the interests of waqfs are different from the interests of family owners.

“ My father has a written will which is 100 percent waqf and cannot be sold. He did this to avoid conflict, but it is dangerous and it could lead to bankruptcy.

“ My father has always had an interest in social work, but it was always done informally, so he wanted to institutionalize it. Our waqf has ownership in all our companies, so if one of our two families want to leave ownership, the waqf can be bought. We did this to ensure the continuity of the family relationships.

“ My father created three trusts: education, healthcare and maintenance. Since his passing, those trusts are locked, and have their trustees, which contributes to creating some stability.

There are many objectives that families can achieve through selecting their legal structure. And there are a variety of legal structures to adopt. There is not one answer that suits all families. Often, business families have a mix of different structures at the same time. What is important is that each family undergoing a generational transition to explore the advantages and disadvantages of each legal structure in helping their particular situation and to achieve their own objectives.

Another important area of ownership transfer is the process through which the shares are actually transferred. Many tend to think that the process of share transfer is already settled by inheritance laws after death. However, business families also have the choice to organize share transfer during the person's life. This grants them more control over the process. Each of the two approaches is available for business families to choose to transfer shares and each of them have its own pros and cons.

Transferring ownership during the owner's life is a good choice for families that wish to redefine who will stay in the business and who will not at the generational transition since it grants families control over who owns the family enterprise in the future and who should be restricted from joining ownership.

This approach also offers a safe option to train the next generation on ownership during the owners' lives by assigning them certain shares to practice the ownership role under supervision.

Given the many advantages that arranging share transfer during the owner's life brings, it was not a surprise to find that the vast majority of the owners in the families we interviewed had fully or partially relinquished shares to the next generation during their life. Only three of the families we interviewed chose the approach of transferring shares upon death based on sharia inheritance laws.

Like any practice, the transfer of shares during the owner's life was positive under certain conditions and negative under others. On the positive side, relinquishing shares to next generation members during the owner's life as a means to train them to become future owners was found to be a positive practice as it also helps create psychological ownership among next generation. So was the case with families who were trying to address family members' perceptions of fairness. One of the owners in our research, who transferred shares during his life, changed the division of shares from being based on the inheritance laws, to equal shares between his sons and daughters, as he realized that owning equal shares was more accepted by his daughters and saw that it would greatly reduce the possibility of conflicts arising among his children if he does not address this concern. As equal shares were accepted by the siblings, this resulted in a positive outcome in their case. In fact, we found in our research many other families that chose to follow equal division of shares among male and female family members in their ownership succession decisions during their lifetime, which indicates this to be more a common practice than an exception.

“ In order to prepare third generation members for ownership, they now own small shares in the group. It was part of the transformation when we changed the business to a closed stock company, as it prepares and encourages them for future ownership.

“ When my father divided the ownership division, we kept discussing his decision with him and he wouldn't change his mind. We then pushed back until he decided to go with equal shares.

On the negative side, the transfer of shares during the owner's life created issues when it was done to favor one of the family members over others. In four of the families we interviewed, owner's granted sweat equity to family members working in the business, in addition to their sharia share. This was not an issue when other family members of the next generation accepted it as a fair arrangement. However, when it was perceived as an act of unfair favoritism by other family members, this has often affected relationships among next generation family members and at times lead to conflict after the owners have passed. In such cases, compensation and bonuses are a safer rout than increasing the percentage of shares for those involved in the business.

“ When the family and the expenses grew, my father decided to give us minority shares in the group and allowed us to practice our roles of ownership. Later on, he changed the ownership percentages to give our older brother a higher percentage because he was active. When I started working more, he added my percentage, meaning that he bases it on involvement.

In general, approaches, objectives, and conditions to the transfer of shares vary. What is important is to consider family members perceptions of fairness when making decisions related to share transfer. Family members' perceptions of unfairness was found to be the one condition under which this process affect family relationships and leads to conflict at times. It is very important for business families at this step in their ownership transition process to make decisions that are accepted by the next generation and the wider family, whatever the decisions are.

