Future Proofing Family Enterprises

By Embracing Climate Related Financial Risks & Opportunities
FUTURE PROOFING FAMILY ENTERPRISES
BY EMBRACING CLIMATE RELATED FINANCIAL RISKS & OPPORTUNITIES

HIGHLIGHTS

• Family Enterprises are, and will be, in the spotlight as governments and global partners go further on their sustainability journeys in order to stem the effects of climate change.
• In the GCC, Family Enterprises contribute about 60% of the regional GDP and employ more than 80% of its workforce.
• Climate change will affect millions of lives in the MENA region. Temperatures in the region are predicted to rise twice as fast as the global average, with an overall warming of up to 4°C by 2050.
• Regulation and top-down approaches by government will incentivise and improve sustainability in the private sector.
• Family Enterprises can tap into opportunities and minimise risks if we change the narrative.

Why Family Enterprises?

• In the GCC, Family Enterprises contribute about 60% of the regional GDP and employ more than 80% of its workforce.¹
• Regional governments and citizens are increasingly concerned about sustainability.
• Family Enterprises are, and will be, in the spotlight as governments and global partners go further on their sustainability journeys.

Why Climate?

In 2015, 191 nations formally approved the Paris Agreement, a landmark agreement with the aim to strengthen the global response to the threat of climate change. They agreed to hold the increase in the global average temperature to well below 2°C above pre-industrial levels and pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels.

Of the 191 countries that have provided updates on their Nationally Determined Contributions (NDC) — the blueprint for how they plan to cut emissions and mitigate the effects of climate change — 18 are Middle East countries.

There’s a good reason why Middle East and North African (MENA) countries should take climate change very seriously. A report submitted at COP27 last year showed climate change could have a devastating effect on the lives of millions in the East Mediterranean and Middle East, where temperatures are rising nearly twice as fast as the global average.

The region could see an overall warming of up to 5°C or more by the end of the century on a business-as-usual scenario.² A temperature spike faster than any other inhabited parts of the world.

In the UAE:

90% 80% of private companies in the country are family businesses.
70% employing more than 70% of the sector’s workforce.
40% contribute about 40% per cent of the Emirates’ GDP.

Some of the largest economies in the MENA region have announced net-zero ambitions (UAE and Oman by 2050, Saudi Arabia and Bahrain by 2060, with Kuwait targeting carbon neutrality by 2050) — all GHG emissions released by human activities are counterbalanced by removing GHGs from the atmosphere.

This is where climate change and sustainability meet. Human activities that contribute to climate change are, by definition, not sustainable.

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Climate through the lens of Sustainability

Carbon Tunnel Vision

Sustainability Transition

Natural Climate Change Plan of the UAE 2017
Creation of the Sustainable Finance Working Group
Creation of the Sustainable Finance Framework 2021
Requiring companies operating in
Government’s announcement of FIVE priorities in 2023
UAE Green Agenda 2015
UAE Net Zero by 2050 Strategic Initiative
Climate Corporate Accountability Act
Inflation Reduction Act of 2022
Directs $500 billion of new funding and tax
Nationally Determined Contribution (NDC)
Declaration of 2023 as the Year of Sustainability
The World Bank states that 40 countries and more than 20 cities, states and
countries have already used carbon pricing mechanisms, with more planning to
implement them in the future.
Hosting COP28 in November 2023
The Council of the EU formally adopted the Corporate Sustainability Reporting
imposing mandatory reporting requirements on many companies
the ‘carrot’
The Companies Climate
2022 updates
What role can governments and policymakers play?

Put simply, ‘sustainability’ means meeting our own needs without compromising the ability of future generations to meet theirs – it’s about how our actions today impact the world tomorrow. Both people and businesses have a fundamental role in fighting climate change and driving measures that support sustainability.

It’s common to hear the term ‘sustainability’ in conversations on climate change, but sustainability is a much broader concept. Beyond environmental concerns, sustainability also looks at global economic prosperity, equality, water and food access, education, and other needs that contribute to people’s quality of life.

What role can governments and policymakers play?

