ENERGY

TRANSFORM TO TRANSITION: FUTURE-PROOFING FAMILY ENTERPRISES THROUGH SUSTAINABILITY

Foreword

> ‘The world needs a business mindset to tackle the climate crisis.’
>
> **Sultan Al Jaber**, the president-designate of the Cop28 summit.

From the energy transition toward alternative sources and the shift to a circular economy that replaces our historical linear system, much is changing. For years we have been talking about the transitions that we will need to collectively make to ensure that the risks of climate change are mitigated and disruptions to our current ways of life are minimized.

Unfortunately, the word transition suggests that this will be an orderly, gradual progression; like the changing of seasons, or from day to night. This incorrect assumption, combined with a lack of global collective action, has led to complacency. A sense that we can afford to wait just a little longer before we need to change what we are doing. That the best course is to ‘wait and see’.

The risk is that we discover, suddenly, that it is too late.

We are faced with the need to halve global greenhouse gas (GHG) emissions to limit global warming to 1.5°C above pre-industrial levels by 2050 whilst mitigating the impacts on developed and developing countries. To reach this goal, the scale of change needed across governments, industry, businesses and consumers, together with the associated investments, is nothing short of a transformation.

Starting from a reality largely dependent on traditional energy sources, A&M is helping propel leading organizations forward to true transformation through leadership, action and results.

This article, the first in the **Transform to Transition** series, addresses the opportunities and challenges for family enterprises within the energy transition, with an emphasis on the Middle East and North Africa (MENA) and Gulf Cooperation Council (GCC) regions.

Transforming family enterprises

Family enterprises are uniquely positioned to take advantage of the energy transformation and sustainability initiatives. This is especially true in the MENA region and GCC countries, where approximately 60 percent of the gross domestic product comes from such businesses.[1] Built to be passed on to future generations, family-owned businesses are typically founded on long-term views, a central pillar of sustainability.[2]

The UN Climate Conference (COP28), set to take place in Dubai in November and December, has been positioned as the "transformational COP of action," with a plan to "reduce emissions by 43% by 2030 and course correct on adaptation, finance, and loss and damage."[3]

From it, more regulatory discussions and announcements appear likely. To avoid falling behind, family enterprises need to remain abreast of upcoming regulations and lock in opportunities to transform their business strategies around sustainability.

This perspective was highlighted in a 2022 report published by the Tharawat Family Business Forum. The report outlines the role of family enterprises in the MENA region's sustainable future and found that their values, traditions and generational visions have always included sustainability and environmental, social and governance (ESG) considerations, just in different ways from standard corporations.[4] Their distinct perspectives mean that family enterprises are extremely well placed to make effective decisions on sustainability.

Though few family enterprises in the region have committed to net zero targets, Tharawat's report found that every family enterprise contacted had implemented sustainability initiatives. Often small in scale, these steps support sustainability and inspire further action. Additionally, in December 2021, over 75 percent of the largest family enterprises measured and reported sustainability metrics.[5]

But family enterprises will need to move quickly if they wish to keep pace with, or even lead, the sustainability transition.

What are the impacts of existing regulations?

Some governments within the MENA region have already passed legislation on sustainability and climate requirements. In 2021, the UAE issued a new policy: All companies subject to Joint Stock Companies Guidance would be required to report on sustainability, remaining in compliance with the Global Reporting Initiative.[6] Similar regulation is anticipated in both Oman and Saudi Arabia over the coming seven years. In 2022, Saudi Arabia's Public Investment Fund announced its Green Finance Framework, which is in line with Vision 2030 goals.[7] Additionally, in July 2023, the Abu Dhabi Global Market (ADGM) began the implementation of its new sustainable finance regulatory framework that covers portfolio companies, investment funds and bonds.[8]

1 Family businesses in the Gulf must not be left behind - Atlantic Council
2 family-business-a-voice-for-change-in-sustainability.pdf (imd.org)
3 https://www.cop28.com/en/ accessed 28 August 2023
4 Climate Change and Family Business Report (tharawat.org)
5 How family enterprises are embracing sustainability | EY - Global
6 A sign of things to come (deloitte.com)
7 https://www.pif.gov.sa/Investors%20Files%20EN/PIF%20Green%20Finance%20Framework.pdf accessed 28 August 2023
8 ADGM Implements its Sustainable Finance Regulatory Framework (prnewswire.com)

These approaches lag sustainability regulations in other countries, especially in the United States and European Union. With at least 35 laws passed in the U.S. to protect people and the environment, and nine reporting regulations in the EU, family enterprises with global operations must be aware of their implications.[9,10] For instance, enterprises with international contracts — such as franchise, distribution or partnering arrangements — as well as significant investments in property and businesses may fall under scrutiny of international regulatory bodies. This can go beyond mere reporting and disclosures to include potential taxes, duties or border adjustments for imports or exports.