Leadership transition

Family members play different roles in the family enterprise; they can be owners, governors, leaders and employees, or a combination of those roles. Typically, the founder(s) play the role of owners and leaders at the early stages of a family business's life. As the business and the family grow, the need for governance structures arises, families start to institutionalize their businesses, create boards, and became board members as well. The role the family plays in the family enterprise continues to evolve as the family and the business evolve and the question has to be revisited at every generational transition.

When thinking about business families, we tend to think that most families keep close control over their businesses by keeping ownership, governance, and leadership inside the family. However, our conversations with families revealed a different reality. We found that the majority of those we interviewed had already changed or are in the process of changing the role of family members in the business. Six of the families have already moved away from leadership and hired a non-family leader, and five families are in the process or have the intention to follow suit. This decision goes back to the objectives of the family and of the business. Families with clear business-focused objective to grow, diversify, or internationalize were the ones that have already assigned leadership to non-family leaders as they realized the need for a different skillset than what the family can offer to achieve their business objectives. In other cases, moving away from a leadership role is motivated by the family's desire to prevent or reduce potential family conflicts by separating ownership from management. It was also a decision that families which did not have capable/qualified and interested family successors have taken.

I told my family that the growth was big and we don't know how to handle it, so we need someone competent to manage. We then hired a headhunter and got a CEO who's not a family member.

No one from the family should be working in the business; it will create conflict. They will be part of the board, but not in the day-to-day work, and all of our third generation family members agree as they are convinced not to join in management.

We won't enforce our sons and daughters to work in the business, their ownership and being in board is important, but not necessarily managing. If they are qualified, then they are welcome to take on managing roles but otherwise we can hire qualified people.

Our research also reveals that most of the families who decided to keep leadership in the family down the generations have some conflicts or problematic family relationships. It is not clear whether the decision to remain in leadership is the cause of conflict and poor relationships or it is the other way around. Whatever the direction of the relationship between these factors, we did find them appearing together in the families we interviewed. A small minority of those families did not suffer conflicts or poor family relationships despite maintaining leadership in the family. What they had in common is either a business structure that separates family member roles from each other in families where there are several interested family members, or one or two running the business in families where the majority of next generation members are not interested.

We're lucky to have more than one business because it helps to employ our sons and daughters in different businesses. This way, we can avoid conflict because everyone works in a different sector.

We learned from these findings that many business families in Saudi Arabia are in fact changing the role the family plays in the business from owner/governor/leader, to just owner/governor. As families grow, family employment and the question of business leadership becomes a sensitive, complex, and a problematic topic to address because family and business agendas often get mixed. This explains why many families decided to leave the business leadership to non-family members and at times also ban family members from working in the business altogether. Whatever the role the family decides to keep in the business at a generational transition, the interests and capabilities of next generation family members must match those roles. Moreover, their relationships should be healthy enough for them to effectively work as a team, otherwise, they are better be structurally separated.

Business families that decide to move away from business leadership follow a clear path of hiring non-family leaders based on their merits and competency according to market value. The process and criteria are fairly straightforward and simple. However, families that choose to keep management within the family will have to address the difficult questions that this choice introduces.

Our conversations with business families revealed certain common practices among Saudi Arabian family businesses when it comes to the leadership model they select and the process by which they deal with interested next generation family members for leadership transition.

More than half of the families we interviewed have adopted a single leader approach to the leadership of their business, yet the model worked well in some families but not in others. Having a single leader that is selected among peers of interested next generation family members and imposed on them by the current leader through a process they do not accept as fair has always harmed the relationship among the next generation members and triggered conflict. We found it to be a common process that the older generation tests the incoming family members competencies by equally assigning each of them a company to run or grant to invest etc. Family members that do not perform well are then fired or excluded. This often happens without proper hiring, evaluation, and training process, neither with clear roles and responsibilities. In many of these cases, family members were put through these tests right after college without any prior training. While this practice is common among Saudi business families, it is not considered to be a good practice because it hurts family members' relationships and affect their ability to work together as owners and effectively make joint ownership decisions. We found many of the families who had this process to have sparked relationship conflict among next generation members and some members who are fired from the business also leave the family as a result.

"My father gave each of us a company to run to test us. He had a conflict with two of my brothers, so one day he fired them both from management, and I remained.

