OWNERSHIP TRANSITION STRATEGIES FOR JORDANIAN ARCHITECTURE & ENGINEERING FIRMS

Adapting and employing international best practices

June 23, 2009

This publication was produced for review by the United States Agency for International Development. It was prepared by Ian C. Rusk / ZweigWhite and with contributions from Lana Habash / Sanad Law Group.

OWNERSHIP TRANSITION STRATEGIES FOR JORDANIAN ARCHITECTURE & ENGINEERING FIRMS

Adapting and Employing International Best Practices

USAID JORDAN ECONOMIC DEVELOPMENT PROGRAM

CONTRACT NUMBER: 278-C-00-06-00332-00

BEARINGPOINT, INC.

USAID/JORDAN
OFFICE OF ECONOMIC GROWTH

JUNE 23, 2009

AUTHOR: IAN RUSK / ZWEIGWHITE AND

LANA HABASH / SANAD LAW GROUP

DELIVERABLE NUMBER: 5.2.5.A.2.15.1

CONTENTS

FOREWORD III
EXECUTIVE SUMMARY 1
VALUATION CONSIDERATIONS 4
LEGAL CONSIDERATIONS IN JORDAN 14
THE MECHANICS OF OWNERSHIP TRANSITION PLANNING 22
CONCLUSION & RECOMMENDATIONS 28
APPENDICES: 29

FOREWORD

Ownership transition planning is a critical element of any privately held architecture or engineering firm's strategic plan and Jordanian firms face many of the same challenges and objectives with respect to ownership planning as their Western counterparts.

Ownership transition planning addresses the following objectives:

- Allow the company to sustain itself over multiple generations of ownership – thereby allowing it to reach a size and scale most first generation firms cannot.
- Align the leadership of a firm with its ownership, thereby aligning the economic advantages with the responsibilities and risks of running a business.
- Provide for an appropriate return on investment for owners, and liquidity when it comes time for an owner to retire and sell his or her ownership stake.
- Provide incentives for attracting and retaining key staff and management talent.
- Provide a source of capital financing for the firm.

While there are differences in governing law and cultural considerations that must be accounted for, Jordanian firms can largely benefit from well-established international best practices for addressing the above objectives.

The workshop developed by ZweigWhite and conducting in Amman on June 10 &11, 2009 was designed to introduce international best practices for ownership transition planning and address some of the legal and cultural differences unique to Jordanian firms. The following report details the content covered in this workshop and our recommendations for the participating firms.

EXECUTIVE SUMMARY

This engagement began with a survey of the 13 participating firms and an analysis of the applicable law governing ownership transition in Jordan. The study was conducted by Sanad Law Group (Amman, Jordan) prior to the workshop on June 10 & 11, 2009. The study revealed an emerging pattern of corporate structure—the private shareholding company or PSC, which appears to best accommodate ownership transition and corporate sustainability. This structure closely resembles corporations in the west and would allow Jordanian firms to employ many of the strategies and best practices discussed herein.

Using the background information provided by Sanad Law Group, we developed a presentation and workshop on ownership transition strategies of a day and a half in length. The program outline was as follows:

- Understanding the value of your firms
    - How appraisers estimate a firm's value (approaches and methods)
    - What factors enhance or detract from value
    - Practical ways to establish and update your firm's value (valuation formulas)
- Valuation considerations when planning transitions
    - Minority versus controlling interests
    - Marketability/liquidity considerations
- Review of Findings on Jordanian Corporate Structure and Legal Considerations
    - Common corporate structures in Jordan
    - Legal issues pertaining to ownership transition
- Demographic and Other Unique Considerations for Jordanian Firms
- Ownership in the Context of Various Incentive Compensation Options
- Ownership Transition Planning Overview
    - What are your options as owners?
    - Pros and cons of internal ownership transition vs. other exit strategies
- The Mechanics of Ownership Planning
    - The shareholders agreement
    - Stock valuation method and considerations
    - Feasibility modeling and testing
- Recommendations for Jordanian participating firms
    - Corporate structure considerations
    - Cultural and strategic considerations
    - Recommended valuation methodology
    - Candidate identification
    - Transaction structuring and financing
    - Road map for transition planning

The workshop included a discussion of five case studies in ownership transition representing a variety of architecture & engineering firms of various sizes and nationality. It culminated in the development of the following 8-step process for the participating firms to use as a roadmap for ownership transition planning.

1. Assess your objectives – memorialize them and establish benchmarks to evaluate success. The key points for consideration are as follows.

- Who will be selling shares and when?
- How many potential ownership candidates are their presently?
- What ratio of owners to staff makes sense for your firm?
- Will you want to reserve a percentage of ownership to be family-held, and if so, how much?
- We recommend that firms (particularly smaller firms) start small, with offers to 2-3 key individuals

2. Determine appropriate corporate structure.

- We recommend that Jordanian firms begin process of transitioning to Private Shareholding Company (PSC) if not organized as a PSC already.

3. Establish a fair and appropriate method of setting the stock's value and update it at least annually.

- Conduct an initial valuation of the company (we strongly advise engaging a third party for this).
- Based on this analysis, construct a valuation formula that can be encompassed in your shareholder agreement and used to update the stock price each year.

4. Develop a method of evaluating ownership candidates for initial and subsequent stock offers.

- Determine what criteria you believe are important for ownership candidates and develop a guideline matrix for evaluating ownership candidates.
- Solicit nominations for ownership candidates and evaluate based on guideline criteria. Decide on initial candidates.

5. Determine whether financing is needed, and what form it will take.

- Will a down payment be required, and if so, how much?
- What will the rates and terms of the financing be?

6. Engage with legal counsel to draft (or update) your shareholders agreement or articles & memorandum of association, and other governing documents (non-compete agreements).

- Using shareholders agreement exhibit as a model, compose an agreement for your firm that covers the essential elements outlined in this presentation and incorporates the method of valuation.

7. Model the financial feasibility of your ownership plan.

- Develop a spreadsheet that models your ownership plan.
- The model should begin with a forecast of your financial statements (income statement and balance sheet) over the transition period.
- Add to that the assumptions for stock transactions in each year.

- Is the transition plan feasible? If not, adjust assumptions and goals accordingly.

8. Extend the ownership offers to candidates. The Candidates should be presented with:

- A summary outline of the firm's ownership plan.
- Financial disclosures (at least as required statutorily, but ideally to include historical financial statements).
- The shareholders agreement, articles and memorandum of association, and any associated transaction documents (share purchase agreement, promissory note if any, stock pledge agreement). Allow time for candidates to review documents.
- Close and execute transaction. We recommend that effective date of closing coincide with end of fiscal year with valuation based on year-end results.

The following report provides details of the information, examples, case studies and recommendations presenting during the workshop.

VALUATION CONSIDERATIONS

One of the first steps and often the largest obstacle to overcome when planning for ownership transition is the question of the company's value. During the workshop, we covered general concepts of business valuation, and unique considerations when assessing the value of architecture and engineering firms in the context of ownership transition planning.

DEFINITION OF VALUE

The concept of value can mean different things to different people, depending on the context. In terms of mergers and acquisitions, the most appropriate definition of value is what is commonly referred to as "fair market value."

U.S. Treasury regulations define fair market value as "...the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts." (Quoted from the Code of Federal Regulations, Title 26, Volume 14, part 20, Section 2031-1, sub-section (b), commonly cited as 26.CFR.20.2031-1(b).)