Even though Climate Action is just one aspect of sustainability it is front and centre on the global stage and on the agenda of governments in the region.

Looking at the UAE, the government has made the following commitments towards climate change and sustainable development:

• Declaration of 2023 as the Year of Sustainability
• UAE Green Agenda 2015-2030
• National Climate Change Plan of the UAE 2017-2050
• UAE Net Zero by 2050 Strategic Initiative
• Nationally Determined Contribution (NDC) – 2022 updates – 31% reduction in GHG emissions by 2030.
• Creation of the Sustainable Finance Framework 2021-2031
• Hosting COP28 in November 2023
• Creation of the Sustainable Finance Working Group
• Government’s announcement of FIVE priorities in 2023 – No 2. Being Environment and sustainability

How are governments bringing climate action to the fore for businesses in the public and private sectors?

Climate change is a macroeconomic and financial policy challenge that will require massive global investments. Estimates range from $3 trillion to $6 trillion per year until 2050. The current level of about $350 billion is a fraction of what is really needed. A major shift is required to harness public and private financing. With $250 trillion in financial assets across firms, the challenge for policymakers and investors is how to direct an increasing share of these holdings to climate mitigation and adaptation projects.

But how should governments approach this difficult subject of getting private sector buy-in to incorporate climate related sustainability into their business planning – the “carrot” (incentives/subsidies) or the “stick” (carbon pricing)?

Here are examples from countries and regulatory bodies that have drafted legislation to address key issues related to climate change and the private sector:

• The Council of the EU formally adopted the Corporate Sustainability Reporting Directive – imposing mandatory reporting requirements on many companies with European operations.
• The Companies Climate-related Financial Disclosure Regulations 2022 require UK registered companies with more than 500 employees and a turnover of more than GBP 500 million to provide climate-related disclosures in their strategic reports.
• Mandatory climate-related disclosures for financial institutions, insurers and investment firms to ultimately act on climate-related risks and opportunities required for financial years beginning in 2023.
• Climate Corporate Accountability Act – Requiring companies operating in California that generate > USD 1 billion in annual revenue to disclose their GHG emissions in line with the GHG Protocol.
• Inflation Reduction Act of 2022 – Directs $500 billion of new funding and tax breaks towards reducing carbon emissions, accelerating the growth of clean energy, electrification and electric vehicles.
• The World Bank states that 40 countries and more than 20 cities, states and provinces already use carbon pricing mechanisms, with more planning to implement them in the future.

Increasingly compulsory sustainability and climate related disclosures will drive national progress towards meeting climate related targets.
With ESG strategies maturing faster than initially predicted within many industry forecasts, it’s easy to become caught up in the hype and need to accelerate ESG adoption. However, it’s essential to understand the key governance topics involved and which of these apply to an organisation’s context before jumping straight in or spending time addressing the wrong areas.

Hamza Al-Haboubi
ESG Advisor
Al Tamimi & Company

The UAE is looking to the finance sector to begin this regulatory journey, creating the UAE Sustainable Finance Framework 2021-2031 and the UAE Sustainable Finance Working Group (SFWG) to help set out action plans to progress the growth of sustainable finance and help the UAE achieve its goal of Net Zero by 2050.

In November 2022, the SFWG issued a second public statement reiterating their commitment towards enabling the UAE’s economic transition and encouraging the adoption of sustainable finance at a national level.

The three interlinked topics (below) indicate the increasing focus on how companies manage and disclose their sustainability and climate change risks, particularly for companies who want to access finance or investment.

The third topic, the UAE taxonomy is an important one for Family Enterprises as green finance taxonomies provide investors, governments, and bond-issuers with guidelines for identifying environmentally-sustainable economic assets and activities, as well as guidance on integrating sustainability into investment decisions – i.e., it has the ability to guide Family Offices into new areas of business.

The UAE Sustainable Finance Framework contains a possible taxonomy for the future – diagram below.

UAE’s adoption of sustainable finance at a national level will involve:

1. Strengthening sustainability disclosures
   - Implement consistency and best practice around the disclosure of data by companies.
   - Equip the banks with the necessary data needed for the purposes of investment/finance decisions.
   - Ensure certain disclosures with respect to sustainability risks and exposure to climate-related risks.

