



FAMILY CAPITAL
— STRATEGY —

Demystifying the Family Office



Welcome

Thank you for accessing Family Capital Strategy’s whitepaper “Demystifying the Family Office.” By way of background, Family Capital Strategy is a boutique consulting firm based in Nashville, TN. We focus on helping families stay invested together.

From our background in consulting with top private equity funds, sophisticated public equity investors, and family businesses, we have observed that families really are unique when it comes to how they manage their capital. Their multi-generational time horizon is a unique advantage unrivaled in the marketplace.

Enduring families of wealth recognize that this advantage only persists through family unity. Unity is best built by having a robust, articulated and aligned strategic infrastructure in place. **To that end, we serve as thought partners with executives and leaders of family offices and family-owned/controlled companies as they build this infrastructure.**

In our work, we have seen that as families face the inevitable periods of change that occur, they are often asking 2 primary questions— Where Do We Want to Go? And How Do We Get There? As we work with families to find answers to these questions, we have seen that most will utilize the support of a family office to achieve their goals— whether they build their own or partner.

This fact has been born out by the rapid growth of family offices over the last 20 years ago. Our white paper is designed to help the reader begin to think through how a family office may support their family or the family they serve in achieving their long-term goals.

Thanks again,



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“If You’ve Seen One Family Office, You’ve Seen One Family Office”

- Common Industry Refrain

The Most Common, But Least Helpful Phrase

On a call recently, a family business executive I was speaking with asked a simple, yet profound question. “What is a family office” or What do you mean when you say family office? Too often, family offices are treated like Justice Potter’s timeless dictum regarding obscenity, “you know it, when you see it.” Even within the family office world, there is an oft repeated maxim of ‘if you’ve seen one family office, you’ve seen one family office.’”

This adage has become so commonly stated and accepted, that it has eliminated most attempts to provide a robust description or analysis of a family office (“FO”). This is to the industry’s detriment. All organizations are unique, whether for profit or not-for profit.

So while this refrain seems to say something profound, it arguably does more harm than good. Of the near hundreds of times we have heard it stated, the speaker is intoning through it that family offices are somehow beyond understanding for the average person.

Instead, we think it is possible to begin from first principles and build a comprehensive model of what a family office is and does. For purposes of this whitepaper, we will consider FOs with a functional lens on – i.e. what is the work to be done, and not concern ourselves with legal structure.

The simplest definition of a family office is this – **a family office is a professional services firm that helps manage the complexity of a family of significant means.**

At their core, family offices are about delivering service to families. Implicit in this understanding is that the family of wealth is willing to invest in the development of a new firm to deliver these services because they are unable to readily procure those services from the open market or do so at a reasonable cost.

This point is vital to consider. There are many services, in fact most, that are best delivered at scale – i.e. spreading a fixed cost of operations across a broad base of customers. If the family is going to consciously choose to de-scale and build an exclusive boutique for their benefit, they must be seeking a value proposition that is materially different from what is in the marketplace.

All this is in order to help manage and steward the inherent complexity that comes with attaining significant wealth. For example, multi-generational

families commonly have hundreds trusts to coordinate planning across. Or a wealthy, liquid entrepreneur may have a household that includes multiple residences, private aircraft, and marine vessels spread globally. Coordinating the location, staffing, and maintenance of these assets is no easy feat.

The family is looking for a partner to manage this complexity. Often because of the scale or the particularities of it, the clearest path forward is to build a specialized internal team to handle.

Family Offices are “En Vogue”

“The Beginning of Wisdom is the Definition of Terms”