In most cases, there is no established and active market for the shares of privately held A/E firms. Very few firms in the industry are publicly traded, and those that have active employee ownership transition plans typically have a Shareholders Agreement that governs transactions under the plan and restricts their liquidity. Therefore, it is necessary to take a more theoretical approach to estimate fair market value. The approaches typically employed by business appraisers are discussed below.

APPROACHES TO ESTIMATING VALUE

The determination of the method or methods utilized to value a closely held business depends on the circumstances of each case and is a judgment decision on the part of the appraiser. The selection of valuation methods depends on the financial history and condition of the company, the type of company being valued, the existence of comparable companies that publicly trade stock, and the availability and reliability of financial forecasts. The various valuation methods available to the business appraiser are described in detail as follows:

PUBLICLY TRADED GUIDELINE COMPANY METHOD

The publicly traded guideline company method involves utilizing the market valuation multiples or ratios of comparable public companies as an indication of the price at which the stock of the subject company might sell for in a public market. The market multiple or ratio is the price of a company's stock divided by various operating criteria of the public company. Under this method, value is determined by multiplying the specific market multiple or ratio by the same criteria base (e.g., an income stream determined to best represent earnings capacity) of the subject company. A common example of one such valuation multiple is the ratio of price to earnings (the P/E ratio).

One of the issues of using this method is the limited number of publicly traded firms in the architecture, engineering, and environmental consulting industry, and their size in comparison to the typical, privately held firm. ZweigWhite tracks the majority of publicly traded firms through two market indices. The first index is the ZweigWhite 15 (ZW15), consisting of 15 publicly traded domestic (U.S.) firms. The second index is the ZweigWhite International (ZWI). It tracks 15 publicly traded international firms. The following table lists the firms that make up the ZWI.

Table 1: ZWI Index of Publicly Traded A/E Firms

Company	Country	Ticker
AMEC plc	England	AMEC
ARCADIS NV	Netherlands	ARCAD
Atkins (WS) plc	England	ATK
Cardno Ltd.	Australia	CDD
Downer EDI Ltd.	Australia	DOW
Fugro NV	Netherlands	FUR
Hyder Consulting plc	England	HYC
JGC Corporation	Japan	1963
Lycopodium Ltd.	Australia	LYL
Monadelphous Group Ltd.	Australia	MND
Mouchel Parkman plc	England	MCHL
Scott Wilson plc	England	SWG
SNC-Lavalin Group, Inc.	Canada	SNC
Tecnicas Reunidas S.A.	Spain	MCE
WSP Group, Inc.	England	WSH

MARKET TRANSACTIONS METHOD

The market transaction method is similar to the publicly traded guideline company method. With the market transactions method, the appraiser attempts to identify mergers and acquisitions of both public and private companies in the same industry as the subject company. The goal is to establish the relative transaction multiples at which the business combination occurred. This information is readily available when two publicly traded firms combine, or when a publicly traded firm acquires a privately held firm. However, information is more difficult to come by when two privately held firms combine.

DISCOUNTED FUTURE CASH FLOW METHOD

The discounted future cash flow method involves utilizing a forecast of future earnings, generally for a period of five years, and discounting the expected future cash flows to their present value. This method is based on the theory that the value of a business represents the present value of future earnings plus the present value of the terminal (residual) value. The two components of value under this method include:

a) The present value of future operations from the valuation date until a stabilized level of growth and sustainable profit margin is reached (generally five years).

b) The present value of the company's value in the terminal year of the forecast (the first full year after the company reaches a stabilized level of growth and sustainable profit margin).

The selection of a discount rate (the appropriate rate of return) for an individual firm must be appropriate for the expected risk of the income stream. In economic terms, the discount rate is an "opportunity cost," that is, the expected rate of return (or yield) that an investor would have to give up by investing in the subject investment, rather than investing in an available alternative investment with comparable risks and investment characteristics.

Several methods exist for determining an appropriate discount rate for a particular firm. The Ibbotson Build-up Method, and the Capital Asset Pricing Model (CAPM) are two common methods. Both use observed market rates of return to try to estimate an appropriate rate of return for a particular company. The starting point is the interest rate an investor could earn on a "risk-free" investment. Long-term government bond rates are typically used as a proxy for a risk-free investment. This "risk-free" rate is then built up by the risk premiums observed in the public marketplace, and the unique risk profile of the subject company. It is important to note that these rates are not static, but are constantly in flux with changes in the marketplace.

CAPITALIZATION OF CASH FLOW METHOD

Under this method, value is calculated by dividing an income stream by a rate of return, referred to as the capitalization rate. The income stream or earnings base to be capitalized is that which is representative of the company's earnings power or capacity at the time of the valuation and is usually net income, pre-tax income, or cash flow. The capitalization rate is the rate of return an investor would require on an investment in the particular company being valued, less the long-term growth rate. The capitalization rate is distinguished from the discount rate discussed earlier by the deduction of the assumed growth rate. An appraiser may also use a blending or weighted average of the equity rate of return and the firm's cost of debt (known as the weighted average cost of capital or "WACC") and apply that to debt-free cash flows.

The critical factors to be determined when utilizing this method are (1) the income stream or earnings base to capitalize and (2) the rate at which to capitalize the income stream. This method is fundamentally very similar to the discounted future cash flow method described above.

MARKETABILITY DISCOUNT

The concept of marketability addresses the ability of an owner to convert their ownership interest to cash, with minimum transaction and administrative costs and with a high degree of certainty of realizing the expected amount of the net proceeds.

Marketability discounts are used to capture the difference in value based on the liquidity of stock traded on the public markets versus the value of holding an ownership interest in a private firm with no ready liquid market in which to transact shares. Many studies have been done to try to quantify the value of marketability of liquidity. One study conducted by the SEC of the purchases of common stock subject to investment restrictions showed an average discount from the freely traded price of 32.7% for companies in a sales range of $1 million to $5 million.[1]

In a second study, the prices paid by certain mutual funds for stock subject to restrictions as compared to identical but freely traded stock were shown to be an average of 35%.[2] John D. Emory has performed eight studies of private placement stock transactions and subsequent initial public offerings of the same stock.[3] All eight studies were done under very diverse market conditions, yet the results were not dissimilar: from the 1980-1981 study, where the prime rate of interest went up to 20%, through the 1987-1989 study which included the October 1987 market crash. The median discount for sales transactions from all eight studies was 43%.

It is important to keep in mind that marketability is not a black and white issue. It is not so much a matter of a firm's stock being marketable or non-marketable, as it is the degree of marketability. When evaluating a business, it is important to consider whether factors that contribute to or detract from marketability exist. Factors that may enhance the marketability of a privately held firm's stock include: The firm's financial performance and condition, the number of shareholders and distribution of stock among them, the dividend paying history of the firm, the history of stock transaction activity within the firm, and the nature and terms of any shareholder agreements in place. All these factors may make it easier or more difficult for an individual shareholder to redeem their shares, or sell them to another party.

THE CONTROL PREMIUM

A key issue in valuing firms for the purpose of a merger or acquisition is to properly account for the additional value inherent in holding a controlling interest of a company's stock. The issue of controlling versus minority interest covers a broad spectrum of factors that influences value. One category of factors is the degree of control elements that may or may not be present in any specific ownership interest. Another factor is the potential ability of a controlling shareholder to implement policies that will enhance the value of control versus a minority interest shareholder's inability to enact changes.