"My father used to alternate us between the businesses. I am the only one who succeeded, and my two brothers left the business.

The single leader model works well when there are no other family members interested in the business or when the single leader is accepted by his family peers as a leader. Another less prevalent condition under which the single leader model works well despite the presence of other family members who are interested in the business is when they are structurally separated, each being a single leader in his/her own structure.

We also found some families who successfully adopted team leadership approach. These families had several next generation family members interested in leading the business together, whether siblings or cousins. The model worked well because next generation members had shared values, trust, and great relationships. Thus, they were able to effectively work together as a team of leaders towards achieving their objectives.

"I had a different mindset and I was the most knowledgeable, I was not a short-term thinking guy, because I believe you have to think long term if you are partnering with your brothers. As a family, we have a strong bond, and we prioritize values. We also have the same mindset when it comes to partnership.

"We were already in the business when succession happened. So, nothing really changed, only the titles changed for us.

Families approaching leadership transition need to build a deep understanding of their next generation members, their interests, capabilities, and relationships. They should also consider the objectives they have for the family and the business. When put together, these pieces of information will guide them in making a decision about their leadership model. The leader(s) in the family enterprise need to not only be qualified for leading the businesses but also accepted by the family and the shareholders. Any practice that undermines such acceptance will eventually spark conflicts.

"It is important that one of the siblings takes on the role of a diplomat during the founding stage in order to manage family politics rather than emotions. Others in the family need to believe in this family member, because having a family business is difficult without this person's input.

Based on our findings, we must warn business families of the dangers that come with enforcing a single leader on a group of equally interested members who do not accept him/her. We would also like to highlight the negative implications of the test and fire approach described above. Eliminating family members in such manners hurts their relationships. Wounded family relationships, especially among future shareholders, are particularly risky for families-in-business because these unresolved emotional wounds almost always resurface when those family members become shareholders. In such cases, the shareholding space becomes a ground of resolving past relationship conflicts, which always harms the business.

The criteria for selecting the next family leader(s) for the family enterprise is as important as the process of selection. Families should have clear criteria for selection that is discussed, agreed, and communicated to all next generation members. The criteria should also consider any specific requirements that the family or business objectives might introduce.

"We made it clear that age does not matter for us. We care about competence, subject matter expertise, performance, and best fit. This is what we look for.

Many of us tend to think about competency and qualification as the main criteria for selecting family leaders. We all often hear experts warning against the practice of selecting the eldest son for leadership irrespective of merits. However, leaders of the family enterprise should be qualified for achieving not only the business objectives but also the family's objectives. Factors apart from qualifications are often overlooked in discussions about leaders in family enterprises. No wonder, the common practices we found among the families we interviewed are not considered to be effective when it comes to leadership transitions, and in many cases, have created negative outcomes.

As opposed to birth order and/or capabilities, we found parental favoritism to consistently be the main selection criteria for family leaders in many of the families we interviewed. Eight families had the son or daughter who are closest to the father in personality, relationship, and perspectives to be appointed as the next leaders or groomed for the role in the future. Father's closeness to the particular son/daughter fosters higher interaction between them during which much of the knowledge and skills are transferred. Consequently, putting the favorite child in a better place when it comes to competence for the job. Nevertheless, even if this approach meets the qualification criteria, it sparks envy and jealousy among next generation peers and affect the quality of their relationships and acceptance of the favored son/daughter as the leader of the business. We found parental favoritism to affect relationship quality among next generation peers in most families that have adopted this approach, and in some cases, it sparked conflict between next generation interested candidates, and in few cases, some conflicts have been taken to courts already.

"I am not the oldest, but I am the most qualified. I work sixteen hours a day, and I doubled the portfolio of stock during my employment. That's why I have a great relationship with my father, he would sign any paper I give him! Because of that, I know some are envious of me, not hateful, but envious.

"Me and my father have a close relationship, he sees himself in me and we have a lot in common. My brother on the other hand can be aggressive and he doesn't have anything in common with my father. This explains why they don't agree on a business level when it comes to ethics, beliefs, and values.