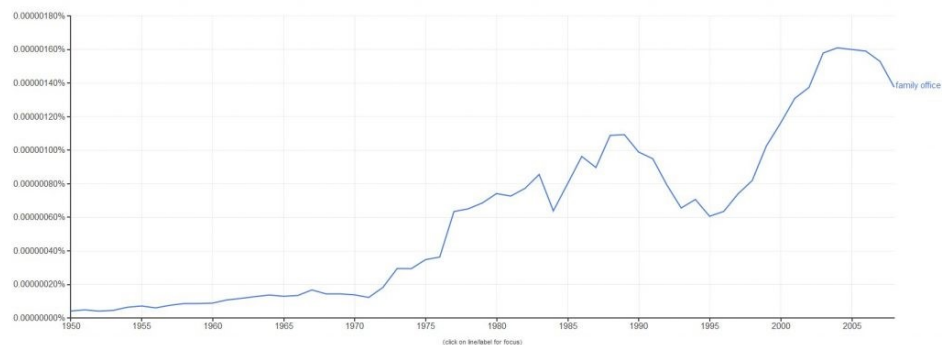
- Socrates

At a recent family dinner, I had the distinct joy of introducing my children to the Abbott and Costello routine of “Who’s On First.” My eldest, who loves to read and a good pun, was near crying from laughter as the act unfolded. There is something wonderful about the simple way in which words and their meaning can lead to confusion.

The financial world is filled with similar examples. Take for example the term ‘financial adviser.’ While sounding somewhat innocuous, the term covers a whole host of possible services and compensation models. In fact, some of recent proposed regulatory reform attempts to clarify the precise meaning of a financial adviser relative to another industry term, investment adviser.

The term “family office” is another of these nebulous terms. **Figure 1** below charts the occurrence of the phrase in print media since the 1950s. As you can see, interest has grown significantly over time, and especially since the mid-1980s.

Figure 1 – Use of the term “Family Office” in Media



Source: Google ngram viewer

Today, it is a common enough term but depending on who is using it, may have vastly different meanings. **There are three common meanings in use to describe a ‘family office.’** Note at the outset that each meaning is not better or worse than the another. Instead, it is important to understand the meaning when the term is used so you are making an apples to apples comparison. Let’s walk through each of the three briefly.

First, family office is often used to refer to higher touch services being offered to the wealthy clients of an existing brokerage firm, accounting practice, trust company etc. Common services may include bill paying, concierge (travel arrangements, dining, entertainment), tax return preparation, etc. The common point here is that the firm has expanded its customary offerings to deliver greater integration of services and potential greater value for its wealthiest clients.

The second most common usage of the term is when a family office is referred to as a type of investment entity. Common examples include the retiring CEO of a public company who decides to establish a family office to invest in new ventures. Or consider as well, a family that establishes a family office in order to buy additional businesses beyond their core operating business. The key distinction in this usage is that a family office is being referred to as a potential source of investment capital – much the same as a private equity fund, university endowment or a pension fund.

The final most common usage of the term refers to what we would call a ‘legacy family office.’ In this instance, the family office is created for the perpetuation and sustainment of the founding family. While it may include the higher touch services of term 1, and potentially as well, the investment acumen of type 2, ultimately this family office is working with the family to help it marshal all forms of its Five Capitals (Financial, Intellectual, Social, Spiritual, and Human) in order to see the family flourish over time.

Again, each of these meanings of family office – high touch services, sophisticated investment operation, or family entity – is neither good, nor bad in and of itself. Instead, it is important to make sure when you hear the term family office mentioned that the meaning intended by the speaker does in fact align with your desired understanding of the term.

The Why of Family Offices

So while the primary role of a family office is to help manage the complexity of a family of significant means, implicit in our discussion is the purpose behind why the family office is created. Yes the FO helps manage the complexity of the family – but in a market place full of experts, there are many well-established and reputable professional services firms that could accomplish the same tasks. **Instead, we would argue that there is a deeper purpose that underlies the choice to establish the family office, the family.**

The family portion of family office can quickly be looked over relative to other more technical considerations when establishing the office. But ultimately, the FO is in place for the family. Embedded within the choice to establish a FO is the opinion, whether verbalized or not, **that the family is better as a result of having a FO in place.**

This fact may come as close as possible to the equivalent of a Hippocratic Oath for those who work within family offices. **Namely, that the actions of the FO must ultimately be about the perpetuation and prosperity of the family.**

Financial metrics and considerations too often overwhelm our sense of prosperity. The prosperity of family instead should conjure images of thriving, flour-

ishing, renewal and growth. Picture growing fields or verdant forests teeming with life. While investment performance, tax efficiency, and risk management are important steps, they are necessary but not sufficient in themselves to support the family in its choice to continue through the passage of time together.