The inherent additional value of control depends on the ability of a buyer to exercise any or all of a variety of rights typically associated with control. Some of the more common prerogatives of control include:

- Electing directors and appointing management;
- Determining management compensation and perquisites;

---

1 SEC Institutional Investor Study, U.S. 92nd Congress, 1st Session House, 1971.

2 J. Michael Maher, "Discounts for lack of Marketability for Closely Held Business Interests," Taxes - The Tax Magazine, pp. 562 -571, (September, 1976).

3 John D. Emory, ASA, "The Value of Marketability as Illustrated in Initial Public Offerings of Common Stock (Eighth in a Series)", *Business Valuation Update Online*, (October 1997), www.bvupdate.com/bvusub/10_97editor.asp.

- Setting policy and changing the course of business;
- Acquiring and/or liquidating assets;
- Making acquisitions;
- Declaring and paying dividends and bonuses; and
- Changing the articles of incorporation or bylaws.

One source for market data on control premiums is the *Mergerstat® / Shannon Pratt's Control Premium Study™.* (*Mergerstat® / Shannon Pratt's Control Premium Study™* is a publication of Business Valuation Resources, LLC.) It is published as an annual study with quarterly updates. The quarterly updates provide premium data for the subject quarter and the most recent twelve-month period. Data includes domestic as well as international transactions. Mergerstat examines transactions whereby 50.01% or more of a company was acquired. In order to obtain unbiased and accurate pricing information, Mergerstat narrows the scope of the study to completed transactions where the target company was publicly traded. The *Mergerstat Control Premium Study* also provides control premium data for a variety of industry segments, including data for "Engineering, Accounting, Research, and Management Services."

ZweigWhite has conducted its own internal study of control premiums in the architecture, engineering, planning, and environmental consulting industry. The study compared transaction prices from ZweigWhite's database of mergers and acquisitions in the industry to the estimated fair market values of the firms as determined by using the Z2 valuation multiples from ZweigWhite's annual *Valuation Survey of Architecture, Engineering, Planning & Environmental Consulting Firms*. (The Z2 valuation formula is based only on valuations conducted through a formal appraisal.) Only transactions that have occurred since 1999 were included and the Z2 valuation multiples applied to each firm were from the then current valuation survey edition. The results of the study indicate a mean control premium of 16.7% median control premium of 37.0%.

These studies clearly indicate a substantial value in holding a controlling interest versus a minority interest and help quantify that additional value for shareholders considering various exit options. The bottom line is that when trying to estimate the value of a business enterprise for ownership transition purposes, it's important to first understand whether the transaction will convey a controlling interest to the buyer or not. If it will, then the value should reflect a control premium as qualified above. If not, it should reflect a minority interest. In either case it may be necessary to make adjustments to the value (i.e. apply a control premium or a minority interest discount) depending on what valuation method was used to determine the value.

USING KEY PEFORMANCE MEASURES TO ASSESS OPERATIONAL STRENGTHS AND WEAKNESSES

Any ownership transition planning effort should include an assessment of the financial performance and condition of the company. A financial analysis will allow all parties to understand the future cash flow of the company, its financing capacity, and its value as an investment. When these financial elements are combined with a complete picture of who will be buying stock, who will be selling stock, how much those parties plan to buy or sell, and when they plan to buy or sell, we can start to model and test the feasibility of various ownership transition options.

OPERATING PERFORMANCE METRICS

Examining the underlying drivers of profits can help in understanding where the firm is performing at a high level, and where there may be room for improvement. Utilizing benchmarking data, where available, is particularly helpful. The goal of this exercise is to understand how recent historical performance relates to potential future performance.

Some basic operating performance metrics include the following:

Chargeability (or utilization), defined as:

<u>Direct Labor Cost (in dollars)</u>

Total Labor Cost (in dollars)

Example: If direct labor costs were JD 1,600,000 and total labor cost was JD 2,600,000.

Chargeability = 1,600,000/2,600,000 = 0.615 or 61.5%

A typical chargeability level for a firm in this industry is between 60% and 62%. This includes all staff. A low utilization level may reflect a firm that is overstaffed relative to its workload, and vice versa.

Net Labor Multiplier, defined as:

<u>Net Service Revenue</u>

Direct Labor Cost

Example: If net service revenue was JD 4,500,000 and direct labor cost was JD 1,600,000.

Labor Multiplier = 4,500,000/1,600,000 = 2.81

A typical labor multiplier for a firm in this industry is between 2.9 and 3.1. Higher multipliers often reflect unique or otherwise highly valued services, while lower multiples often reflect commodity services and high levels of competition.

Revenue Factor, defined as:

<u>Net Service Revenue</u>

Total Labor Cost

or

Labor Multiplier X Chargeability

Example: If net service revenue was JD 4,500,000 and total labor cost was JD 2,600,000.

Revenue Factor = 4,500,000/2,600,000 = 1.73

or

Labor Multiplier of 2.81 X chargeability of 61.5% (0.615) = 1.73

A typical revenue factor for firms in the industry is between 1.7 and 1.9.

Overhead Rate, defined as:

<u>Total Overhead Expenses</u>

Direct Labor Cost

Example: If total overhead expenses for the period were JD 2,545,000 and direct labor was JD 1,600,000.

Overhead Rate = (2,545,000 / 1,600,000) = 1.59 or 159%

A typical overhead rate for the industry (excluding discretionary profit distributions) would be between 150% and 165%.

Average Collection Period (ACP), defined as:

<u>Accounts Receivable</u>

Annual Gross Revenue

X 365 (*to express in terms of days*)

Example: If accounts receivable at the end of the period was JD 1,200,000 and gross revenue for the last twelve months was JD 5,400,000.

ACP = (1,200,000 / 5,400,000) x 365

= 81 days

A typical average collection period for the industry would be between 78 and 82 days:

Once you understand how your firm is performing relative to industry norms, and how that performance has been trending, you can make informed assumptions about future performance. These assumptions and the income statement and balance sheet forecasts that are derived from them are a critical part of the ownership planning process.

BALANCE SHEET CONSIDERATIONS

Some key considerations related to the company's balance sheet include the aforementioned average collection period, and how that will impact growth in accounts receivable balances (the single largest asset on most A/E firm's balance sheets) as the firm grows.

Another consideration is what sort of capital expenditures the firm anticipates needing to make over the forecast period. This is an often overlooked component of forecasting. A fact of doing business is that equipment becomes obsolete and must be replaced, and in a growing firm, there is constant need to invest in new property and equipment. These expenditures must be budgeted for.

Another balance sheet consideration is the firm's use of debt over the forecast period. Any anticipated financing, whether related to the ownership transition plan or not, needs to be incorporated in the forecasts. Debt financing has a direct impact on value (i.e. the more debt a firm carries, all other things being equal, the less its equity value)

GROWTH EXPECTATIONS

Assumptions about top-line revenue growth are a difficult exercise, even in the near-term. Any growth expectations should take into consideration historical growth rates, the company's strategic plans and initiatives as they relate to growth, and the economic and industry outlook.