The actual process of transitioning leadership of the family enterprise is similar to the transfer of ownership, it can be left to settle after the founders' passing and it can be managed during their life as they retire. Unlike ownership transition though, there could be risky implications on the business if a sudden vacuum in leadership occurs due to sudden death. For this reason, it is important for business families to prepare and be ready, whether the transition takes place upon death or retirement.

We asked the families we interviewed what do they think might happen if sudden succession occurs in their family business. Four families expressed their concern that the business will collapse or suffer. Others have a pool of possible leaders either family or non-family but couldn't name one and have no clear criteria for selection. Only two family businesses were able to identify the next leader based on a clear and communicated criteria and have implemented proper preparation.

Much of the focus when it comes to leadership transition is on the next generation and its readiness. However, leadership transition is a two-way process and it involves the incumbent as much as it involves the successor. Many family businesses either fail to plan for succession or leave it far too late, risking the viability of their business and family. That is because family business leaders tend to build a phycological/emotional attachment to the business making them reluctant to let go and give up control to the next generation. This emotional attachment should be addressed and resolved before starting the leadership transition by having a clear retirement plan.

After selecting the successor based on a clear and communicated criteria that involves both competency and acceptance, the process of handing over the leadership should start. The process of transitioning leadership to the next generation needs time and involves multi stages where the current leader gradually decreases his/her involvement in the business. The current leader and successor play different roles throughout those stages, shifting power and responsibility over time, from the leader being the sole operator and the successor having no leadership role to the leader being an advisor and the successor a CEO. This process involves mentoring, overseeing, and delegation and it is important in order to transfer technical and tacit knowledge to the successor.

It is not clear how succession will be handled. Now that this cannot be procrastinated any longer, I am stressed about what is going to happen next.

There is no clarity on who will successed, it could be someone outside the family if there isn't a qualified family member.

We already have the group CEO and the successor being developed under him for the last two years. There will be a three-year overlap period and that should be smooth.

The role of the current leader post leadership transition and the way to get there should be clear to the successor in order to avoid ambiguities and frustration that often occur between the current and next generation leaders. There are a variety of roles to choose from for current leaders post the transition, whether related to the business such as being a board member or an advisor/consultant, or away from the business such as starting a new venture or enjoying a hobby.

I started considering it. I am already retired in a way; I only attend board meetings and get involved if there is a need for me.

I decided to slowly reduce my involvement, as I am trying to retire. I am now at a stage where I should not be doing a lot for the next five years, which is when I am 75. I am fine with letting go, I am not holding on to the role.

In case of a sudden succession, a contingency plan should be in place that details how leadership transition will be handled.

If a sudden succession occurs, it will be a problem because we didn't finish the process. Maybe my father will take over, but technically, I am the most experienced one. The question is, are they going to agree?

Should there be a sudden case of death among active partners today, the organization will continue as the board will continue to manage and the next generation will have to elect among themselves someone to sit in the board once they are of age, until then, the board will operate.

We have a non-family CEO. I am not involved, so the business will continue.

Business families should plan for leadership transition and also implement those plans as they approach the transition. Both incumbent and successors should have their roles, plans, process and timing of the transition clear and communicated. Moreover, families should be ready for sudden succession in cases of death or incapacitation of the current family leader. There are many cases where family enterprises dissolved as a result of the latter scenario as families were not ready to address a sudden vacuum in leadership.

Next generation development

The next generation in a business family will always play some role in the family enterprise in the future as long as the family continues to be a dominant owner in it. As explained above, there are different roles that family members can play: they can be owners, governors, leaders, employees, and most likely a mix of all.

Successful generational transition requires next-generation members who are prepared for their future roles. The process of developing the next generation requires cross-generational collaboration for it to be successful.

Preparing next generation members in business families depends on the role the family decides to play in its family enterprise in the future, whether to own, govern, and/or manage. However, the roles of leading and governing the family enterprise are to some extent optional and mostly will not include all next generation family members. The role of ownership on the other side, is less likely to be optional and most family members will have to take it given sharia inheritance laws. This makes preparing next generation family members as future owners particularly important.