Regulations around emissions and energy efficiency standards may result in stranded European real estate and other assets, with the potential to directly affect families from the MENA region and GCC countries when they seek to realize or refinance these holdings.[11]

While most ESG disclosure requirements do not directly impact family enterprises today, as they only apply to publicly traded companies, private companies cannot afford to ignore them. As ESG topics have come to the forefront, companies that don't demonstrate a dedication to ESG will lose favor with investors who are looking to support a sustainable future. Family offices must comply with reporting regulations or lose access to financing from banks and investors. Furthermore, by getting ahead of regulations, bringing sustainability into the core of their operations, and expanding reporting pre-emptively, family enterprises can even position themselves ahead of their competitors. To do so, though, enterprises must understand what is to come.

Can companies predict regulation evolution?

Family enterprises can look to the more stringent ESG regulations in the U.S. and EU as models for the potential future of sustainability and reporting requirements in the MENA region and GCC countries. Typically, the focus of legislation has been on three areas: reporting and emissions, reduction plans and targets, and taxes.

Europe currently leads ESG and sustainability reporting with requirements that cover a range of topics — including emissions, pollution and effects on biodiversity — with more guidelines and regulations to come. The most recent directives to take effect, the Corporate Sustainability Reporting Directive (CSRD), has further solidified reporting mandates for companies operating in the region.[12]

Unlike Europe, the U.S. has not required any ESG reporting, though the U.S. Securities and Exchange Committee is preparing to announce mandatory reporting regulations for reporting companies later in 2023.[13] While it is still unknown what these new regulations will cover, it is a major step toward sustainability that will be looked upon as an example by other countries still developing their approaches.

It is a formative time for all countries regarding ESG regulations, with even the U.S. and EU continuing to alter and broaden their legislation. Understanding the current states of sustainability reporting in the U.S. and EU allows family offices in the MENA region to predict the next steps of their own countries, allowing them to prepare for coming changes.

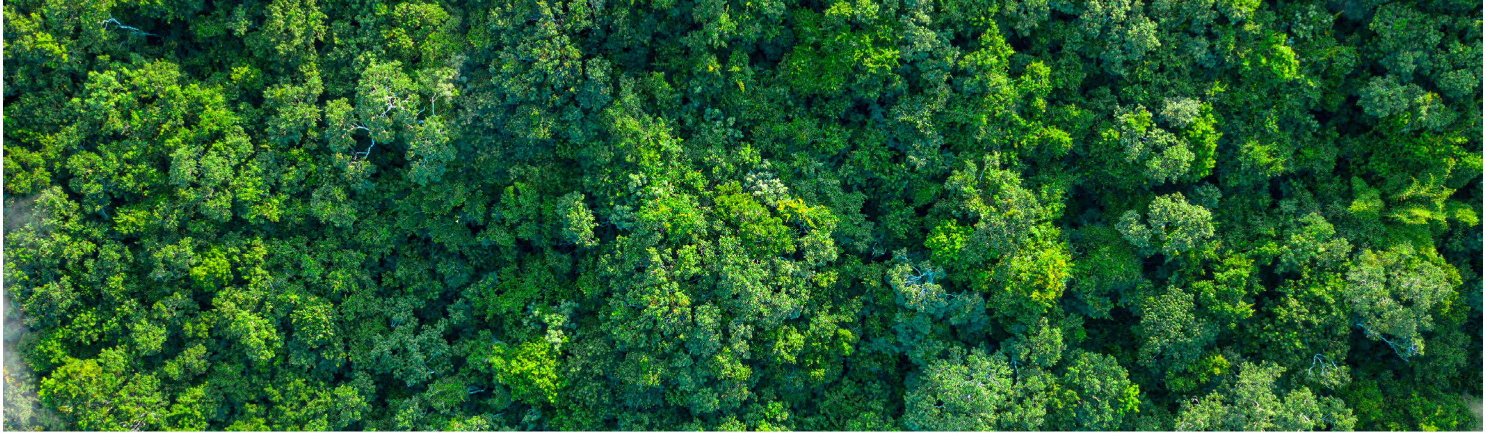
9 Laws and Executive Orders | US EPA

10 EU Sustainability Reporting Requirements in 2023 - Laws, Rules & Regulations (brightest.io)

11 Stranded Real Estate – A Real Possibility (matheson.com)

12 EU Finalizes ESG Reporting Rules with International Impacts (harvard.edu)

13 Sustainability Reporting USA 2023 (reutersevents.com)



How should MENA governments proceed?

Governments in the MENA region can learn lessons from the actions other countries have already taken in order to chart the best course toward sustainability. Following the lead of the U.S. and EU allows the region to see what strategies have worked, and which weren't as successful. It removes some of the inherent uncertainty that comes with new regulations.

One area MENA governments might follow the U.S. and EU into is environmental taxation, including potential carbon taxes. According to the Organization for Economic Co-operation and Development, there are two ways environmental taxes can function. They can apply tax rates to environmentally damaging behaviors or pollutants — providing incentives for corporations and family enterprises to avoid them — or decrease taxes on environmentally friendly behaviors and products.[14]

Although taxes remain controversial in the region, governments will look for ways to incentivize companies to create climate-friendly products and services whilst they fund climate-related activities and incentives. Meanwhile, family enterprises and other corporations that take advantage of lower tax rates can put the money saved towards innovation and decarbonization.