While an aggressively growing firm might reasonably expect to continue such growth in the near-term, all firms will eventually hit a point where growth slows. Therefore, when making long-term assumptions with respect to revenue growth, it is best to use conservative growth assumptions.

OPERATING CASH FLOW

The combination of projected profits and balance sheet assumptions will allow you to project the future cash flow of the firm. This projection will be the basis of any internal ownership transition modeling. It will allow you to understand the feasibility of an internal transition and how changes in the way you value your firm's stock and the way shares are transacted impact the company.

UPDATING THE VALUATION

A company's value is not a static thing. Internal and external forces are constantly pushing values up and down. Without an active public market for their shares, privately held firms must set their share prices through a process of valuation. It's highly advisable to have a thorough valuation completed when commencing an ownership transition process. But how frequently should valuations occur after that?

Most firms choose to value their company's stock annually. That value is then used for any transactions that might occur over the course of the year. A firm actively trading shares in its stock each year might have an independent appraisal conducted each year. However, this can be expensive and time consuming, and, therefore, more difficult to justify for smaller firms. As a result, it is common for firms to develop and use a stock valuation formula to update their stock value each year.

Stock valuation formulas should be developed only after a thorough independent valuation has been performed. The formula may then be developed using the initial valuation analysis as the basis.

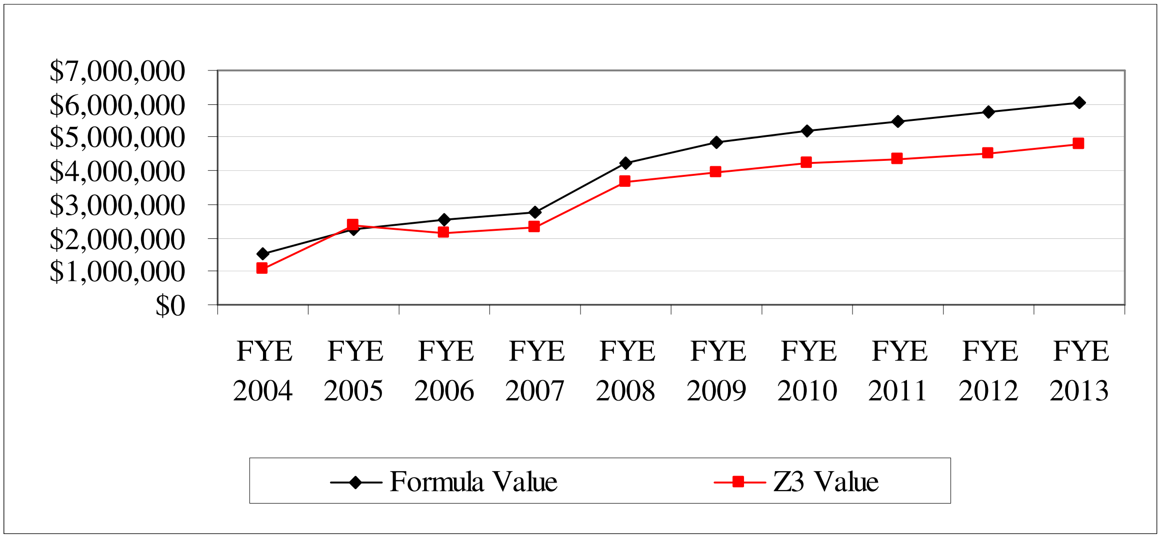
A good formula should be based on a number of characteristics of the firm's financial performance and condition. Factors that should certainly be part of any formula include net service revenue, earnings (profit) and capital structure (i.e. relative debt levels). Depending on the firm, other factors might need to be considered as well.

Developing a formula that will stand the test of time requires testing of the proposed formula based on historical and projected results— what value would the formula have produced last year, and the year before, and what value will it produce next year, and the year after.

This testing will reveal if it is overly sensitive to one factor or another, or if it is likely to produce volatile results (i.e. wild fluctuations from year to year). Sticker price volatility is undesirable when it comes to ownership transition, as it can cause fear and uncertainty among buyers and sellers.

The trick to this sort of testing is to provide a context for understanding whether the valuation results produced by the formula are reasonable or not. One way is to compare the formula results to a valuation "rule of thumb" such as ZweigWhite's Z-formulas as published it the annual *Valuation Survey of Architecture, Engineering, Planning & Environmental Consulting Firms*. The chart below shows the results of such an analysis.

Figure 2: Stock valuation formula analysis



RECOMMENDATIONS WITH RESPECT TO VALUATION

For Jordanian firms beginning the process of ownership transition we would recommend beginning by having a business appraisal conducted. A qualified third-party appraiser can address the issue of value in a dispassionate way that a party to the ownership transaction simply cannot, and that will add credibility to the entire process.

For subsequent transactions, the company may consider developing a valuation formula to update the stock value. This can be a cost-effective alternative when there is no statutory requirement to have an independent third-party appraisal conducted.

LEGAL CONSIDERATIONS IN JORDAN

The following section was authored by Lana Habash of The Sanad Law Group (Amman, Jordan).

INTRODUCTION

The Architecture and Engineering Firms[4] in Jordan range in terms of their corporate structure and the services they offer from basic engineering offices, owned by a single engineer to very sophisticated enterprises operating in a number of jurisdictions. However, irrespective of the form that such Firms exist and operate under, they all face one major challenge; sustainability and continuity.

Historically, professions in Jordan took the form of small family offices, and the practice was passed from one generation to the next. However, this trend, while still existent, is becoming the exception, as professionals now seek to form specialized professional entities, on the one hand, and second generations are moving away from family businesses, taking on a more independent career path, not necessarily in the same profession.

Like any other professionals in Jordan, Architects and Engineers belong to an association;[5] the Engineering practices is regulated and governed by the Engineers Association Law,[6] establishing the Association and the Regulations issued pursuant to it.[7] However, the organization of engineering firms as corporations is governed by the Companies Law.[8]

This report will shed the light on the available corporate forms under Jordanian Law, highlighting the characteristics of some of these forms that accommodate the requirements of the Engineering Practice while providing the necessary flexibility to ensure the growth and sustainability of the Engineering Firms, providing the necessary context for the International Consultant to devise appropriate "Ownership Transformation Strategies" based on international best practices, and that are viable within the parameters of Jordanian Law.

To assist the International Consultant in devising such Strategies and to enable him to gauge the readiness of the various Engineering Firms to implement the recommended transformation plans, a survey of a sample Engineering Firms, representing Tier 1 and Tier 2 Members[9] of the Architecture & Engineering Business Council (A&E BC), was conducted by the Local Consultant. The results of the survey are provided in the Matrix attached to this Memo as Exhibit (A).

---

[4] For the purposes of this Memo, Engineering Firms, wherever used, equally includes both Architecture & Engineering Firms.

[5] The Jordanian Engineers Association

[6] Law No (15) for the year 1972

[7] The Engineering Offices & Firms Regulation No (2) for the year 1985 and Regulation governing the Engineering Practice No (22) for the year 1999.

[8] Law No (22) for the year 1997 and the amendments thereto.

[9] The sample included a total of 13 Engineering Firms; 8 Tier 1 Firms and 5 Tier 2 Firms. The Tiers reflect the degree of involvement with the A&E BC; Tier 1 Firms are full Members and Tier 2 Firms are supporting Members.