Despite the importance of next generation development, the majority of the families we talked to do not have a formal next generation development plan. Some have informal rules such as education requirements and external experience, while others are doing it organically without any kind of planning such as keeping the next generation informed about the business, and mentoring and coaching them. In general, those families were not sure about the next generation's ability to become owners and leaders of their businesses. We found that business families with formal next generation development programs that are implemented were comfortable about the future and able to identify a pool of potential next generation leaders for their businesses.

> **My father used to never bring business home, so we grew up knowing nothing about the business. I want the next generation to know because they will be shareholders. So because of that, I shared the documents with them, but they were not interested.**

> **We did not think about it yet. Being busy with operations and structuring keeps you from thinking about things such as next generation development.**

> **We do have some kind of preparation, but not a formal one. Each one of us is doing it his way. For me they have to work for a large company, then after three years they have to get a masters degree, then they can join the business.**

Next generation development is critical in business families given the roles expected for the next generation to handle. Those who do not adopt good next generation development practices that suit their objectives for the family enterprise often find themselves reaching the point where they need to transition to the next generation, yet, don't find capable and interested family members to take over the business. Developing the next generation is a long process that does not happen overnight. Thus, families need to engage with their next generation as early as possible.

Values and legacy

What differentiate family business from other forms of organization is the family values and legacy that the business is built upon. When values and legacy are transitioned to future generations, it serves as the glue that keeps a growing family united behind a business. The family's values and legacy develop naturally in the next generation through upbringing, the smaller the family and the closer it is to the founder(s). However, as families grow, such rich history and core values tend to fade generation after generation if families don't consciously put efforts to transition them down the generations.

Founders of the families we talked to have strong values that guided their families and businesses such as sharia compliance, honesty, commitment, charitable contributions, etc. Founders worked very hard to build the business and encountered many challenges that together with their values shaped the family business. However, most families we talked to do not realize the importance of the family legacy in the generational transition. Some of them convey the family values and legacy to the next generation organically in an unstructured way by individual efforts such as setting an example and storytelling. Most of them assume the values are just inherent and understood.

Family legacy is an intangible asset that binds family members together, its importance increases with the passage of time as the family gets bigger and the business grows because it builds a sense of belonging and pride in the next generation. Therefore, preserving legacy should not be left to chances, rather families should actively work on it.

"It worries me if the listed company stops being a family business through sellouts. It's a legacy for me personally. I carry a strong sense of legacy because I was close to the company, and I witnessed my father working hard for it.

"Family businesses perform better than public companies because of the legacy behind it, and reputational risk motivates us to perform better.

"When we do the family retreat, we communicate our values to the next generations. We set ourselves as an example that they can see and follow. This work requires sacrifices. We do not take salaries. The company does not give me anything except for a car. It is also not allowed that I take a land outside the group or shares from outside the group, and not allowed to work outside the group. So, there is sacrifices to keep this entity. Even the fees that we receive, do not enter our accounts. We teach and raise our sons and daughters on this mindset and give them a live example by being like this.

It is important for business families to find ways to ensure their values and legacy are transferred in their generational transitions. Unlike other decisions in this process which are made with faster results such as decisions on the ownership structure for example, transferring legacy and values is a process that starts in family members' childhood and requires significant communication throughout their early lives in order for them to identify with and internalize the values and legacy.

In conclusion

Summary

Family businesses are not a homogeneous group of organizations, each family has a different set of objectives for the family and the business that will affect their succession decisions. Therefore, there is no one clear succession process that all business families should follow. Instead, families should first understand and agree on their objectives and vision for the future as a family in business to be able to decide which route they will take in their succession journey.

Having a unified vision and clear objectives for the family and the business will facilitate decisions related to ownership and management transition. Family businesses have many options to choose from in transferring ownership and management to the next generation. However, for a smooth transition it should be supported by an effective next generation development plan and a strong maintenance of the family legacy and values.

A set of decisions needs to be taken throughout the succession process, some of which are challenging decisions and some are emotional ones. Involving all family members in the succession decisions and keeping a culture of open communication and transparency is a key success factor in overcoming these challenges. It is very important to keep an open mind and listen to other family members' perspectives and concerns taking into consideration what is perceived as fair by all family members.