2. Fostering sustainability focused corporate governance
   - Review corporate governance standards and practices to embed sustainability across corporate governance structures in the UAE through focusing on risk management, stress testing and data collection.
   - Ensuring all companies are taking the necessary steps to contribute to the sustainability of the economy.

3. UAE taxonomy of sustainable activities
   - Development of UAE focused taxonomy of sustainable activities, e.g., climate change mitigation, adaptation and environmental objectives.
   - Setting out a standardized criteria to define the path for economic transition to sustainable developments.

UAE’s national commitments and the creation of collaborative working groups such as the SFWG that have the necessary stakeholders to create and apply policies will result in the financial sector directing private capital towards sustainable projects, sustainable businesses, and sustainable products.
What role will the financial sector play?

The financial sector has a pivotal role to play by financing the global transition away from carbon-emitting activities. Under pressure from governments and stakeholders, financial institutions are reducing the financed emissions footprint of their loan portfolios. Increasingly, investment performance is being measured and analysed according to sustainability criteria based on corporate environmental, social, and governance (ESG) scores. These ESG scores combine social needs, economic criteria, and the environment, allowing investors to determine companies’ sustainable performance and identify low-risk investment opportunities. Incorporating ESG (as shown below) allows Financial Institutions to de-risk portfolios, protect value, and create value.

Raising capital:
- Actively monitoring ESG risks across the portfolio, e.g., excluding business propositions with high ESG risks

Effective and transparent reporting and proactive engagement with the portfolio company

Ensuring effective, and transparent communication and engagement

Risk factoring:
- Inclusion of ESG risks in investment processes and decisions and overall strategy

How can leaders prepare for these changes?

By understanding physical and transition risks, leaders are better able to react to those challenges, e.g., by adapting buildings, infrastructure and supply chains to withstand extreme weather events, and to diversify investment portfolios in response to anticipated regulatory and legal changes to energy policy.

Done well, climate adaptation leads to climate resilience, the capacity of organisations to survive, adapt, and grow no matter what kinds of climate-related chronic stresses and acute shocks they experience.

Resilient companies are also looking to adapt their products and services to survive and thrive in a low-carbon world. The more resilient a company, the lower its climate risks.

Enhance corporate growth
- Capturing ESG trends such as climate impact and decarbonization can create new business models, products, services, and generate opportunities to enter new markets

Improve risk management
- Corporations with strong ESG performance tend to be better aware of enterprise risks and proactively take steps to mitigate these risks. Strong ESG performers are typically better prepared to weather market volatility and economic downturns

Boost operating margins
- Corporations with strong ESG performance often take a more holistic, long-term view to assessing and managing operations, allowing them to operate more efficiently and gain access to more advantageous financing and capital arrangements

Examples of financial products and initiatives available to build on or kick-start a sustainability journey

The proceeds of Shariah-compliant financial instruments like green sukuk (similar to green bonds) can be used to fund environment-friendly projects. The total value of green and sustainable bond and sukuk issuance in the GCC exceeded US$8.5 billion in 2022, a large increase from $605 million issued in 2021. Banks in the UAE such as Emirates NBD and FAB, have issued green bonds since 2017. Of the FAB bond issued in 2017 ($1587 million) about 63% of the funds supported projects focused on energy efficiency, 30% for renewable energy, and the remaining 8% for wastewater management projects. Of the total amount of green bonds issued by FAB, 75% has been invested in projects in the UAE, some in North Africa, and the rest in Europe.

Other initiatives such as the Thabit Venture Builder, aim to transform 200 family business projects into major companies by 2030. The initiative will help family businesses enter sectors outside their traditional fields and encourage them to embrace advanced knowledge-driven industries such as artificial intelligence, biotechnology, agricultural technology, space sciences and renewable energy. This initiative is supported by the Ministry of Economy’s Investopia Summit, Abu Dhabi global technology ecosystem Hub71, Dubai Chambers, Family Business Council Gulf, CSR UAE and Dubai Internet City incubator ins.

