Fix, sell or close?

Forced to navigate evolving complexities on a daily basis—from regulatory changes to political risks and new technologies—management teams are often left with limited capacity to focus on all the required facets of a business. Under such circumstances one needs to take a step back and consider a plan for non-core, or underperforming operations that could benefit from a change in trajectory.

Deloitte's research of 80,000 overseas-owned trading businesses highlights the challenge at hand with over 20 percent generating an operating loss. The preferred option in this case is to pursue a turnaround strategy and right the ship immediately. In parallel, a carefully crafted exit plan needs to be put in place in order to minimize any potential liabilities and maximize asset recovery values.

Opportunities for business transformation

In January 2016, the daily spot price of West Texas Intermediate (WTI) crude oil reached US$26.88 per barrel, its lowest level in 13 years. Although the catalyst for this price action was abundant gas deposits formed 300 to 400 million years ago in North America, the repercussions were felt immediately and profoundly in the Middle East. With the era of high oil prices no longer a certainty, a number of key stakeholders, including family businesses, have put in motion plans for the region's next phase of growth.

Family businesses: investing for the future

Family businesses are a significant contributor to the economic engine in the region, comprising an estimated 70 percent of private sector activity in the Middle East. Initially set up as trading companies that over time grew into conglomerates with combined revenues reaching US$100 billion, they traditionally focused on the following sectors:

- Real estate;
- Construction;
- Retail;
- Manufacturing;
- Travel and leisure.[1]

Over time these sectors matured and reached a saturation point, forcing family businesses to rethink their industry, geography and asset allocations, and presenting an interesting opportunity to reposition GCC conglomerates on new growth paths, while carefully managing exits from legacy investments. With up to US$1 trillion worth of assets currently changing hands between generations of family owners, the reallocation of resources is expected to be significant.[2]

State-owned enterprises: creating global market leaders

Out of the total proven oil and gas reserves around the world, GCC countries control around 30 percent of oil reserves and 22 percent of gas reserves.[3] This natural resource abundance has created a diverse set of energy businesses that compete effectively with each other. However, the real opportunity lies in pooling resources and creating global market leaders. This explains some of the motivation behind recent government initiatives, including Aramco's acquisition of a 70 percent stake in Saudi Basic Industries Corp (SABIC).

Post Aramco's blockbuster Initial Public Offering (IPO), there are now 15 publicly traded petrochemical companies on the Saudi Stock Exchange Tadawul, indicating that we are likely at the start of a journey that will result in a handful of national champions, not just in the kingdom but in the rest of the GCC as well. As a part of this journey the companies will have to undergo a holistic operational review to identify what their core portfolio and product offering looks like within the context of the global market.

Underperforming, or non-core assets, that emerge during the transformation process could be viewed as an additional source of liquidity to fund future growth of the wider portfolio. For example, they could be turned around and retained within the existing business. Alternatively, the stakeholders could pursue an exit plan focused on value maximization while managing downside risk for company directors.

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Regulators: taking a lead

A number of regulators throughout the GCC have been introducing legislation aimed at maintaining the region's attractiveness as a destination for capital inflows. Ranging from revised accounting standards to Anti-Money Laundering (AML) and bankruptcy laws, the changes have been positive. With the reforms also came an added layer of costs, putting local financial institutions under increased pressure and nudging a recent wave of banking mergers.

The trend seems to signal that there are opportunities to rationalize overheads and optimize existing capital structures to improve shareholders' returns. Since financial institutions are regulated entities, in addition to the usual exit considerations, due care should be taken to ensure compliance with local regulatory bodies. In the case of mergers between conventional and Islamic banks, portfolios of assets would need additional review before being integrated or disposed of—without destroying economic value.

The importance of acting decisively

Faced with these opportunities, management teams need to proactively address businesses that are non-core, underperforming or that could be monetized to fund focused growth. And timing matters—when boards fail to act in a timely manner, the options and opportunities to manage risk and capture financial upsides are diminished. This is especially true when management is under pressure to deliver increasing value in a rapidly changing economic, political, and regulatory landscape.

However, implementing an exit without a well-thought-out and carefully structured plan can negatively impact many aspects of long-term success, including:

- **Reputational**—Managing brand, public relations, and employee, political, and customer relations.
- **Employee**—Mitigating impacts on employees, including retention, recruitment, and other human resources concerns.
- **Financial**—Addressing employee severances, contractual and contingent liabilities, tax, and potential impacts on financial stakeholders and markets.
- **Commercial**—Protecting commercial and sales relationships with customers and through the supply chain.
- **Governance**—Addressing the needs and interests of boards and regulators.
- **Scale/Reach**—Administering the complexity that can arise as a result of exiting in different jurisdictions.

There is more pressure than ever on shareholder value, in part driven by activist investors—who actively push their target companies to divest of non-core assets. It is important to deal now with parts of a business that no longer fit, and are draining capital and management resources.

Banks	New entity	Combined assets (US$ bn)	Country	Date
National Bank of Abu Dhabi and First Gulf Bank	First Abu Dhabi Bank	183	UAE	2017
Alawwal and Saudi British Bank	SABB - Alawwal	71	KSA	2018
Abu Dhabi Commercial Bank and Union National Bank and Al Hilal Bank	ADCB	114	UAE	2019

Source: Bloomberg

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by **Vuk Prelevic**, Assistant Director, Financial Advisory, Deloitte Middle East

Endnotes

1. Gulf Family Business Council
2. World Economic Forum on the Middle East and North Africa, 2013
3. International Renewable Energy Agency – Market Analysis, GCC 2019