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FAMILY OFFICE MANAGEMENT

Why that famous adage about family offices is so wrong

BY RICHARD WOLKOWITZ

"If you have seen one family office, then you have seen only one family office."

Sam Walton founded and built one of the most prolific family businesses in history, Walmart. In revolutionizing the supply chain and the retail customer experience, he was a contrarian and a believer in the unconventional. These beliefs fueled Walton's success as an entrepreneur and innovator.

One expression he'd frequently utter was: "Swim upstream. Go the other way. Ignore the conventional wisdom."

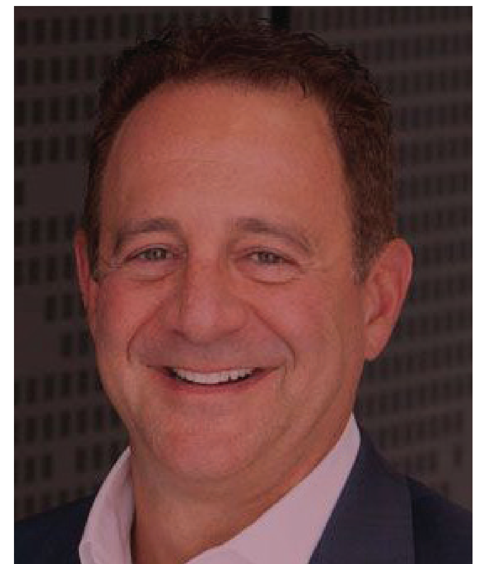
Within the family office community, it is time to take Mr. Walton's motto to heart and challenge the oft-recited adage, "If you have seen one family office, then you have seen only one family office."

Academics, advisers and families repeat this slogan ad nauseam. But it is just plain wrong.

In all industry sectors, owners, boards and managers customize and tailor their businesses to comport with their unique vision and capacity. The same is true within family offices. Each family office is unique in the purpose, mission, strategy, services provided and desired, generational stage, number of households/individuals served, wealth size, profit model, capital invested and nuances of tailoring the family office to fit the family's requirements, needs and desires.

However, fundamental business principles, best practices, assessment approaches and identifiable risk factors should be considered and applied to every family office to support a solid foundation with less complexity for both the family and its office.

It is time to stop treating family offices like "snowflakes," each one-of-a-kind, unique and different. Operating by this false adage encourages managing the family office by "exception," rather than managing to the "norm." Hence, it's time to put this adage in the rearview mirror and consider it obsolete.



Credit: KRISTINA RUOTOLO

CONSEQUENCES OF THE EXPRESSION

The dangers in perpetuating this old expression outweigh the risks to challenging the status quo.

Despite the growing proliferation of global family office peer groups, investment clubs and educational forums, most family office members do not know their peers and have limited or no insight into best practices and the performance of other family offices. The most frequently asked questions by family office operators and principals are:

- What do other family offices do?
- Are there benchmarks that are used?
- What are family office best practices?
- What do successful family offices do?
- What do dysfunctional family offices do that I should avoid doing?

Most academics and professional advisers also have limited visibility into a broad cross-section of family offices, aside from the few that their institution represents and the limited scope that they serve. This small data set forecloses the possibility of gaining insight into pat-

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terns, best practices and experiences that can be applied uniformly.

Belief in this expression justifies and enables underperforming or dysfunctional families.

Due to this ambiguity, families and their advisers hyperfocus on known, objective and tangible, technical-only solutions to wealth, investment, legal, accounting, tax and estate planning, banking, insurance, etc., without ample focus on the more difficult yet often pejoratively labeled "soft" skills of handling qualitative family matters that lead to lasting harmony.

The more this saying endures, the more families and their family offices are at risk by not adopting fundamental business principles and best practices, exacerbating the nascent family office community that materially contributes to a healthy and productive society. Family offices, individually and collectively, contribute so much to global innovation, employment, GDP/GNP and philanthropy on both a micro and macro basis. As a society, we need families and their family offices to be healthy and high-performing.

DEFINING 'FAMILY OFFICE'

Like other nebulous business categories of marketing, technology or consulting, the term "family office" creates confusion. There is no uniform definition. Therefore, the fallacy of the adage is perpetuated, preventing the establishment of uniform best practices to build and operate family offices.

We can align on the most basic definition of a family office. Family office means different things to different people, and there are a variety of family office types — single, multi, embedded, virtual and hybrid — and likely new types are evolving. Additionally, many trusted advisers and their firms offer "family office services," which adds to the confusion.

Some in the industry are working to develop a new moniker for "family office," but there is no consensus or real motivation to drive a name-changing effort. Regardless of the name, the seminal question is "What is a 'family office'?"