REGULATORY FRAMEWORK GOVERNING ENGINEERING FIRMS IN JORDAN

As stated above, the existence and operation of the Engineering Firms in Jordan is governed under two bodies of Law; the Engineers Association Law; and the Companies Law.

i. Registration Requirements with the Jordanian Engineers Association:

The Engineers Association Law provides for the basic requirements for Engineers to be admitted to the Association and thus be able to practice the Engineering Profession in Jordan; in addition to educational qualification, such requirements include that the applicant must be a Jordanian citizen,[10] enjoying civil competence, and not convicted with a crime contradictory to ethics, honor or dignity.

The Law also provides for a set of requirements for Engineering Offices and Engineering Firms; an Engineering Office must be owned and operated by a Jordanian active Engineer[11], with an experience of at least 7 years, 3 of which in design works. Jordanian Engineering Firms must meet the following requirements:

- to be registered as a company pursuant to the valid Companies Law;
- to have its primary place of business in Jordan, where its main technical team is located;
- at least half of the registered shareholders are:
    - active Engineers;
    - fully available to work in the Firm; and
    - hold at least 50% of the registered capital;
- at least one of the working shareholders has practiced for at least 7 years;

A non-Jordanian Engineering Firm may be registered with the Association as well, if registered as an operating non-Jordanian company under the valid Companies Law, and operates in association with a Jordanian Office or Firm, pursuant to a contract, a copy of which must be filed with the Association. Engineers, as individuals, Offices or Firms, are not allowed to operate as contractors or to be engaged in commercial activities related to their business.

The Engineering Offices & Firms Regulation[12] sets out in more detail the requirements and procedures for obtaining the registration with the Association, as well as obtaining the classification as: a) Engineer's Office; b) Consulting Engineering Office; c) Engineering Firm; and d) Consulting Engineering Firm. Engineering Offices & Firms are further classified in terms of the field they practice in, and in terms of their capacity and expertise. The Engineering Offices & Firms form the general assembly of the Engineering Offices & Firms

[10] Arab engineers are allowed to join the Association subject to reciprocal treatment. Non-Arabs may be admitted upon a decision from the Minister of Public Works, provided that such engineer is working under a valid contract with a government or semi government department, or with a local company or a foreign operating company, and no Jordanian Engineer has the requisite qualification and/or experience.

[11] For the purposes of this Memo, an active engineer is an engineer who is registered with the Association, paid his dues and has no disciplinary record.

[12] Regulation No (2) for the year 1985

Commission, established pursuant to the provisions of the Engineers Association Law and the Engineering Offices & Firms Regulation.

ii. Corporate Forms under the Companies Law

The Engineers Association Law provides that a company must be registered in accordance with the valid Companies Law, in order to qualify for registration with the Jordanian Engineers Association; the Engineers Association Law while provides for ownership requirements, does not stipulate a specific form of incorporation. Therefore, in theory, any form available under the Companies Law qualifies for registration with the Association; such forms include General Partnerships (GP), Limited Partnership, Limited Liability Companies (LLC), Limited Partnership in Shares, Private Shareholding Companies (PSC) and Public Shareholding Companies (PLC). Also, the Law provides for a special type of companies for shareholders from the same profession called Civil Companies, and are governed by the general provisions of the Civil Code. For purposes of this Memo, the review will be restricted to the more common forms of incorporation; GP, LLC, PSC, PLC, and the Civil Companies.[13]

- General Partnerships

In spite of the open liability for shareholders, General Partnerships have been very common, due to the ease of the registration process, the minimal capital requirements and the low reporting and compliance requirements. However, the main drawback for General Partnerships is that the Partnership is not an independent legal entity from the shareholders, and as such the shareholders remain liable in their personal capacity. Moreover, shareholders must be natural persons. The Law provides the shareholders with the flexibility to regulate the relationship amongst them in the establishment contract, and to specify the rights and privileges of each of the shareholders. However, they all remain jointly liable towards third parties for the actions of the Partnership.

- Limited Liability Companies

Limited Liability Companies are a very common form of incorporation, mainly because upon incorporation, the company assumes an independent entity from the shareholders, who may be corporate entities as well, and the shareholders are only liable to the extent of their contribution in the capital. In light of a recent amendment to the Companies Law, the minimum capital requirement has been reduced to JD 1,000 instead of JD 30,000, encouraging many General Partnerships to transform into Limited Liability Companies to benefit from the limitation on liability.

The main drawback for Limited Liability Companies is that the provisions of their Articles & Memorandum of Association are strictly regulated under the Law, leaving very little flexibility for the shareholders. Therefore, LLC(s) appear to be an inadequate form for businesses, which need to meet certain regulatory requirements, or desiring to have a unique corporate structure.

[13] The full text of the Companies Law is available at http://www.ccd.gov.jo/english/inside.php?id=19&src=ml

- Private Shareholding Companies

Private Shareholding Companies are relatively a new form of incorporation introduced under Jordanian Law in 2002, in an effort to attract international investments to Jordan and to reestablish the basic legal principle constituting that the “contract is the law that governs the contracting parties”. Private Shareholding Companies are similar to Limited Liability Companies in terms of the limitation on the liability of the shareholders. The capital consists of two component; authorized capital and subscribed capital. The minimum subscribed capital of a PSC is JD 50,000. The Authorized capital must be subscribed to over the course of three years from the date of registration unless otherwise provided in the Memorandum and Articles of Association.

One of the main characteristics of Private Shareholding Companies, rendering them an attractive option for investors, is that the shares may be divided into categories/ classes, granting each category distinctive rights and privileges or placing certain restrictions on the holders of certain category shares. Examples of variations among the categories can be in terms of profit distribution, voting powers, right of first refusal, restriction on share transfers, obligation to surrender shares to the company on the occurrence of certain circumstances, etc… The Private Shareholding Company may also issue redeemable shares, and may list its shares on the stock market and issue bonds as well, if provided for in the Articles & Memorandum of Association, however, so far, no company has exercised this right. In theory, and according to the letter of the law, there are no restrictions that are applicable to PSCs as opposed to PLCs; the Companies Law grants this as an option to the PSCs provided that it is allowed in the Articles & Memorandum of Association, and carried out in accordance with the regulations of the Jordan Securities Commission (JSC), which are given precedence over the Companies Law, in that case. According to the Legal Dept. at the JSC, only one company has put forward an application to list its stocks, and was rejected for reasons the JSC could not disclose; they maintain that any PSC can put forward an application, which will be considered by the Board of Commissioners, and decided on the specifics of the case at hand, in accordance with the valid regulations and instructions, which apply to the “issuing company” irrespective of being a PSC or a PLC.

Other two key features of Private Shareholding Companies are the ability to grant shareholding options, and providing the mechanism to introduce Employee Stock Option Plans (ESOP), which may be exercised over a period of 10 years. Private Shareholding Companies may also offer shares the Provident Fund established pursuant to the provisions of the Labor Law.[14] The Provident Fund is considered a separate legal entity from the company and enjoys financial independence; the regulations of the Fund must be certified by the Minister of Labor, and may allow for complete or partial investment of the pool of money in the company itself. Such funds are optional and the contributions made by the company on behalf of its employees entitle the company to tax deductions. The contributions made by the employees are exempt from the income tax, while the income generated for the employee through such funds may be exempt from income tax upon the approval of the Minister of Finance.[15]

[14] Article 33 of the Labor Law No (8) for the year 1996.

