STEP JOURNAL

Time well spent

Ian Macdonald explores the importance of process and governance in establishing a family office.

A family office is the structure used to manage the business of a family. This very practical definition offers opportunities for advisors who can create processes to help families develop a family office strategically over time.

The definition moves away from the orthodox view of family offices, which is based on the past rather than the future. The first family offices, with their own infrastructure, including professional and administrative staff, were created by very wealthy families (Rockefeller, Pitcairn, Carnegie) to look after the needs of family members ranging from sophisticated wealth management through to household services. Some of these single family offices (SFOs) later branched out into providing services for families who could not afford, or had no inclination, to run their own SFO. These businesses became known as multi-family offices (MFOs), a model that was adopted by others, mainly banks, who could provide investment and compliance services.

The costs of setting up a SFO and the charges levied by existing MFOs have made it appear that family offices are suitable only for families of substantial wealth, but this ignores an important fact. Every family has a family office because they must all devise a way of managing the business of their family. The challenge is how to develop the concept of the family office to serve any family who wants ‘the business of their family’ to be well managed.

Family offices tend to ‘just grow’ as the result of well-intentioned efforts by senior family members and their advisors based on various assumptions, understandings and expectations. Parents usually set the family’s attitude and values in relation to wealth, risk and asset allocation and choose advisors to help with technical structures, planning and compliance issues. However, allowing the family office to evolve in this way usually results in ‘bits and pieces’ of structure that the wider family often know little about, and understand even less.

Process

It is important to offer families a process for building a family office. The first stage should be to state clearly what the family office is there to achieve. That might seem obvious, but in practice it rarely happens and the purpose is assumed to be clear to everyone. The family office purpose could include the likes of the following, but it will of course be unique to each family.

- Maximising overall return on investment by the family co-investing instead of doing this individually.
- Diversifying the family’s wealth, for example, where it is currently concentrated in an operating business or other asset categories.
- Saving tax by ensuring every family member’s affairs are in good order as well as any shared activities being properly structured.
- Achieving financial security for all generations of the family.
- Putting something back through philanthropy.

Another reason for having a clearly stated purpose is that it will allow the family office to be targeted with achieving certain outcomes and its performance can then be appraised. Otherwise it will be difficult for a family to judge whether or not their family office has been successful.

Each family has to decide who will participate in articulating the family office purpose. Some might want to hold a family meeting of those over a certain age, whose lives will be affected by the family office. Other families, however, might prefer to leave the decision to family members whose decisions will be respected.

A family office can be designed to look after the shared interests of a wider family and/or the private affairs of individual family members. This requires a decision about how to balance looking after individual family members with the shared interests of the family as a whole.

There are two key factors a family should consider:

- The balance between individual expression and collective family values.
- The role of spouses/partners in the 'family' office.

The balance between 'we' as a family and 'me' as an individual will be influenced by how each family values individual control and expression compared to collective values such as duty, loyalty and overall family harmony. No one other than the family can articulate this boundary and they might want to do this in the same way as creating the family office purpose; by discussing the matter at a family meeting or, if it suits them better, agreeing to abide by what a respected family member dictates.

Some family's natural instinct is to absorb spouses and partners so that they become part of the wider family. This requires openness on the part of the family and willingness by the spouse/partner to take on the role of 'family' member, sometimes even if this to some extent crowds out their own family of origin. The opposite end of the spectrum is a tendency for a family to be a bit suspicious towards spouses/partners and concerned about the longevity of relationships, which tends to be reflected in structures that 'protect' the family wealth, for example, from marital breakdown. Between these two points lie many variants, and when creating a family office the family has to decide whether or not spouses/partners are included and then apply their decision consistently.

A very important part of the process for creating a family office is the opportunities it creates for family members to be actively involved in managing or governing the business of their family. This feature of the family office will be particularly attractive to families who like to be in control of their own affairs to some extent, which is a particularly apposite point at a time when the recession has probably resulted in a diminished level of trust in the idea that specialist advisors know best.

The extent to which family members can be actively involved in managing their family office will depend on whether or not they have the skills to do what is included in the family office. Some families might want to design their family office to capitalise on the skills of family members in order to ensure that the family has a prominent role in managing the family office. However, if family members do not have the interest or ability to manage their own family office or there are just too many family members for the number of roles needed, the family office will need to engage outsiders, including advisors to help them run the family office, but this does not mean that family members need be isolated from their family office and become only passive participants.

Family governance

There must be a forum where the interests and concerns of the family whose lives are affected by the family office can be discussed. In a small family these discussions can usually occur spontaneously, whenever needed. However, as the family and its family office both grow, the business of the family requires more thought and formality. This challenge is often met by creating a Family Assembly.

The purpose of a Family Assembly can be a mixture of social, formal and educational.

As a family grows and the demographics become more complex, the Assembly can generate social interaction that will help to create and sustain the ‘glue’ that binds the family to each other and their shared investments in the family office. Family Assembly meetings can help to ensure that all family members are kept in touch with what’s happening in the family office and in the lives of their relatives.

The formal role of a Family Assembly can include creating a Family Constitution or Family Charter to govern areas that are of importance to the family office. This document can include the following:

- The family office purpose.
- A statement of values that are deeply rooted in the family and which must be reflected in all family office activities.
- Guidelines or more detailed rules in relation to family office activities such as overall investment and asset allocation; distribution policies to govern who gets what from the family office and whether any key decisions are specifically reserved for the Family Assembly.
- Rules for the proceedings at the Family Assembly.
- How information about the family office will be collated and distributed.
- Rules on how family members can be appointed to manage parts of the family office and whether these appointments will be made on a ‘family first’ or ‘business first’ basis.

The Family Constitution will be a confidential document and will be of such length as is needed to ensure that the family is satisfied that their family office will be well governed and well managed.

The Family Assembly can be used as an opportunity to provide family members with information and education about all aspects of the family office and more generally in relation to wealth management and business.

In larger families it may be necessary to delegate the task of running the Family Assembly to a smaller group, called the Family Council. The Family Council is very flexible, so it is important that clear goals and tasks are set against which its performance can be evaluated. For example, as well as organising Family Assembly meetings, the Family Council can act as the main governance link between the Family Assembly and the different parts of the family office. The Council can be asked to ensure that there is good communication between those who are running the family office and the wider family. Depending on its roles, the Family Council may be staffed by volunteers or if a family prefers it may be elected or selected by some means to ensure that members of the Family Council represent a balance of different family interests.

What can advisors to do help?

Every family office will need a professional service that integrates several technical specialisms with innovative ideas about family offices and family governance.

It is very important to stress that creating family offices should be a process rather than a product. The process approach helps to protect against two predictable risks.

The first is 'procrastination'. One reason why clients procrastinate is that although they know they should be doing something, what is being offered does not feel quite right for them. It is essential that a family office is built in the image of the family, to achieve what they want and not what the advisors think the family should want. By creating a process to build a family office that a family can understand and implement, advisors are more likely to succeed in getting the client to do the work that needs to be done to create a family office.

It is also important that the process can be actioned at any time a family feels ready to do the work. The trigger may be, for example, sale of business, other notable events in the family (retirement) or in the external environment (changes in markets), or just the gnawing realisation that 'we need to do something'.

The second risk to avoid is jumping straight to technical solutions. This is an understandable temptation because it can appear to be the fastest way to deal with feelings like 'we really need to do something'.

A series of actions, either in response to perceived problems or to take advantage of opportunities, does not spontaneously add up to a coherent strategy for looking after a family's wealth. Building a family office takes time, but if it is to endure, even across generations, it is time well spent.

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