The simplest answer is that a family office is a "professional services firm." Depending on what services are being provided and how they are provided allows for a secondary definition that could also include the words "integrated" or "multidisciplinary." Hence, a family office, at its core, is an "integrated or multidisciplinary professional services firm." Period.

A synonym for "firm" is "office," and the "office" serves the "family." Hence, a "family office."

Say you have a relative, friend or client who considers their family a "manufacturing family" or a "real estate family" or a "car dealership family" or a "widget-making family." Or, perhaps, you know a family who has had a liquidity event and is now considered an "all-liquid family." In each of these cases, do they necessarily have the capability, experience, knowledge, skill set and desire to operate a highly technical and ever-evolving "integrated or multidisciplinary professional services firm"? In my experience, the answer is a resounding "heck, no!"

Extreme wealth, plus the "can do anything" attitude, combined with lack of understanding of the business of family offices, results in unwise business/financial/philanthropic decisions and unhealthy family dynamics and engagement. As a result, most of the thousands of family offices globally are underperforming and not carrying out the goal of family legacy and wealth sustainment. Many fail or reconstitute in a different form with great human and financial expense beyond the founder's generation.

FOUNDATIONAL PRINCIPLES AND BEST PRACTICES

The assertion here is to begin viewing and operating family offices like a business. The same fundamental business concepts that are applied to businesses in other industries will help to professionalize and codify the family office industry.

Certain foundational business principles and best practices apply to every business, especially among the healthy, high-performing family offices. While family offices are businesses, at times they are not viewed that way by the founders, family, nonfamily employees and outside advisers. This contributes to the variances in family office operations and performance and underscores the many ways in which they should professionalize.

Every type of business is built upon the same foundational principles:

- People: Attract, retain and develop employees/managers; nurture consumers/clients; focus on ownership alignment.
- Strategy: Clarify vision, values and goals that benefit the organization and its stakeholders.
- Planning: Formalize the strategy into tactics that can be executed upon.
- Execution: Implement and operationalize the plan with defined controls, systems, processes, procedures and technology.
- Capital: Have the sources and resources required to execute the plan, with contingency plans as well.
- Culture: Understand your personal

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"why" and alignment with the organization's "why."

Family offices should treat their family office organization as a business and define their purpose, mission, value proposition — and then adopt a strategic plan, business plan, operating budget and properly forecast. Businesses need structure and governance. Family offices — as a type of family business — need to consider the value of including independent and nonfamily fiduciaries and advisory board directors with specific committees — like a division of a traditional business — for focus, expertise, perspective and professionalization.

ESTABLISH A FAMILY OFFICE FRAMEWORK

Families are never static and, in fact, embody dynamism. Their family offices require corresponding adaptability, too. Establishing a purposeful methodology and framework will support alignment of the stakeholders around foundational business principles and make room to develop a strategic plan, identify challenges and reveal necessary evolutionary needs.

While family offices are highly customized integrated or multidisciplinary professional services firms, using a three-circle Venn diagram framework for every act or decision encourages alignment, identifies challenges and surfaces necessary changes to keep both the family and the family office healthy and high-performing:

- Durable Family Harmony. Durable family harmony is essential for the emotional, social and physical well-being of its members and family dynamics. Durable family harmony contributes to individual happiness, resilience and overall life satisfaction while also fostering strong collective family bonds and providing a supportive foundation for each family member's individual growth and development, as well as the collective's. Every act or decision should consider whether it encourages or undermines "durable" family harmony. Making decisions that result in short-term happiness may not be best for the individual/collective and can impact the durability of family harmony.
- Financial Prosperity. Accumulation of wealth is what allows the family office to exist. Financial prosperity is important because it enhances quality of life, provides opportunities for personal and professional growth, supports economic stability and security, and allows individuals and the collective to invest in a better future. While it is not the sole measure of well-being, it plays a significant role in shaping the opportunities and choices available to people and communities. Every act or decision should consider whether it encourages or undermines financial prosperity. At times, there may be nonfinancial drivers for making financial decisions. And that is certainly justifiable and acceptable, so long as those instances are done with intentionality and an understanding of the consequences. However, over time, making financial decisions that undermine financial prosperity will negatively impact the family office's financial sustainability and will bleed into both durable family harmony (described above) and operational excellence (described below).
- Operational Excellence. Operationalizing is critical for family offices because it serves as both the glue and foundation for durable family harmony and financial prosperity. Excellence is the standard because perfection is not attainable, and anything less than excellent will not meet either the family's expectations or be able to manage its complexity. Operational excellence is the underpin to effectively manage and preserve the family's relationships and wealth and reduce risks, ensure confidentiality and provide high-quality services to the family clients. By optimizing their operations, family offices can better serve the needs and objectives of the family's constituents, ultimately contributing to durable family harmony and financial prosperity.