[15] Article 7 (B) of the Income Tax Law No (57)| for the year 1985; the Income Tax Law is undergoing some major amendments, and it is not clear as of this date, how the treatment of such funds will be under the amended law.

Also, the Private Shareholding Company may buy back its shares (Treasury Stocks) and may reissue such shares, or decrease the capital, at its own discretion.

- Public Shareholding Companies

Public Shareholding Companies are highly regulated both under the Companies Law and the Securities Law,[16] with minimum authorized capital requirement of JD 500,000 and subscribed capital requirement of JD 100,000, or 20% of authorized capital, whichever is greater. The Public Shareholding Companies must list their stocks for trading on the stock market; however the founding shares are subject to a lock up period of 2 years.[17] The founders' shares in Public Traded Companies must not exceed 75% of the company's authorized capital, unless the company is the result of transforming an LLC or a PSC into a PLC, where this restriction does not apply.

A Public Shareholding Company may allocate a percentage of its authorized capital to offer to employees under a Stock Option Plan approved by the Extraordinary General Assembly of the Company, with a maximum period of four years to exercise the options. The Jordan Securities Commission has recently passed instructions regulating the process of granting ESOP for Public Shareholding Companies, which are not entirely consistent with the provisions of the Companies Law; for example, the period for exercising the options stipulated under the Companies Law is not observed in these Instructions.

In Jordan so far, there are no Engineering Firms that are incorporated as PLC(s); while the Law does not explicitly prevent engineering firms from incorporating as PLC(s), the ownership requirement of 50% of the shares by active working engineers, is being interpreted as a practical obstacle for establishing an engineering firm as a publicly traded company, particularly, as this requirement may limit its tradability. Also, the regulation of publicly traded companies does not allow much flexibility in the Articles & Memorandum of Association in terms of having various classes of shares, or limiting the right of the shareholders to dispose of their shares.

- Civil Companies

The Companies Law provides only one paragraph regarding Civil Companies and refers to the provisions of the Civil Code to regulate this type of companies. Civil Companies are a vehicle introduced to enable professionals to come together and form an entity through which they can jointly practice their profession. The Law provides the shareholders with a great deal of flexibility to regulate the relationship amongst themselves, and to specify how shares are transferred and how the company is liquidated, etc… However, the major disadvantage for Civil Companies is that they do not provide the corporate shield necessary to separate the liability of the firm from that of the individual shareholders. Certain professions in Jordan are restricted to that form, as stipulated in their respective associations' laws, such as attorneys.

---

[16] Securities Law No (76) for the year 2002 (Provisional Law)

[17] This restriction does not include transfers to other founding shareholders, transfers as a result of inheritance, among spouses, and parents and children.

CORPORATE STRUCTURE FOR JORDANIAN ENGINEERING FIRMS

Most of the Engineering Firms in the surveyed sample are currently incorporated as Limited Liability Companies; three of them are undergoing transformation into Private Shareholding Company. Only one Firm exists as a Sole Proprietorship and two as General Partnerships. Three of the surveyed firms already exist as Private Shareholding Companies.

A close examination of the corporate history of most of the surveyed Firms indicates that such Firms have been following the legal developments and followed more or less the same path maturing from sole proprietorships or general partnerships into private shareholding companies in most of the cases.

A number of the surveyed Firms resulted from the individual shareholders of smaller firms taking the decision to join their practices through forming a larger company; mergers as typically provided for under the law are not common in the sector. However, the majority of the surveyed firms confirmed that mergers are necessary for the growth of the sector, provided that the right elements are secured, particularly, the cultural aspects of the merging firms and the added value brought by each one of them, as well as logical valuations. In short, all the surveyed firms are open for mergers under the right conditions. Some Firms had failed experiences with mergers and dissolved them after forming some kind of coalitions or associations, and others had undergone serious steps towards acquisition, but negotiations failed on issues of valuation.

The Firms existing as Private Shareholding Companies opted for not listing their shares on the stock market, partially due to the fact that the system is not yet available to allow for that, but more importantly, some of them strictly believe that listing the shares will commercialize the practice, and will take away the dignity of the profession. Most of the surveyed firms indicated that it is premature for the Engineering Firms in Jordan to exist as Public Shareholding Companies, although a small minority took a varying view.

The survey indicated that there are two schools of thought among the Engineering Firms in terms of separating ownership from operation; some felt strongly that Engineering Firms must be wholly owned by people who are working in the Firm with a certain percentage maintained for active engineers. Others took the view that ownership should be separated from operation, and are strong advocates for changing the Engineers Association Law to eliminate the 50% capital requirement to be held by active working engineers.

A very limited number of the surveyed Firms had an open and transparent policy, where employees were involved in management, with access to financial records, while the majority limits such access.

SUSTAINABILITY PROBLEM / EFFORTS TO OVERCOME IT

Whether the surveyed Firms where advocates of maintaining the operation and ownership of the Engineering Firms separate, both groups emphasized the problem of continuity and sustainability of the firm beyond the first or second generation.

To overcome this major issue, a number of creative solutions were introduced and others are being experimented with. Some Firms created a separate company and called it an “ESOP Company”, which will hold a certain percentage of the Engineering Firm. However, the problem with this approach is that while it might succeed in retaining employees, it fails to secure the continuity of the Firm, if due to reasons of liquidation of the corporate qualifying shareholder[18] or disqualification for any reason, or the retirement or death of the natural shareholder, the Firm may become disqualified, and lose its registration with the Association.[19]

Other Firms took a more direct approach, through introducing certain schemes within the Firm’s Articles & Memorandum of Association; to achieve this, such Firms had undergone transformation into Private Shareholding Companies, and adopted more or less a similar capital structure comprising of more than one class/category of shares and placing restrictions on the transfer of shares under certain categories, giving the Firm, or the General Assembly the right to buy back these shares on retirement, resignation or death, based on pre agreed price formula, where the shareholder or the heir(s) will take the monetary value of the shares. It is worth noting that this is an untested area of the Law, and although the majority view supports the interpretation of the Companies Law in conjunction with the provisions of the Civil Code governing inheritance as allowing such arrangements. The dissenting view, however considers that any future disposition involving the estate of a person, while still alive is not allowed, even with his/her consent, unless explicitly stated in the Law.[20]

The advocates of the first view also rely on the provisions of the Civil Code, where the basic rule is that the partnership terminates upon the death of one of the partners; however the company may continue if the other partners agree to such continuity, and the heirs of the deceased partner become partners in the company in place of the deceased. Conversely, the partners may agree to continue with the partnership upon the death of one of the partners, and in such a case, the heirs will only be entitled to the value of the share of the deceased partner, valuated on the date of the his/her death.

This view is supported by following the train of references from the Companies Law to the Civil Code; matters that are not governed under the Companies Law, the Law refers to the provisions of the Commercial Code, then the Civil Code, then Commercial Practice. The provisions governing the General Partnerships suggest that the Partnership must terminate upon the death of the Partners unless provided otherwise in a contract signed by all the Partners prior to the death of any one of them. If no such contract exists, the Partnership shall continue, and the heirs become partners. The provisions governing the LLCs explicitly state that the shares of the deceased shareholder must be transferred to his/her heirs. Whereas, the provisions governing PSCs are silent on the issue of inheritance, and only state that the Articles & Memorandum of Association must provide for rules governing the “transfer” of shares in general. If this is to be construed narrowly not to include the transfer by way of inheritance, the provisions governing the PLCs must be applied, which in turn are

[18] The Engineers Association has accepted the qualified engineering firm as a qualifying corporate shareholder for purposes of achieving the 50% shareholding by an active engineer.

