The Skorina Letter

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Building the World's Best Investment Management

Family office survival: nothing's guaranteed

If you're a great entrepreneur, you're likely a pretty bad investor

Michael Hyatt

Family office survival is no sure bet according to Josh Baron and Rob Lachenauer, co-founders of BanyanGlobal Advisors. In fact, family-owned companies have a better chance of managing succession than the family investment office. But wealth preservation has never been easy. For those founders facing the perils of passing on the legacy, Messrs. Baron and Lachenauer have a few suggestions that just might help.

Their September 2022 article in Harvard Business Review, Is Your Family Office Built for the Future, highlights internal office tensions, the lack of emotional connections among generations, and unintentional dependencies.

The authors argue that family office founders face five key decisions which determine success or failure. They are:

- Design: How will you own your assets together?
- Decide: How will you structure governance?
- Value: How will you define success for your family office?
- Inform: What will and what won't you communicate with your family?
- Transfer: How will you handle the transition to the next generation?

Family office clout

It's tough to get a handle on how many family offices there are in the US, the assets they control, or their objectives because most prefer to stay unnoticed. But no matter how you count them, they are a significant force for investment and philanthropy.

An oft-cited Campden Wealth study estimates roughly 3,100 large single-family offices in North America, 42 percent of the global 7,300.

Forbes reported in 2020 that the top fifty wealthiest US families alone were collectively worth about $1.2 trillion.

Casting a broader net, Credit Suisse counts about 140,000 ultra-high-net-worth individuals in the US with wealth over $50 million.

While endowments and foundations get most of the attention, the family office universe is larger, growing faster, and doing a great deal of good while doing well.

So, what's on their minds?

Family dynamics, more than money

In our experience, UHNW families have multiple and often conflicting priorities for establishing an investment office and, as many practitioners and wealth advisors have emphasized, a family office is usually a means to a more complicated end.

"The transition from founder, builder and risk taker to wealth preserver and risk assessor can be one of the most difficult challenges for founders of family offices" writes Robert Frank, wealth editor for CNBC.

More than half of North American family offices serve at least three generations according to The North America Family Office Report 2021, (RBC & Campden Wealth) yet less than half the offices surveyed have formal succession plans in place.

Ashvin B. Chhabra, in his book, The Aspirational Investor, lists three basic goals for family office investing: "the need for financial security in the face of known and unknowable risks; the need to maintain current living standards over time despite inflation; and the need to pursue aspirational goals for wealth creation.

But dig deeper and we often find conflicts and tension between the goals of the founders and the aspirations of upcoming generations.

What about the grandkids?

Jon Hirtle, co-founder of Hirtle Callaghan, has been managing family and institutional money for almost forty years. When I asked him what weighs on the minds of his first and second-gen clients he said most worry about how their fortunes will affect their children and grandchildren. Especially the grandchildren.

"The children usually wind up assuming their parent's values. They can see how hard their parents worked and they understand that success did not come easy. Mom and Dad were the role models, they worked long hours and the kids know that, but the grandchildren are removed. By the third generation that immediacy has worn off."

Pay your own bills.

Mr. Hirtle has one personal piece of advice for families based on his experience. "I think everyone in the family should pay their own bills, then they know what things cost."

"Our typical family clients have substantial assets, some very large, but no matter how big the legacy, when we discuss responsibility I encourage them to show the kids how to pay their bills. It may seem trite, but it keeps them grounded."

Practicing what they preach

Stuart Lucas and Michael Kane are both family office heads and contributors to private wealth management programs at the University of Chicago and University of Pennsylvania, respectively – Mr. Lucas as program director and Mr. Kane as professor.

They both caution that many of the questions raised in their family office sessions are subjects which cannot be reduced to financial measures yet weight heavily on families as they think about how to manage their wealth.

Four questions that repeatably come up, according to Mr. Kane, are:

- How can I promote family coherence?
- How can I keep the family wealth intact?
- How will my wealth change the motivation of following generations?
- And, how do you create a governance structure that can't be changed on a whim, once the family establishes an internal investment office?

Best in Class

Because we focus mostly on the investment side of family office management, we thought it helpful to feature once again one of the best managed and cohesive family offices we've come across.

Europeans have created and managed family offices for centuries. One of the largest is a multi-billion-dollar, multi-generational office in Germany, and we'll refer to the principal as Herr Anonymous.

This office not only provides inter-generational financial support, it also supplies research, due diligence, advice, and council for each generation's educational, environmental, and conservational pursuits.

Most German companies are small, family-owned enterprises – members of the "Mittelstand" – and skill-based technical excellence helps them survive and thrive against the world's best.

Our anonymous German family office is no exception. We worked with them a while back and I had a chance to sit down with the managing director, headquartered in one of German's largest cities, to discuss their rigorous professional standards and staff development process.

The office is run like a top-tier, institutional asset manager, with meticulous systems, controls, and investment processes. They benchmark their investment performance against the world's best institutional investors and continuously evaluate and refine their process.

Investment activities fall into three categories; endowment style (the "Yale" model is highly regarded), opportunistic, and direct real estate. And there is a strong emphasis on socially responsible investing (SRI) with a particular focus on environmental stewardship.

The professional investment staff members must all study and achieve educational and technical development goals.

With Teutonic thoroughness they've implemented a best-in-class organization that rivals any Wall Street or institutional investment operation.

New employees are offered three-year contracts. During that initial three-year period, employees are assigned goals and objectives with regular feedback and assessment.

They must earn the CFA designation and the CAIA charter, and acquire a global, multi-asset, long-term approach to capital deployment. At the end of the three years, they may be offered an additional five-year employment contract depending on performance.

There is a competitive and detailed compensation formula with clear objectives. All bonus vesting is retained as earned. No matter when they leave, they retain their rights to the portion of their bonus already accrued.

Building superior investment teams is a daunting task. Our client has built theirs to last.

Final thoughts

Not every aspiring family office can hope to operate on the scale of a Herr Anonymous but that's not the point. You identify the best-in-class examples and adapt their standards to your own circumstances.

As Mr. Lucas explained to us in our interview last year:

The family wealth engine must generate a decent return on inherited money. But it also has to include the energy and talent of each succeeding generation, all coordinated with realistic, disciplined spending limits.

Each member of each generation will hopefully produce enough value through their own creativity, careers, and businesses to supplement the returns on the inheritance.

If you can do that, you increase the odds that your wealth will support a productive, useful, prosperous family for generations to come.

But it's not easy.

— Charles Skorina

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