The Family Investment Office: Defending the Legacy

Why build a family investment office? Because, as one chief investment officer at a large family office told me recently, “bad stuff happens.”

He mentioned that when the head of the family and business founder was thinking about hiring internal investment talent, the founder asked other family leaders he knew why they had hired a CIO.

They all said that having investment expertise inhouse and a portion of the assets in a diversified portfolio separate from the main business helped them when the unexpected struck.

In the last twenty-five years we’ve weathered a slew of financial storms including the 1997 Asian financial crisis, the 1998 Russian collapse, the 2000 Dot-com bubble, the Twin Tower attacks, and the 2007–2008 and February 2020 crashes. Remember those? And for the last two years Covid. And now there’s the appalling Russian assault on Ukraine.

And yet, in every crisis there’s opportunity. In 2020, according to the Credit Suisse [2021 Global Wealth Report](), total wealth in North America rose by US 12.4 trillion. And probably more in 2021.

Looking at the ultra-high-net-worth segment, Boston Consulting Group counts 20,600 UHNW individuals in the US with personal wealth over $100 million, totaling about $5.8 trillion in investable assets.

Meanwhile, depending on the source, the number of US family investment offices grew from 3,000 to well over 5,000 during the last decade.

Personally, we have received more family office chief investment officer inquiries in the last two years than we've had in the ten prior.

Why?

Don't Lose the Money

Building a legacy is different than preserving it. Founders who are good at wealth-creation usually have little experience with wealth-maintenance, where capital preservation is paramount and diversification is key.

Wealth is created by entrepreneurs, but maintained through diversification, sophisticated risk-management, and prudence. The psychological profile of the former does not easily transform to the latter.

Long-term investing, looking a generation or more ahead, demands a strategic mindset and patience in the face of market volatility. As a profit center, performance and volatility are always a concern.

Focus and Cohesion

A family investment office encourages consensus. If the objective is to preserve the family legacy, there needs to be focus.

In our interviews with family office heads, they all say the key to a productive investment process is to maintain focus in the face of fragmenting assets and multiple agendas. They all mention succession planning. And the internal debate over what to do with the money?

Families expand over time, and outsiders with different views marry into them. Larger, more diverse families can lose their cohesion if they don't fight to keep it. The first generation wants to own and manage (hands-on), but the next gen may not.

As another family office member told me. Prior to hiring a CIO, individual members were making random investments that made no sense. From mushroom and abalone farms to films and ill-conceived startups, there was no consistency or real analysis as to how all these investments fit, no way to maintain focus on core objectives.

"Now, there's someone in our corner that has our interests at heart." The investment staff has only one priority and the family has control, with updates available 24/7.

When I sent my draft to the CIO I mentioned above. He said . . .

Thanks Charles. I like the piece. The only thing I might add would be the importance of the Family clearly articulating their goals in establishing an internal investment team. This will help them determine the appropriate skills to hire and the market price they will have to pay. I have seen a number of situations turn sour as a result of this lack of clarity between the internal team and the family.

Given the need for cohesion and focus, family office CIOs should have excellent people skills. There are opaque but vital intra-familial and cultural issues that must be dealt with. They're all important and inter-related.

What's It Going to Cost Me?

As Stuart Lucas: wealth manager, educator, and family scion pointed out in our interview a few years ago, "hiring a chief investment officer suggests that the family office is going to be predominantly a profit center, not just a service or administrative office."

"Building a family investment office means you are prepared to design and manage a profitable business, one that is likely very different from the one that built your wealth in the first place." And, be prepared to pay for talent.

Since AUM size usually dictates the office cost structure and where and how you invest, it's better to have the scale and resources that a family with common aims can provide.

Here is one set of cost estimates for a six-person investment team from the CFA Institute.

We think some of these CFA numbers are unrealistic based on our most recent experience recruiting investment talent, particularly for a chief investment officer. So we've added our own compensation estimates to the chart and broken out our total comp by base salary and bonus potential.

Estimated Compensation for Six-Person Family Office

CFA Institute 2019 Compensation Study
Skorina 2021 Compensation Estimates

Role	Total Comp CFA est.	Base Comp Skorina est.	Bonus Skorina est.	Tax & Benefits CFA est.	Rent & Infrastructure CFA est.
Chief Investment Officer	**$239,000**	**$350,000 - $850,000**	**50% - 200% + carry**	**$298,750**	**$522,813**
Manager Equity	$177,000	$225,000 - $500,000	60% - 110%	$221,250	$387,188
Manager Fixed Income	**$181,000**	**same as above**	**same as above**	**$226,250**	**$395,938**
Manager Hedge Fund	$461,000	same as above	same as above	$576,250	$1,008,438
Manager Private Equity	**$325,000**	**same as above**	**same as above**	**$406,250**	**$710,938**
Acctg & Admin	$182,000	$110,000 - $325,000	-	$227,500	$398,125
Total	**$1,565,000**	**$1,360,000 - $3,175,000**	**$1,360,000 - $3,175,000**	**$1,956,250**	**$3,423,440**

Final Thoughts

Most UHNW families do not come from the financial sector so, they shouldn't be afraid to ask dumb questions about arcane terms that are hard to understand.

Demand plain answers. And don’t be in a hurry to embrace complex strategies or exotic asset classes you aren’t comfortable with.