Each of these three circles are intertwined and impact the other. Having none of the three prongs will almost guarantee the failure of both the family and family office. Having intentionality with one, two or all three of these circles substantially increases the likelihood of achieving a healthy, high-performing, sustaining family office.

UNDERSTANDING THE FAMILY OFFICE/FAMILY OFFICE TEAM

Family offices are made up of family members. There are a myriad of nonfinancial issues, complexities and dynamics that can arise based upon generation, founder-led or nonfounder/nonfamily-led, number of households served, number of individuals involved, number of owners, number of branches, marital status, upbringing, values, education, motivation, drive, work ethic, personal ethics, level or type of spirituality of each individual, number of those who work for or in the family office or one of the portfolio operating companies.

Recognizing that the family office eco-

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system is complex, fragile and ever-evolving, families and their nonfamily colleagues need to better understand themselves and each other. While there is a plethora of excellent, sophisticated and scientific-based assessments, the straightforward "four Q's" model can help a family office get started or realigned:

- Intelligence Quotient (IQ). Measure of one's intellectual ability and potential. It is typically measured through standardized tests of cognitive abilities such as logical reasoning, spatial perception, and problem-solving.
- Adaptive Quotient (AQ). Measure of one's ability to adapt and succeed in the face of change, adversity or challenges. AQ involves traits such as flexibility, adaptability and resourcefulness.
- Emotional Quotient (EQ). Measure of one's ability to perceive, understand and manage their emotions and the emotions of others. EQ involves skills such as empathy, self-awareness, self-regulation and social awareness.
- Spiritual Quotient (SQ). Refers to one's level of spiritual intelligence or their ability to understand and navigate the spiritual or metaphysical aspects of life. It's a measure of one's awareness of the interconnectedness of all things, including the recognition of both the individual and the collective.

Using this four-Q lens or other assessment tool serves to support and nurture interpersonal relationships, operating, developing and communicating in a healthy, resilient and sustainable manner

RISK FACTOR ASSESSMENT

A family office, or an integrated or multidisciplinary professional services firm, faces various risk factors that can impact durable family harmony, financial prosperity and operational excellence. Regardless of the structure or the services being provided, a risk assessment of your family office will help achieve sustainability. Some of these risk factors include:

- Investment Risk
- Liquidity Risk
- Credit Risk
- Currency Risk
- Interest Rate Risk
- Concentration Risk
- Economic Risk
- Market Trend and Disruption Risk
- Political Risk
- Geographic Risk
- Operational Risk
- Legal Risk
- Estate and Tax Risk
- Regulatory and Compliance Risk
- Technology Risk
- Cybersecurity Risk
- Succession-Continuity-Transition Risk
- Vendor Risk
- Client/Customer Risk
- Reputational Risk
- Family Dynamics and Governance Risk
- Force Majeure Risk

To mitigate these risks, family offices typically establish a formal governance structure with defined policies, implement a comprehensive and regularly scheduled risk management audit, act/modify/adapt based upon the findings, and develop contingency plans to navigate unexpected challenges.

CONCLUSION

Family offices are more similar than dissimilar. The professional services the family office provides are offered by many other professional services firms. The key is tailoring those services to meet the family's needs, managing family dynamics and managing the family office like a standalone business (in the case of a single, multi, virtual or hybrid) or as a division (in the case of an embedded family office).

Understanding the origin of the adage "If you have seen one family office, then you have seen only one family office" provides perspective. That perspective has become so accepted without challenge that family offices manage "by exception" rather than manage "by the norm." This philosophy has contributed significantly to overly complex structures and families, with ineffective internal and external adviser teams who have a higher degree of failure with an inability to own and operate healthy, high-performing, sustainable family offices.

While there is no one-size-fits-all solution, and there is no template to build and operate a family office, several uniform components and tools can be deployed to provide a framework; make structures and operations less complex; and achieve a healthy, high-performing, sustainable family office, such as:

- Define it. Understand that a family office is an integrated or multidisciplinary professional services firm.
- Own and manage your family office like a business, using foundational business principles and best practices.
- Establish a family office framework that focuses on durable family harmony, financial prosperity and operational excellence.
- Understand or assess your family and family office team and manage with that understanding.
- Conduct a risk-factor assessment and then act on the findings.

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