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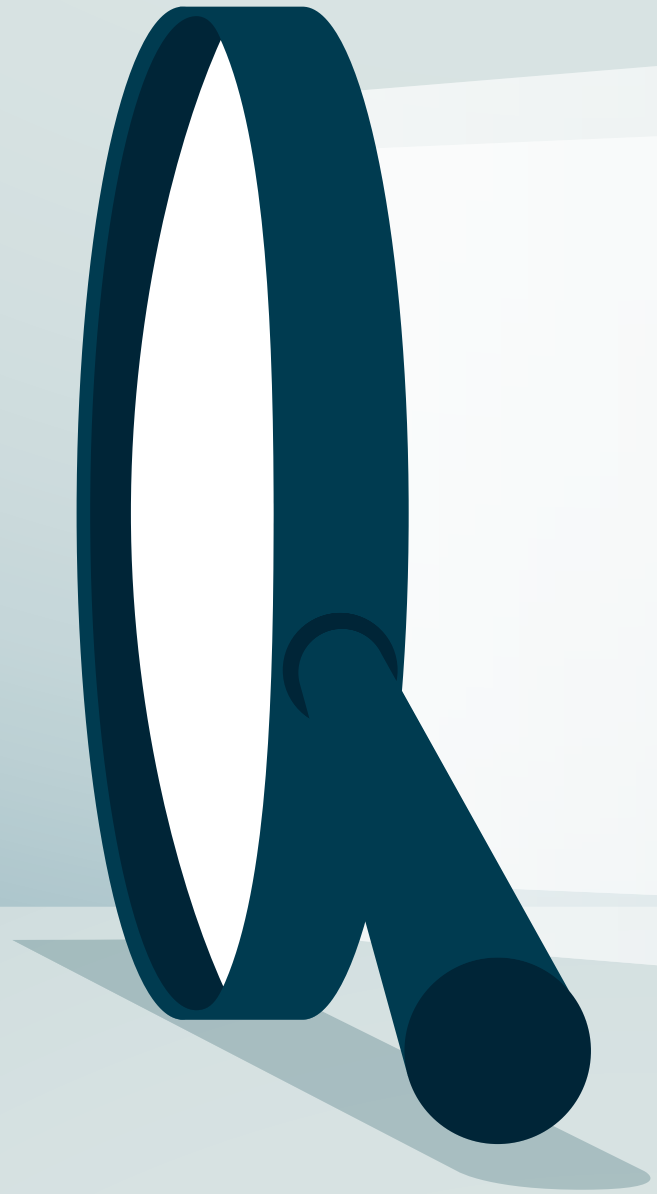

Structured valuation policies: Essential for the growing Middle East investment management industry

All valuation specialists agree on one point: valuation is both an art and a science, highlighting the inherent subjectivity of the process. While differences of opinion are generally minor, the dispersion between appraisers' views can vary significantly when appraising businesses in high-growth, emerging sectors.

A valuation policy framework helps reduce discrepancies by providing a consistent approach to the valuation process. A valuation policy is a structured framework covering various aspects of the valuation process in an organization: what to value, how to value, when to value, who should value (internal versus external independent appraisers), frequency of valuation, approval, and sign-offs on valuation. This bespoke document considers the practical and operational limitations of the organization and is driven by the purpose for which valuations are conducted.

The policy defines the roles and responsibilities of various teams within the organization concerning the valuation process (for example, financial reporting versus investment team), while avoiding conflicts of interest in the way valuations are reported for performance measurement. It provides guidelines for the timing and frequency of valuations for different investment types based on their complexity, availability of input financial and operational data from underlying investee companies, and a mechanism for resolving differences in valuation opinions.

Since valuations are inherently point-in-time estimates, a common question that an entity's valuation policy aims to address is: when does a valuation become stale? This refers to the time period after which a fresh valuation exercise becomes necessary, and whether the guidance should vary based on the nature of the investment, the organization's investment style, or other relevant factors.

By designing a governance framework around the valuation process, an organization ensures alignment between all stakeholders, providing a clear and consistent approach to measuring value. A well-defined valuation policy helps maintain transparency and consistency for effective investment decision-making and accurate financial reporting. This alignment is also essential for building trust and ensuring that all parties have a common understanding of the valuation process and outcomes.

A valuation policy is essential for any fund, business, or organization that needs to monitor valuations over time for decision-making or financial reporting. This includes asset management firms, investment funds, businesses with multiple shareholders, and large family offices dealing with inheritance and succession planning. In these contexts, accurate and consistent valuations are crucial for assessing assets under management (AUM), appraising investment performance, determining investment managers' remuneration, and facilitating the entry and exit of partners or shareholders.

Over the past few years, Middle East-based sovereign wealth funds have taken center stage on the global investment arena, growing significantly both in terms of the sovereign wealth entrusted to them to generate financial returns (exceeding US$5 trillion in AUM) and the level of their investment activity.[1] Similarly, Middle East-based family offices continue to gain prominence as their AUM soar and the Middle East increasingly becomes a global wealth hub.[2] With the growth of these investment powerhouses, the demand for bespoke, robust valuation policies to provide governance around valuation procedures has grown.

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By establishing clear guidelines, the policy helps maintain the integrity and reliability of the valuation process, reducing the risk of disputes and ensuring that valuations are conducted systematically and in a controlled manner. Without a clearly articulated valuation policy, valuations can become inconsistent, overly subjective, and prone to manipulation, leading to inaccurate financial reporting, poor decision-making, and potential conflicts among stakeholders. A valuation policy mitigates these risks by providing a clear framework that ensures valuations are conducted consistently, transparently, and reliably.

A good valuation policy should be purpose-led and provide operational guardrails for the valuation process. It does not need to be overly prescriptive in how to perform valuations, for which reference can be made to International Valuation Standards (IVS)[3] or International Private Equity Valuation (IPEV) guidelines.[4] Instead, the policy should provide practical application guidelines that ensure consistency and reliability.

In conclusion, a valuation policy is a critical tool for ensuring alignment, governance, and consistency in the valuation process. It is essential for any entity that needs to monitor valuations over time for decision-making or financial reporting. With the growth of the Middle East investment management industry, there is an increasing awareness of the need for bespoke valuation policies among sovereign and family-owned funds, and an appreciation for the benefits these policies bring to the discipline of financial reporting, AUM assessment, performance management, and investment decision-making. As valuation continues to be both an art and a science, having a structured policy becomes increasingly relevant to ensure accurate and reliable valuations.

By providing clear guidelines and governance, a valuation policy helps mitigate risks, build trust among stakeholders, and ultimately contributes to better decision-making and financial reporting.

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Endnotes

1. "Deloitte Middle East report: Gulf Sovereign Wealth Funds lead global growth as assets forecast to reach USD 18 tn by 2030" by Deloitte Middle East
URL: https://www.deloitte.com/middle-east/en/about/press-room/gulf-sovereign-wealth-funds-lead-global-growth-as-assets-forecast-to-reach-usd18-tn-by-2030.html.
2. "How family offices are spreading their wings in the Middle East" by The CFA Institute
URL: https://www.cfainstitute.org/insights/articles/family-offices-middle-east-expansion.
3. "International Valuation Standards" by International Valuation Standards Council (IVSC)
4. URL: https://ivsc.org/."IPEV Valuation Guidelines" by The International Private Equity and Venture Capital Valuation (IPEV)
URL: https://www.privateequityvaluation.com/Valuation-Guidelines.