FAMILY OFFICES: AN OLD YET EMERGING MODEL

Despite their potential value to business families and shareholders, family offices are often underused. **Francois de Visscher** explodes some common myths of family offices, wealth management and family unity

Have you ever wondered whether or not a family office is for you? Or, if you have a family office, does it accomplish everything you want it to for your family and your business? As an over-used phrase, family offices come in all shapes and sizes, to meet the needs of business families.

First-generation entrepreneurs often have the company CFO handle certain family financial functions, such as paying some personal bills, handling personal income-tax filings, and booking business and personal travel. Such entrepreneurs may not think of the CFO's activities as family-office functions, but essentially that is the case.

At the other end of the spectrum, some multi-generation family business owners have found that a family office can be quite a useful vehicle for active as well as inactive shareholders.

John D Rockefeller created his family office in 1882. It operated more as a business office than an investment office, dealing with the patriarch's personal and philanthropic financial activities. Over time, as the family's business investments became more liquid and diversified, the family office began handling family investments as well. In the 1930s, John D Rockefeller Jr separated the family office from the operating companies and became a separate entity, so it could more effectively handle the financial and investment affairs of the increasingly disparate and numerous active and inactive shareholders, spread all over the world. Today, Rockefeller & Co operates as a full-fledged family office for the descendents of John D Rockefeller and other high net-worth individuals.

In fact, many experienced family offices of highly liquid families, such as Bessemer's Phipps family and PPG's Pitcairns, discovered, just like the Rockefellers did in their time, that they could leverage the overhead of their family office to provide similar investment services to other families. Hence, the birth of the multi-family offices (MFO). The traditional focus of single or multi-family offices has been on investment products and other concierge services. However, families now recognise that their family office can and must fulfil one of the most important emerging needs of business and financial families: the need for unbiased, non-product motivated advice about how to allocate and diversify all their assets. This new role of the family office as the objective, trusted financial adviser on investment decisions as well as business and even personal financial matters, is now emerging as the highest value added service. Family shareholders who become overwhelmed by different financial products that planners try to hawk desperately need an independent and financially savvy advisor to help them sift through product-based advice and plans. These assets may or may not include an operating business, but will certainly include non-financial assets such as real estate, foundations and liquid assets.

We may not all be Rockefellers, Rothschilds or Phippses or as liquid as those families, but many of us can benefit from a family office. However, often families with operating businesses rule this option out because they harbour several myths about family offices.

Myth 1: Only families who have sold their businesses need a family office
A family office can be very useful for many multi-generational companies, especially those with shareholders who do not work in the business. A family office focuses on structural and financial responsibilities, and can help tighten family bonds, bolster the members' financial and legal savvy, and enhance their purchasing power.

There are many different types of family governance structures. As the company and the family evolve in size and complexity, the family governance should also evolve, and may include some or all of the following structures.

A family council mainly provides a forum for discussion among family members, and mainly addresses governance and communication issues.

A family trust or holding company owns shares of the operating company, concentrates control and regroups the family company to allow the input of outside capital in the business.

John D Rockefeller Jr: He was one of the first to operate the family office as a separate entity to the business.

A family investment company is a structure that parallels the family business and manages assets outside the family company, such as real estate or liquid assets.

A family office can take many forms, such as a family limited partnership, but in all cases addresses four main roles when the family still owns a business:

- Family as owners. The family office can provide stewardship of the family's patient capital, which may include setting investment guidelines for the operating company. My family office, for instance, works with management and the board of directors to set shareholders' return expectations – both return on equity and return on assets. The family office can also decide which family members will fill available seats on the board of directors.
- Family as employees. The family office can determine rules of entry for family members seeking to join the business, as well as what kinds of training and development programs the business should provide for relatives who have management aspirations.
- Family as family. How will the family perpetrate its heritage, maintain communication and resolve conflicts? How, if at all, will it support family members, and under what circumstances? Some family offices create a fund to invest in relatives' ventures.
- Family as community. A family office can decide how and where the family wants to direct its philanthropic giving. It can also identify leadership opportunities, such as open board seats, at charitable, community, industry and other non-profit organisations where the family may want to maintain a presence.

Especially during times of family and business transition, a family office can help educate relatives about various options, help the family articulate and live by its values and strengthen patient capital.

