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Built for generations

Family Office Compass

Great Wealth

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Family Office Compass

Foreword

We are pleased to present you with the Family Office Compass, which is intended to be a practical guide for families setting up their own dedicated family office. The Compass takes you through a structured process and prompts your thinking about your family's needs and how your family office should be set up to meet these needs. You will also find examples of how other families have designed their family offices.

UBS and the Cambridge Institute for Family Enterprise have a long history of supporting wealthy families to achieve multi-generational success. Our advisory, education and research work in areas such as wealth transition, family governance and family office makes us appreciate the complexity of an UHNW family. Crafting a solution in any area must consider the other aspects of the family's life and be supportive of the family's strategy.

We believe that it is crucial for families to identify their driving purpose and to formulate an overall family strategy. Clarity of purpose for the family and, in turn, the family office leads to improved performance of the family office over time and increased usefulness to the family. Periodically reviewing how the family office supports the family strategy also helps maintain its multi-generational relevance.

We hope that you will find our Family Office Compass a valuable tool for you to set up a successfully operating family office, creating value for your family in excess of its cost and able to succeed and survive over generations.

Best regards,

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Founder and Chairman
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Best regards,

Josef Stadler
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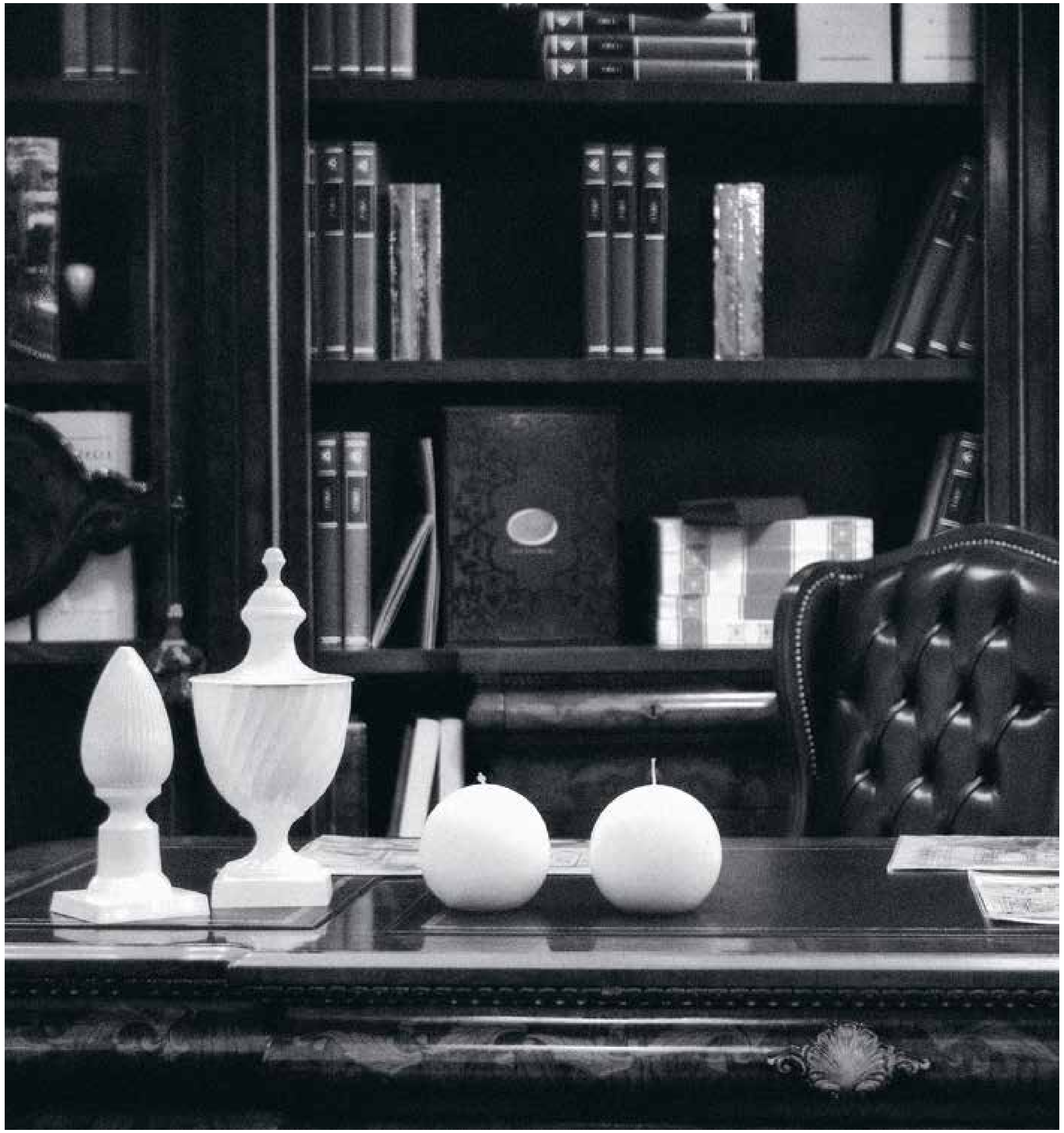