Going forward

Thoughts and knowledge in the field of family businesses are developing rapidly, so as the support available to business families to aid them in their journey of generational transition. What is important is for business families to start early, explore the different resources that they can tap into, and commit to the hard work involved in the process.

Business families are not different from other families in their dynamics. Like others, they have members with different personalities, interests, priorities and maybe values. Family members often have their family history, early childhood experiences, and family events that shape the relationship between family members, and the cohesion of the family overall. With family comes emotions of love, care, trust, but also envy, jealousy, and competition. It is very important for business families to acknowledge the family side and its deeper dynamics when evaluating options for the different succession decisions. If a family decides to use external advisory support, it is crucial to hire qualified business family advisors who are able to navigate not only the business system but also the family's dynamics and focus on developing structures and policies on the business sides that are in harmony with the family's emotions, history, and psychology. Capable advisors for business families would be able to assist family members in the most challenging part of the process, which is to build alignment around the different decisions and also to understand the long-term implications for the different choices on the particular family situation.

A well-prepared next generation is key to generational transitions. Apart from the preparation and grooming that happens inside the family, there are today many educational opportunities tailored for the needs of next generation in business families that families can tap into. The development of the next generation in business families is broader than just leadership development which many families pursue. The next generation has to be trained as responsible future owners of the family enterprise. This requires a specific knowledge that is not taught in MBAs and leadership development programs in business schools around the world. Families should also have their own internal on the job training programs and group activities side in side with external educational opportunities.

Some of the choices families make during their generational transitions are internal to the family with no external influence. However, some choices would introduce external forces into the family business system and influence the transition such as the options presented by the legal system. It is essential for families to work with qualified lawyers who are not only experts of the different legal structures but who also understand the implications, both structurally on the business sides, and psychologically on the family side, that the legal choices would bring. This will help business families choose the structures that facilitate their generational transition as oppose to complicate it.

Lastly, there is today a large body of research on family businesses that families can tap into and learn from. After all, families around the world have more commonalities than differences in the decisions they have to make and the challenges they face as families in business. Research on business families offer a rich body of lessons and thoughts that business families on the ground overlook as they focus on the day-to-day running of their businesses. It is advisable that families take time off the operational world to contemplate the larger picture and think through the higher-level topics. This should help business families gain more clarity about the more operational side of their daily activities. Research on family businesses is a good place go for fresh ideas and lessons.

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About the organizations

KPMG Private Enterprise & Family Business

KPMG Private Enterprise was established as a sub-brand of KPMG in 2015, focusing on companies with private ownership and High Net Worth Individuals (HNWI). The businesses are typically financed by venture capital, private equity, family offices, or are either standalone private entities or family businesses. Trust drives the relationship with KPMG's Private Enterprise clients. As such, when it comes to family businesses, KPMG provides services that aid, not only the operations of family businesses, but also taps into the family dynamics of business families. KPMG's advantage depends on leveraging on its global network of professionals, ability to provide a technology enabled one stop shop of cross functional services, and expertise in serving businesses across their business lifecycle as the personal and/or family wealth grows.

KPMG Private Enterprise & Family Business is the trusted adviser for a significant number of the major Saudi business families across the service lines of Audit, Tax and Advisory. Being in close touch with the family business ecosystem helps the team in catering KPMG's solutions to fit the needs of business families in the Kingdom. KPMG Private Enterprise is also active in producing research publications and organizing periodic events in the form of summits, webinars, and discussion roundtables to discuss topics which are of great importance to Business Families such as governance, succession, NextGen, and philanthropy, just to name a few. For further details on KPMG Private Enterprise & Family Business services, please visit: https://home.kpmg/sa/en/home/industries/enterprise-and-family-business.html

National Center for Family Business

The National Center for Family Business (NCFB) was established under the Royal Decree in 2012, as a joint initiative by the Ministry of Commerce and the Federation of Saudi Chambers. NCFB has been working on achieving its mission through providing services and communicating effectively with family businesses, government organizations, consulting firms, and the public to build an ecosystem that reinforces the sustainability of family businesses.

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