[19] If a company loses the 50% ownership requirement, it is granted a grace period by the Association to finalize any open projects, under supervision of the Association, and then forced to close down. Unless the heirs find a suitable candidate to whom they sell the Firm or part thereof.

[20] Article 160 of the Civil Code

silent on this issue. This leads to the Commercial Code, which in turn does not address the transfer of shares by inheritance, leading eventually to the Civil Code. While, the provisions of the Civil Code apply to Partnerships (which are not regulated under the Companies Law), as well as to the Civil Companies by explicit reference in the Companies Law, the general reference to the Civil Code at the beginning of the Companies Law, supports such interpretation; i.e. allowing arrangement preventing the heirs from becoming shareholders in PSCs as prescribed in the Civil Code.

Moreover, this matter is particularly sensitive because inheritance law is largely based on Shari'a rulings. Sanad Law Group is trying to obtain a "Fatwa" supposedly issued by Al Azhar, allowing such arrangements, and declaring them as not in contradiction with the rules of Islam and Public Order. Unfortunately, until this matter is tested in courts, or until the Companies Law is amended; we cannot be 100% sure about the validity of such arrangements, although the supporting view does provide strong arguments.

THE MECHANICS OF OWNERSHIP TRANSITION PLANNING

OVERVIEW

In order to help the participating Jordanian architecture and engineering firms better understand the process of ownership transition, we presented our recommendations in the form of a systematic action plan or “road map.” These steps are as follows:

1. Assess your objectives – memorialize them and establish benchmarks to evaluate success
2. Determine appropriate corporate structure
3. Establish a fair and appropriate method of setting the stock’s value and updating it at least annually
4. Decide whether the firm will need to provide financing for buyers and if so what form it will take
5. Develop a method of evaluating ownership candidates for initial and subsequent stock offers
6. Engage with legal counsel to draft (or update) your shareholders agreement and other governing documents (non-compete agreements)
7. Model financial feasibility of your ownership plan
8. Roll out the first offer to “would-be” shareholders

1. ASSESSING YOUR OBJECTIVES

A well-conceived and developed ownership transition plan will accomplish the following:

- Allows companies to sustain themselves over multiple generations of ownership – often reaching a size and scale most first generation firms cannot
- Helps align the leadership of a firm with its ownership, thereby aligning the economic advantages with the responsibilities and risks
- Provides for an appropriate return on investment for owners, and liquidity when it comes time to sell
- Provides incentives for attracting and retaining key staff and management talent
- Provides a source of capital financing for the firm

For the participating Jordanian firms, providing incentives for attracting and retaining key staff seemed to be the foremost priority. In addition to the above, a unique cultural consideration articulated by individual owners was the Arab tradition of building something of value to pass on to one’s heirs. For this reason, creating a vehicle for preserving an ownership stake to pass on to one’s heirs will be an important objective of the ownership planning process for many of the participating Jordanian firms.

DEMOGRAPHIC TRENDS IMPACTING JORDANIAN FIRMS

Unlike firms in the U.S., Jordanian firms face more favorable demographic trends as they relate to ownership transition. In the U.S. and other western countries, a spike in birth rates between 1946 and 1965 created the "Baby Boomer" generation. Members of this generation are now reaching retirement age, and the generation that immediate follows them is significantly smaller, creating an issue of supply and demand that in turn creates challenges for ownership transition planning.

By contrast, according to the United Nations Population Division in Jordan, birth rates have grown steadily from 1950 to the present and the ratio of the working age population to dependent population is forecast to increase through the year 2040.

While this would suggest that Jordanian firms do not face the same demographic challenges as their U.S. counterparts when it comes to the first objective (sustaining themselves over multiple generations), it does not alleviate the need for advance planning to ensure the successful transition of ownership.

2. DETERMINING THE APPROPRIATE CORPORATE STRUCTURE

Based on the research conducted by Sanad Law Group and presented earlier in this report, it would appear that among the corporate structures available for Jordanian firms, the one that lends itself best to established best-practices for ownership transition is the private shareholding company (PSC). Of the 13 firms surveyed by Sanad Law Group, 7 were structured as limited liability companies (LLC), four as PSCs and the rest were general partnerships or sole proprietorships. While LLCs are still the most prevalent, this is most likely due to the fact that the PSC is still a relatively new structure, having been introduced under Jordanian law in 2002.

The PSC structure offers many advantages over the other available structures. Shareholders in a PSC are not personally liable for the obligations of the corporation beyond the value of their investment. The PSC can offer multiple classes of stock with distinct rights and privileges. The PSC structure also opens up other possibilities for ownership transition including the introduction of an Employee Stock Option Plan, or creation of a Provident Fund for the benefit of the employees.

3. ESTABLISHING A FAIR AND APPROPRIATE METHOD OF SETTING THE STOCK'S VALUE

In the Valuation Considerations section of this report, we present our recommendations with respect to assessing the value of an architecture or engineering firms in the context of ownership transition. Firms undertaking this process should consider having a third-party appraisal of their stock conducted, and based on those findings could then develop a formula for updating the value in successive years.

4. PROVIDING FINANCING FOR BUYERS

When it comes to the financing of internal ownership transition plans, there are two basic schools of thought. One recognizes the reality that most prospective owners lack the financial resources to buy substantial amounts of stock, and therefore either the company or the seller must provide financing. The other school of thought is that it is important that buyers take on some financial risk, and therefore it is better to force them to secure their own financing directly.

While there are merits to both points of view, for most companies, the solution falls somewhere in between. For instance, company or seller financing may be provided, but there might be a cash down payment requirement as well. Or if sellers are required to get outside financing with a bank, the company could guarantee or otherwise facilitate the loan, thereby ensuring access to financing at favorable rates and terms.

Such compromises provide the best of both worlds— the pool of buyers is not limited to only those with independent financial means, and yet buyers still have something at stake and will incur an out-of-pocket cost to become an owner.

Financing rates and terms are unique to the particular ownership transition scenario, but there are some basic guidelines. The loan term will need to be longer for larger, more costly blocks of stock. Terms could range from as short as three years for small initial purchases, to up to ten years for much larger investments. Rates should be tied to market indices, such as the London Interbank Offered Rate (LIBOR) plus a certain margin where appropriate.

To illustrate the affordability of an initial purchase of JD 50,000 worth of stock by a new shareholder, consider the following chart.

Investment (100 Shares):		50,000
Interest Rate		7.00%
Term (years)		3
Monthly Payment		1,544
Annual Payment		**18,526**
Buyer's Salary		80,000
Shareholder Distribution @	10%	5,000
Salary Increase	10%	8,000
Performance Bonus	?%	?
Additional Compensation		**13,000**
Income tax impacts (?)		?
Annual Difference		
Covered by Buyer		**5,526**
		or 460.5/mo

In the case above, the purchase was financed via a promissory note in the amount of JD 50,000. Immediately after the transaction occurs, the buyer begins to receive his or her pro-rata share of owner distributions. Assuming that "dividend" is 10% of the stock value, this would equate to additional annual income of JD 5,000. If this employee's purchase of stock was coincidental with a promotion and salary increase (as is typically the case) there might be an additional JD 8,000 in income. Notwithstanding taxes on the incremental income, the net effect in this scenario is that the buyer is able to acquire JD 50,000 worth of company stock for payment of just JD 460.5 a month year for three years.