Without a family office, the only glue holding together a growing, dispersed family is the business. So shareholders may cling to the business – in its current form – to preserve its identity and closeness, even if that means passing up opportunities to expand, evolve or sell the business. By providing another organisational structure around which the family can unite, a family office enables the family to base decisions on business and financial factors, not emotions.

FAMILY OFFICES OFTEN PROVIDE MANY SERVICES AND PRODUCTS BEYOND INVESTMENT MANAGEMENT

Myth 2: Family offices are solely for managing a family's wealth

Family offices often provide many services and products beyond investment management. Today, family offices may navigate different products for the family, such as insurance, personal lines of credit, and business and family travel and legal services. Family offices can also harness the family's purchasing power, enabling it to negotiate much better prices and terms on these products and services than individuals could negotiate on their own. The professional staff at some family offices can even review business plans developed by family members attempting to launch new business ventures.

One critical role the family office can play is sponsoring educational programs on topics like the family's business, new developments in the industry, personal finance, technology or career planning. In addition, the family office can help connect disparate family members and keep them informed about business, family wealth and other issues.

Myth 3: Our business is too small; we can't afford a family office.

The size of your business isn't the most relevant factor; it's the size of your family, and how dispersed your relatives are. For example, take a second-generation business with one parent and three children active in the company, plus two other inactive children. This family may be able to learn and make decisions effectively among themselves. But what will happen ten or 15 years from now, in the next generation? That same business family may have expanded from six members to 20, with only a handful of shareholders involved in day-to-day management. The rest of the relatives may have spread throughout the country, or even overseas. The company may have grown, stagnated or even downsized in this time. Whatever its circumstances, it is likely it will benefit now more than before from a family office.

A family office doesn't have to be a big expense. At first, the office might consist of one administrative person to provide the various services mentioned above. In the founder generation, the founder's secretary often handled such details. Fourth-generation Freedom Communications, which owns 28 daily newspapers, 37 weeklies and eight TV stations, employs one 'shareholder relations' person, who actually provides the functions of a family office. She attends family business conferences to find new services and ideas for family shareholders, organises educational seminars and researches financial and legal resources.

At the next level, a family office can include a dedicated staff of professionals – a lawyer, an accountant, an insurance specialist, an investment counsellor – to provide, or perhaps help outsource, those services. The last stage could be a full-fledged, legal structure, a holding company that has some shares of the family business not owned by shareholders. It also can provide asset management, legal services, trust relationships services, helicopter services or a fractional ownership programme of a private jet.

Another option is outsourcing your family office function to a MFO without incurring the overhead expense of operating a family office internally. Many families with $5m or more of investible assets have become clients of MFOs like Bessemer, Glenmede, Pitcairn and Whittier, primarily farming out their investment management.

Large institutions (Credit Suisse First Boston, JP Morgan, Citibank Private Bank) have also got into the game of advising high net-worth families. The competition among external service providers for family offices has cut down the margins in the business. This prompted a consolidation, resulting in large MFOs such as Pictet in Europe and Atlantic Trust in the US. At the same time, services that a single-family office can no longer provide competitively to its clients are being outsourced.

By navigating through the various investment products available and outsourcing when appropriate to an MFO or an institution, a family office can offer family shareholder clients the most competitive investment strategy and other services.

There are at least two possible caveats to family offices, which shareholders should try to avoid at all costs. First, by providing so many services for family members, shareholders may inadvertently come to depend on the family offices, to the extent that they do not know how to take care of basic things for themselves, such as balancing a chequebook or understanding a basic contract. Smart business families ensure that their family office enhances members' abilities through constant education that leaves them more, not less, empowered to handle life's complexities. The family office merely serves as a convenience and uses the power of its numbers to bargain for services and products at a better price than members could negotiate as individuals.

The second potential problem is that, especially in the personal finance realm, when family members depend on the family office to take care of everything, they often fail to oversee the family office staff, who may find – and take advantage of – opportunities to bilk the family. To avoid that, some families have turned their single-family office into an MFO, providing its services to several other business families that want to outsource their own family office activities. Becoming an MFO helps align the interests of its own shareholders with those of outside clients and staff.

Despite their potential value to financial and business families, active and inactive shareholders, family offices are often underused. By navigating through the various investment products available and outsourcing when appropriate to an MFO or an institution, a family office can offer family shareholder clients the most competitive investment strategy and financial services. ■

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