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Building the World's Best Investment Management

Wealth and Succession, Family Matters

I've been poor and I've been rich. Rich is better! -- Beatrice Kaufman, author and raconteur, 1895-1945

Here's some good news for those UHNW families who have worked hard to make it and hope to keep it. Turns out that contrary to conventional wisdom, wealthy families are likely to stay wealthy over multiple generations.

"We can predict strongly, based on family background, who is likely to have the compulsion to strive and the talent to prosper" writes professor Gregory Clark, University of California, Davis.

James Grubman, Ph.D. family wealth consultant agrees. If we focus on the families rather than the family firms, we find "significant longevity and success across generations."

He rejects the apocryphal adage that it's shirtsleeves to shirtsleeves in three generations and the related oft-quoted statistic that 70 percent of family businesses don't survive the second generation.

After combing through the literature, Dr. Grubman traced each hoary myth back to the same narrowly focused study published in the mid-1980s. His conclusion? These pessimistic views of family business survival simply aren't true.

The Quick and the Bold

According to the Center for Family Business at University of St. Gallen, a privately-held firm is considered family-owned if a family controls more than 50 percent of the voting rights, while a publicly-held company is defined as family-owned if a family holds at least a 32 percent share of the voting rights.

Although it's hard to get an accurate fix on the number of family businesses in the US – between 7.2 and 32.4 million in one recent study – there is broad consensus that family controlled enterprises are key drivers of U.S. GDP and employment, accounting for anywhere from 14 to 54 percent of private sector GDP and 14 to 59 percent of the private sector workforce. Walmart alone, with 2.3 million employees, adds 2.4 percent to GDP.

But it's not just their numbers that gives them clout, explain professors Asker, Farre-Mensa, and Ljungqvist, "private firms invest substantially more than public ones on average, holding firm size, industry, and investment opportunities constant" and their "investment decisions are around four times more responsive to changes in investment opportunities than are those of public firms."

Some family businesses are exceptionally good at navigating life's twists and turns.

Take the Zildjian company for example, the oldest family-owned and operating business in the USA. Supplying the world's percussionists from Norwell Massachusetts since 1929, Avedis Zildjian the elder began forging cymbals – those shiny shimmering saucers – around 1620 in Constantinople. Four hundred years later they are still at it. Same family, same specialty.

By the way, they are not the oldest family business by a long shot. The record was held by Japanese temple-builder Kongo Gumi, in business from 578 to 2005. Bad luck and a fading heritage finally did them in. But what a run.

Does a Family Office matter?

Since we recruit investment professionals for private family offices and institutional asset managers, we pay close attention to the nuances of ownership and succession, culture and fit.

We had hoped to find irrefutable evidence that a family investment office helps preserve wealth and the family legacy. But alas, it's not that simple according to Dr. Grubman. When we asked him what he thought he replied:

Charles, conflating family business transition with wealth transfer and family longevity is a huge conceptual and practical problem because they are unique processes. The basic issue is that the interplay of *wealth and family businesses is much more complicated than most pundits admit.*

At the UHNW level, business succession and longevity are dependent on a host of factors apart from those that influence wealth transition within the family.

For example, despite what some wealth consultants allege, good strategic planning may be much more important to business longevity than trust and communication, while wealth longevity may be related to family communication and learning. The processes are different.

Finally, passing on a family business is much more about ownership issues than wealth issues since the wealth is tied up in ownership.

In theory a family office investment team should focus on education, opportunities, and performance.

In practice, UHNW families have multiple and often conflicting priorities for establishing an investment office and, as we and many others have emphasized, a family office is usually a means to a more complicated end.

It's difficult to transition from a damn-the-torpedoes entrepreneur or business titan to a diversified hands-off portfolio manager. But of the nearly 10,000 individuals in the U.S. with $100 million dollars or more in investable assets (735 of which are billionaires) there are roughly 3000 families that have set up investment offices. Quite a few founders see value in the effort.

Tales from the private side

You don't have to run a company to own it, or build an investment office to keep it, but sometimes it helps. Professor Mandy at the Singapore Management University describes a constructive family office as a forum where the generations can negotiate and agree on investment goals and legacy. The Cargill-MacMillan family (Cargill Corp.) and the Waltons (Walmart) are just two prominent examples.

Of course, they both have impressive family offices – Waycrosse for the Cargill-MacMillans and Zoma Capital and Madrone Capital Partners for the Waltons. But as Josh Baron and Rob Lachenauer, co-founders of BanyanGlobal Advisors caution, "the forces that hold a family business together are not always present in family offices."

We wondered what our private company clients thought, so we went straight to the source. We asked them how they dealt with family business succession, wealth transfer, and the role, if any, a family investment office played in the process. We'll tell their stories over the next few months . . to be continued.