These financing guidelines apply similarly to sellers. If the transition is to occur indirectly, the company should have the ability to finance its redemptions of stock with notes payable to the seller. In this way, the company's cash flow is protected.

5. DEVELOP A METHOD OF EVALUATING OWNERSHIP CANDIDATES

One of the objectives of ownership transition planning is to align a firm's leadership with its ownership such that those that bear the risks and responsibilities of leadership enjoy commensurate economic benefits. This requires careful assessment of ownership candidates. In Jordan there is also the regulatory framework governing engineering firms, which must be considered, specifically laws requiring a certain percentage of ownership by active engineers.

Initial questions a firm should address when planning for ownership transition include:

- Will ownership be restricted to technical professionals? If not, what statutory limits must you comply with?
- Will you require a minimum tenure?
- What will minimum and maximum ownership levels be?

Once these basic questions are answered, the firm should establish a set of guidelines for evaluating candidates.

Criteria may include**:**

- Tenure (years with the firm)
- Overall Experience
- Business Development Acumen
- Management Experience
- Technical Skills
- Leadership Qualities
- Personal Values
- Demonstrated Commitment to the Firm

Evaluating and determining ownership candidates is often a function of the company's board of directors (or equivalent). Larger firms often set up sub-committees to field nominations, evaluate candidates, and recommend new owners to board.

The bottom line is that the board must be able to maintain a degree of control over the firm's ownership profile. This is accomplished by the processes above, and through provisions of the shareholder agreement

6. DEVELOPING A SHAREHOLDERS AGREEMENT

A Shareholders Agreement, sometimes referred to as a Buy/Sell Agreement, is one of the foundation documents of any ownership transition plan. It governs how stock transactions will be conducted under various foreseeable circumstances. In the case of Jordanian corporations, many of the terms normally included in a shareholders agreement may instead be included in the memorandum and articles of association.

One of the functions of the Shareholders Agreement is to define how and when shares will be repurchased by the company (i.e. redeemed). The agreement should cover the following circumstances.

- Death
- Disability
- Retirement
- Termination (voluntary or involuntary)
- Other (loss of professional license, conviction of a serious crime, bankruptcy)

We note that the provision for redemption of shares upon the death of a shareholder is a matter of conflicting law as detailed by Sanad Law Group in the Legal Considerations section of this report, and is as yet unresolved.

A Sample Shareholders agreement is included in the exhibits, however, it should be noted that as with almost all legal documents, there is no "one size fits all" Shareholder Agreement. We recommend using an attorney experienced in Jordanian corporate practice to draw up your Shareholders Agreement, or amend the company's memorandum and articles of association accordingly.

7. MODELING THE FINANCIAL FEASIBILITY OF YOUR OWNERSHIP PLAN

The details of an internal ownership transition plan come together in the feasibility model. This is financial forecast that begins with projections of the firm's income statement and balance sheet. The impact of the ownership transition must then be layered upon this forecast.

Obviously there are many assumptions that must be made. The first pertain to the company's future growth and profitability. These should be firmly grounded in the reality of the company's historical performance and the current industry and economic outlook, as previously discussed.

After that come the ownership transition assumptions. These begin with the current shareholders and how much stock they intend to sell and when. This can sometimes be based on the shareholders' ages, but it is dangerous to assume that all shareholders will be similarly inclined when it comes to retiring and selling their stock. These assumptions should be based on interviews with each party.

Trickier still are the assumptions as to prospective shareholders. How much do they imagine buying, and over what period of time? These, too, should be based on interviews with the candidates.

Yet another moving part in the feasibility modeling process is the impact of all these factors on the company's stock value. Not only will assumptions about growth and profitability impact the price at which future transactions take place, but the price may also be impacted by the transactions themselves. The impact of shareholder debt and the dilutive or reverse-dilutive impact of issuing or redeeming shares must also be considered.

Only when all these factors have been addressed can a plan be properly evaluated. A sample feasibility model is included in the exhibits.

8. EXTEND THE FIRST OFFER TO "WOULD-BE" SHAREHOLDERS

Once all the elements of the ownership plan are in place, it is time to extend the formal offer of ownership to the first candidates. Given the size and the current distribution of ownership among the member firms, we would recommend that the first offer be limited to a small group (1-4 key individuals, depending on the size of the firm and current number of shareholders).

The offer should include sufficient information for the candidates to make an informed decision about whether or not to invest. This would include:

- A summary outline of the firm's ownership plan
- Financial disclosures (at least as required statutorily, but ideally to include historical financial statements)
- The shareholders agreement or equivalent and any associated transaction documents (share purchase agreement, promissory note if any, stock pledge agreement).

Candidates should be allowed sufficient time to review the documents and seek advice of their own counsel (legal and financial advisors). A firm date should be set for executing the transaction. We recommend that the effective date of closing coincide with end of fiscal year with the stock valuation based on year-end results.

CONCLUSION & RECOMMENDATIONS

Ownership planning is a necessity for ensuring the sustainability of any business and the recapture of the investors' equity. Ownership opportunities can also serve as a powerful tool for attracting and retaining key staff.

It is evident that the participating Jordanian firms are well aware of the problem of sustainability and the need for ownership transition planning, and some of them have already taken serious measures to overcome that problem. However, as discussed in the Legal Considerations section of this report, such solutions were designed strictly in the context of current Jordanian Law, and do not necessarily follow international best practices.

In light of the parameters of the Regulatory Framework for architecture and engineering firms in Jordan, the most appropriate form for incorporation is the Private Shareholding Company, as it allows certain flexibilities that are not available under other forms. However, such solutions remain to be tested, and perhaps amendments to some legal provisions may be necessary to eliminate any uncertainty in the future. For example, it is highly recommended that the provisions of the Companies Law governing the PSCs be amended to explicitly allow for the exclusion of the shareholders' heirs from the company, provided that the heirs receive the monetary value of such shares, in line with what is permitted under the Civil Code.

We also recommend that the firms lobby both the Engineers Association, as well as the JSC to effect the provisions under the Companies Law, which allow the listing of the shares of the Private Shareholding Companies on the Stock Market, to ensure the growth and sustainability of such Firms. If it proves impossible to convince the Association to change their Law to remove the ownership requirement of 50%, then perhaps new regulations accommodating such requirements when listing will need to be introduced.

Finally, while there is no "one size fits all" model for ownership in the architecture and engineering industry, the basic mechanics outlined in the workshop conducted by ZweigWhite on behalf of SABEQ apply in most scenarios and have been demonstrated to work as evidenced by the case studies provided. Jordanian architecture and engineering firms face many of the same issues that western firms face with respect to ownership planning, and notwithstanding the unique aspects of Jordanian corporate structures and applicable law and cultural considerations, may employ similar approaches to ownership planning as their western counterparts.

APPENDICES:

USAID Jordan Economic Development Program
Salem Center, Sequleyah Street
Al Rabieh, Amman
Phone: +962 6 550 3050
Fax: +962 6 550 3069
Web address: **http://www.sabeq-jordan.org**