In a modern world of high vocational and geographic mobility, the reality is that most families may see 3 generations of realistic relational intimacy – grandparents, parents and grandchildren. But as grandparents age and pass on, grandchildren across sibling branches are simply unlikely to maintain strong relationships without significant effort. Yes, they may remain cordial and friendly in their dealings, but they would not make the favorites list in your iPhone.

When family's choose to manage their wealth, in all forms, collectively, they fight back against this natural tendency. As such, the family office is ultimately a tool to support the broad success of the family, and this must be the North Star against which success is managed.

How a Family Office Operates

A family seeking its own multi-generational success needs help along the way., and a family office is uniquely positioned to assist the family. We want to build off this general conception and highlight what family offices actually do in pursuit of that goal.

Similar to how Michael Porter outlined that there are really only two strategies that businesses can follow – being the low cost competitor or being highly differentiated, similarly there are two primary strategies that family offices can pursue – exceptional coordination or exceptional comprehensiveness. Best in class family offices pursue either strategy by assembling a team that provides an unrivaled depth of service delivery or they assemble a team that provides an exceptionally broad service offering.

Whether the family chooses the inch or the mile-wide approach, realistically the family office is unlikely to do all things for all family members exceptionally well. Really, the only circumstance where that might be possible is an exceptionally small but wealthy family – think like a tech founder – where there is zero regard for operating cost.

FO's that pursue the exceptional coordination approach build out a team of highly sophisticated professionals that bring a degree of integration in services that are difficult to replicate. Inherently, this structure recognizes that supporting a family is multi-faceted and multi-disciplinary, and building the “Seal Team 6” equivalent is the best way to serve the family. Doing this well, also means carefully monitoring and assessing where services are best delivered by a third-party vs. done in-house.

The other option is the comprehensive approach. **Under this framework, the family office goes extremely broad in its offering, but is likely limited in how deep it can get.** As the classic saying goes, work expands to fill the time available, and the same is true for the range of possible work the family office is asked to engage. FO's pursuing a comprehensive strategy embrace this and build out a team, likely more of generalists, who are able to cover a wide-range of roles.

In terms of the actual workflow that FO's oversee and manage, it is helpful to think of them as modular buckets. By being modular, a FO may choose to provide services in one bucket and not another. The typical buckets are:

Module 1 – Integrated Planning and Implementation – Covering tax, estate, risk management, and wealth planning, this offering is about ensuring the alignment of the family's financial capital with its long-term goals. Because of the number of moving pieces, breaking the silo'd mentality that this advice is typically delivered in is extremely helpful.

The natural output from planning work is the administration of the "plan." This may cover everything from general ledger accounting and tax return preparation to data aggregation / reporting. Because of how closely this follows behind planning work, FO's can easily slip into doing more of this work than they are ready for or desire. Administrative work generally seems to expand at an exponential pace and can quickly overwhelm the team if it is not carefully managed.

Module 2 – Investments – Family offices tackle the question of investment in a myriad of ways. Some build out robust internal teams to manage public investments. Other may launch an in-house private equity or venture capital-like fund. Still others, may hire an Outsourced Chief Investment officer (OCIO) firm to take over the entire management of the family's assets. Or perhaps more likely, some bits and pieces of each.

Module 3 – Family Support – The final bucket is what we call family support. This may include things that are traditionally thought of as "concierge services" – household management, etc. But as well, it may include supporting the family's governance entities such as a family council, helping to plan family retreats, coordinate family educational initiatives, etc.

While each family office is unique in the services it delivers, generally that offering derives from the family choosing (consciously or not) which of the four modules above they want to build an in-house capacity to address. That selection is a direct outflow of whether the FO is pursuing a coordination or comprehensive strategy. But keep in mind, all these choices are about helping manage complexity to enable the family to pursue its hopefully greater goal of continuing to live life together.

Conclusion

There are certainly many more facets that can be discussed regarding family offices. Yet far too often, the desire to run too quickly to specific technical questions or the minutia of a particular question means that the forest is lost for the trees. Understanding why a family chooses to create an office and what the efforts of the office are directed towards are key points to keep in mind when evaluating whether to form a new office, continue to invest in a single-family office, or join with a multi-family office.



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