Where does climate change fit in financial evaluations?

Climate is a risk factor that interacts with—and exacerbates—all three ESG categories, as well as traditional financial risks.

Organisations can reduce their vulnerability to climate-related risks by understanding the climate impacts on their operations, assets, and customers, and by strengthening their governance to minimise these impacts, and to adapt. Effective management of climate change risks and opportunities will help meet the board’s obligation to generate value for the company’s stakeholders. Knowing how to identify, assess and manage climate risk and opportunities is neither a simple nor obvious exercise. However, using scenario analysis and physical risk assessments, owners and executives can significantly enhance their understanding of how climate change will impact their business—both in terms of challenges and opportunities—and enhance their strategies to address those impacts.

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Major Categories of Financial Impact

The financial impacts of climate-related issues on an organization are driven by the specific climate-related risks and opportunities to which the organization is exposed and its strategic and risk management decisions on managing those risks (i.e., mitigate, transfer, accept, or control) and seizing those opportunities.¹¹

### Income Statement

**Revenues:** Transition and physical risks may affect demand for products and services. Identify potential opportunities for enhancing or developing new revenues. Growth of carbon pricing as a mechanism to regulate emissions affected industries should consider impacts on business revenues.

**Expenditures:** Transparency on cost structure and flexibility to adapt, capital expenditure plans, and the level of debt or equity needed may provide greater access to capital markets or improved financing terms. Additional regulatory costs of disclosures. Potential for tax increases to fund national adaptation and resilience.

### Balance Sheet

**Assets and Liabilities:** Supply and demand changes from changes in policies, technology, and market dynamics related to climate change could affect the valuation of organizations’ assets and liabilities. Climate-related impacts on long-lived capital assets should focus on existing and committed future activities and decisions requiring new investment, restructuring, write-downs, or impairment.

### Capital and Financing

Climate-related risks and opportunities may change the profile of an organization’s debt and equity structure, either by increasing debt levels to compensate for reduced operating cash flows or for new capital expenditures or R&D. It may also affect the ability to raise new debt or refinance existing debt, or reduce the tenor of borrowing available to the organization. There could also be changes to capital and reserves from operating losses, asset write-downs, or the need to raise new equity to meet investment.

### Transition Risks

- **Policy & Legal**
  - Increased pricing of GHG emissions
  - Enhanced emissions-reporting obligations
  - Mandates on and regulations of existing products and services
  - Exposure to litigation

- **Technology**
  - Substitution of existing Products and Services with lower emissions options
  - Unsuccessful investments in new tech
  - Costs to transition to a lower emissions technologies

- **Markets**
  - Changing customer behaviour
  - Uncertainty in market signals
  - Increased costs of raw materials
  - Supply chain risks

- **Reputation**
  - Shifts in consumer preferences
  - Stigmatisation (disapproval) of sector
  - Increased stakeholder concern or negative feedback
  - Ability to attract high-quality employees wanting to work at new companies

- **Physical Risks**
  - Increased severity of weather events (i.e., cyclones, heat days)
  - Changes in rain patterns and extreme variability – water scarcity
  - Rising mean temperatures
  - Rising sea levels

### Strategies (Path Forward)

- **Governance** - Share a clear vision rooted in the Family’s founding principles and advocated by the owner and leadership
- **Build an ecosystem of sustainability** - Partner with organisations that share a common vision and be willing to adapt and invest
- **Make sustainability less conceptual and more results driven** from the outset – adjust business plans, possibly establish a start-up within the Group with a step-by-step strategy.
- **Commit to the financial investment of a green transition**
- **Establish a sustainability division to apply standards and generate change**
- **Materiality Assessment** – critical factors impacting activities in locations and sectors of operations. Start with what is in the Family Group’s control and where the biggest impacts can be made first before chasing the next objective.