Carbon credit programs (either compliance, voluntary or hybrids of the two) can work similarly to and in combination with a carbon tax. To support emission reductions, companies are given credits for pollution up to a cap that decreases over time. If emissions exceed these credits, the company must buy more. But, if a company has more credits than it needs, it may sell them to others. This system is especially effective for private companies and incentivizes them to reduce greenhouse gas emissions.[15]

The UAE aims to introduce the National Carbon Registry (NCR), the first platform of its kind in the region. The NCR intends to create an efficient mechanism for the reduction of GHG emissions and is the first step in establishing the ecosystem necessary to support a compliance market such as a cap-and-trade system for carbon credits.[16]

Her Excellency Mariam bint Mohammed Almheiri, UAE Minister of Climate Change and Environment, addressing the 12th National Dialogue for Climate Ambition (NDCA) in September 2023 announced, "As the UAE prepares to host COP28 with the goal of delivering the most inclusive and solutions-driven COP summit, it is important to engage all partners to accelerate climate action, here and abroad. In this, our goal is to make sustainability mainstream because we believe that if we can make complex climate change issues relatable to communities across the world, then we can definitely achieve the goals of the Paris Agreement."

What will be the role of banks?

Finance is intertwined with family enterprise, across operating requirements as well as growth and succession objectives. Access to financial services enables trade, international expansion and asset diversification. Increasingly banks, asset managers and insurance companies are considering ESG dimensions in pricing the products and services they offer. These range from assessing the business operations of the company, such as no longer funding fossil fuel-related businesses, to requiring the preparation of climate risk-related disclosures and action plans and even divesting assets that are not compatible with an ESG lens or risk appetite.

Understanding where banking, finance and insurance partners are seeing future trends, regulations and their own operational objectives and commitments will help family enterprises identify further risks and opportunities within their transition journeys.

14 48164926.pdf (oecd.org)
15 Carbon Credits and How They Can Offset Your Carbon Footprint (investopedia.com)
16 HE Mariam Almheiri urges UAE businesses to mainstream sustainability as a pathway for unlocking inclusive climate solutions (zawya.com)

What can family enterprises do to prepare?

New regulations are inevitable, especially with COP28 imminent, but there are ways family enterprises in MENA and GCC countries can prepare:

Planning

Developing scenarios for each family asset and enterprise will identify portfolio assets that need significant investment, or potential divestment, as regulations and finance opportunities change. A trusted adviser to family members can ensure this process is objective and well thought through, considering both family history and preferences.

Footprint

Family enterprises will also need to consider all aspects of their GHG emissions footprint, not just their internal operations and purchased energy as covered by scopes 1 and 2 of the GHG Protocol. As focus on scope 3 emissions increases globally, all companies will need to take a close look at the sustainability of their supply chains to decrease risks and decarbonize their upstream and downstream emissions.

Funding

The most important step in preparing for new requirements is to secure funding to support necessary changes. Decarbonization and a shift to renewable energy and materials is a costly endeavor, but even just an increase in reporting will require capital to support the additional workload. Family enterprises will need to assess the options available to them and identify the ones that meet their needs. One option is sustainability-linked loans, which aim to fund to step-change improvements from business as usual in sustainability performance.

Reporting

The most straightforward way to prepare for changing regulations is to act pre-emptively. By analyzing their current reporting and sustainability practices, family enterprises can determine their readiness to comply with existing and potential requirements. Once the baseline is understood, family offices can identify where they need to strengthen their practices to comply with, or even surpass, more stringent foreign regulations.

By staying on top of ESG regulations both within and outside of their home countries and transforming operations to conform to them, family enterprises can prepare for new legislation and reporting requirements, minimize risk and become leaders for generations to come.

How A&M can help

As a global professional services firm, Alvarez & Marsal interacts with global issues that are of relevance to our clients, staff, and other stakeholders.

A&M can help you navigate the energy transformation and prepare for evolving environmental regulations. When conventional approaches are not enough to create transformation and drive change, clients seek our deep expertise and ability to deliver practical solutions to their unique problems.

Our expertise includes creating value from transformations, guiding family enterprises through acquisitions and divestitures in line with a view of the opportunities and challenges of the future, preparing for public and supply chain disclosures, assessing assets and financing risks, unlocking value through innovation and empowering our clients with proprietary data and insights.

For more information or if you have any questions about this article, please contact our team of experts.

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With over 8,000 people providing services across six continents, we deliver tangible results for corporates, boards, private equity firms, law firms and government agencies facing complex challenges. Our senior leaders, and their teams, leverage A&M's restructuring heritage to help companies act decisively, catapult growth and accelerate results. We are experienced operators, world-class consultants, former regulators and industry authorities with a shared commitment to telling clients what's really needed for turning change into a strategic business asset, managing risk and unlocking value at every stage of growth.

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