### Challenges

- Multi-generational perspectives - Overcoming Family perception of the environment and climate change – difficult conversations to get buy-in
- Uncertainty about the future – is sustainability going to matter?
- Unfamiliar environmental solutions and carbon-neutral business structures.
- Needing to adapt operations to meet standards (e.g., United Nations Global Compact)
- Data gaps on environmental impact in regions and industries of operations

### Opportunities

- Education and Communication of sustainability initiatives and goals to stakeholders, employees and partners
- New systems to address concerns of environment – i.e., water consumption, electricity use and waste creation
- Family Groups representing brands do not control the production i.e., not just buy-in internally but also complex network of partners – suppliers, logistics, retailers, real estate developers

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#### Summary Table of the Climate Risks and Opportunities for Businesses

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<thead>
<tr>
<th>Type</th>
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<th>Type</th>
<th>Opportunities</th>
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<tbody>
<tr>
<td>Policy &amp; Legal</td>
<td>• Increased pricing of GHG emissions</td>
<td>Resource Efficiency</td>
<td>• Use of more efficient modes of transport</td>
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<td></td>
<td>• Enhanced emissions-reporting obligations</td>
<td></td>
<td>• More efficient production and distribution</td>
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<td></td>
<td>• Mandates on and regulations of existing products and services</td>
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<td>• Use of recycling</td>
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<td>• Exposure to litigation</td>
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<tr>
<td>Technology</td>
<td>• Substitution of existing Products and Services with lower emissions options</td>
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<td>• Reduced water usage and consumption</td>
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<tr>
<td>Markets</td>
<td>• Changing customer behaviour</td>
<td>Energy Source</td>
<td>• Use of lower emission sources of energy</td>
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<td></td>
<td>• Uncertainty in market signals</td>
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<td>• Use of supportive policy incentives</td>
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<td>• Increased costs of raw materials</td>
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<td>• New technologies</td>
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<td>• Supply chain risks</td>
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<td>• Participation in carbon markets</td>
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<td>• Changes in rain patterns and extreme variability – water scarcity</td>
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<td>• Access to new markets (new countries, new JV partners etc.)</td>
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<td></td>
<td>• Rising mean temperatures</td>
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<td>• Use of public-sector incentives</td>
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<td>• Rising sea levels</td>
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<td>• Access to new assets</td>
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For us at Chalhoub Group, a clear vision by our leadership was key to the success of our company-wide sustainability initiative. We became signatories of the United Nations Global Compact (UNGC) in 2014 and this was the trigger for us. We engage with our suppliers, brands and industry experts to enhance the sustainability performance of our business practices.

It is important to look at trends in the markets, approach each sector separately and partner with organisations that share a common vision.

Sustainable impacts are amplified when organisations can collaborate well.

Florence Bulté
Chief Sustainability Officer
Chalhoub Group
Values, Traditions, Generational Vision – Family Enterprises Are Well Prepared To Embrace Climate Related Opportunities

How might Family Enterprises embrace climate risks & opportunities?

As national legislation around climate disclosure is imminent in many GCC countries, financial institutions are having to prepare themselves for climate related disclosures. Investors and lenders are looking to encourage Family Enterprises to incorporate ESG practices make disclosures, but how will Family Enterprises step towards incorporating sustainability and climate risk into their business strategy and portfolio management? What will influence that decision?

The Tharawat Family Business Forum produced a report in 2022 looking at the role family-owned enterprises will play in a more sustainable future for the MENA region. One of the aims of the report was to address why many family businesses under estimate their exposure to climate risk and, at the same time, overlook the business opportunities associated with climate adaptation.\(^1\)

The report focuses on four areas; climate measurement (i.e., carbon footprints), climate risk, climate opportunity and climate practicality (i.e., which standards should be used and how they can be applied).

Family enterprises are extremely well placed to be very effective on making decisions on sustainability but there’s a need for us to understand how they think. We need to incentivise and understand the reality that they think differently. Don’t speak at them, speak with them.

Farida F. El Agamy
General Manager
Tharawat Family Business Forum

The Tharawat Family Business Forum report found that values, traditions, and generational vision has always talked about ESG, just in a different way. As such, Family Enterprises are extremely well placed to make effective decisions on sustainability. The reality is that they think differently from other businesses.

The report also found that every family enterprise contacted had sustainability initiatives and a story worth sharing, although these were often minimized as being too small. Upon digging deeper, these ‘small things’, whilst not transformational, still speak to sustainability and would inspire and catalyse further action.

Whilst few Family Enterprises in the region have committed today to net-zero targets, many positive initiatives and small steps are worth highlighting. The following are just some of the Family Enterprises through the MENA region that have made meaningful steps:

- **KSA** – Abdul Lateef Jameel (Founded in 1945 – Auto, Transport, Health, Financial Services, Energy and Enviro Services) – adapted UN SDGs in 2015 and committed to creating sustainable energy and energy efficiency. Its J-PAL initiative measures the impacts of energy and environmental policies on climate change in its missions to address world poverty.
- **KSA** – Alaktiri Holding (Founded in 1975 – Construction, Infrastructure, Transport, Real Estate) – in 2019 the company began assessing investment decisions based on ESG performance as part of the company’s Sustainability Integration Roadmap.
- **Kuwait** – Al Sayer Group (Founded in 1954 – Auto, Heavy Equipment, Transport) – Published its first sustainability report in 2015 with all operations government by its ‘Sustainability Compass’.
- **Qatar** – Aamal (Founded in 1964 – Industrial Manufacturing, Trade & Distribution, Real Estate). Has reduced its GHG emissions to 2019 levels.
- **Lebanon** – Fatouh Group (Founded in 1897 – Brand Distribution) – five business segments across seven countries. In 2016 conducted GHG audit for its warehouses and has since reduced its carbon emissions by 25% in its warehouse operations, recycled/reused 30 tons of glass bottles, saved 10,000 trees through paper saving initiatives and prevented 54 tons of landfill plastic.
- **Egypt** – Juhayna Group (Founded 1983 – Food & Beverage) – one of the largest dairy and juice producers in Egypt. Joined UN Global Compact in 2017. Committed to reducing GHG emissions by 15% and reducing farming emissions by 10%. First Egyptian company to partner with an Egyptian solar energy start-up, KarmSolar.

The AW Rostamani Group, a family enterprise in the UAE (focused on Automotive, Real Estate, Retail, Logistics, Lighting and Lifestyle) sponsored the report and is starting to implement sustainability and ESG across its businesses and divisions, following the report findings. The diagrams opposite (references 16 and 17) illustrate the complexities that can exist within a Family Enterprise around how a decision is made and the groups of stakeholders involved. A decision such as to embark on incorporating sustainability and climate risk into business operations and investment decisions. When talking sustainability regulations, ESG, value creation and strategy, we need to respect that all bases should be covered. Consultants, for example, tend only to speak at the corporate/business executive level and not to the family and owner(s).

Possible stakeholders and activities having differing perspectives on sustainability – the Three-Circle Model of the Family Business System and The Family Enterprise

Source: Tagouri & Davis, 1978

Source: Davis, 2003
Conclusions

Family businesses have an opportunity to leverage their expertise and capital to support the transition to an environmentally and socially sustainable global economy.

However, talking in a technocratic way to family offices about the need to invest in climate-related change will likely result in a step backwards. Family Enterprises are happy to be part of the solution when engaged, and when regulation and policy are well defined.

Sustainability, and the fundamentals of ESG, have been rooted in the values and practices of Family Enterprises for decades. By talking with (rather than at) all relevant stakeholders in Family Enterprises (i.e., owners, family members and at the corporate level), we can inspire current and future generations to embrace the risks and opportunities that climate change will bring.

Both governments and the financial sector within the region are working to provide Family Enterprises the tools and support required to facilitate the region becoming a key ally in the global efforts to reach net-zero.

Sustainable finance can contribute to climate change mitigation by providing incentives for family businesses to adopt less carbon-intensive technologies, and specifically financing the rapid development and adoption of new technologies. The proceeds of Shariah-compliant financial instruments like green sukuk (similar to green bonds) can be used to fund environment-friendly projects.

It will be those family-owned businesses – with capital, a clear vision, strong values, and a long-term focus on the future – that will be best placed to not only navigate the economic transition, but to future-proof their business for generations to come.

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