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Moving the needle

by John A. Davis and Florence Tsai

The experience of families that become and stay wealthy is very clear: successful families grow their assets well above their consumption rate, maintain family unity, and develop family and non-family talent that can contribute to these objectives. Stumbling in one area (asset growth, talent, or family unity) can slow your family down; falling behind in two areas for several years means it is hard to recover; failing in all three for a decade generally signals the end for the family's wealth.

Creating lasting success
Many wealthy families find family offices to be essential vehicles for creating lasting family and financial success. But to create a high-performing family office that helps your family achieve its goals and broader purpose, you must set it up and manage it correctly – according to your family's purpose, characteristics, needs and aspirations.

This guide will help you set up a family office that is right for your family. You can use it to ask important questions; and then design, create and run your family office.

Defining your purpose
Family success generally isn't sustainable unless a family has a compelling mission or purpose that motivates these essential activities.

To define a family's purpose, family leaders can ask:

- what are we, as a family, trying to accomplish?
- what do we want to build and sustain, and why?
- do we want to be leaders in our industry or community?
- do we have a social mission?
- how can wealth help us achieve our key goals and purpose?
- do we want to provide a sound financial base for the next generations? If so, for what purposes?

We urge you to spend time understanding your family's purpose, strengths, needs and aspirations before designing your family office – and before deciding whether a family office is right for you.

Family offices are generally set up by family wealth owners to be a group of experts aiming to achieve solid investment returns. The family office may continue to focus on this objective or adapt to meet other family needs, such as complying with tax requirements, advising on important purchases, providing legal advice, informing the family about its business and other investments, staying united, and developing family talent.

What your family office needs to do for your family depends on your family's characteristics, needs and aspirations, which are clearer if a family has a compelling purpose and clear goals.

Your family strategy
In our experience, wealthy families that survive over generations have clear and sensible strategies to achieve their purpose and key goals. A strategy expresses how you will get from where you are now to where you want to be. You will find it easier to create a strategy for your family once you are clear about your family's purpose or mission. To succeed over generations, families need strategies to ensure they:

- grow their assets much faster than they or their activities consume these assets
- nurture family talent, including wealth creators, good owners, philanthropists, family unifiers, and board members
- maintain family unity, for example through family meetings and family policies, including well-crafted shareholder agreements that include safeguards that facilitate buying out owners when needed.

So, your family strategy should outline how family members and its organizations (including its family office) will contribute to advance the family mission and achieve the family's key goals.

It is important to align your family's mission and its specific plans with the mission and plans of its business, family office, philanthropic activities, and other organizations that the family supports. When everything is in harmony, the groups are more likely to support each other and work together to achieve the goals. You should review your family strategy and its alignment every three to five years.

Evolving your office
Setting up and running your family office can be expensive and require a significant time investment from the family owners. As your family evolves, you should redefine the purpose of the family office, and adjust its leadership, governance, and management to better achieve the aspirations and serve the needs of the family. There are rewards for this attention and effort. For families driven to accomplish extraordinary things, an effective family office moves the needle.

Close relationships
The effective family office holds a special place in family life, in part because of its people. Its leaders and staff can develop close relationships with family members that play a key role in spotting and developing talent in the family, keeping the family informed and communicating internally, and building family unity for lasting success. The office's staff can help to transform your family, and sustain the family's passion for staying together, building wealth, and supporting society.

So, make sure you build and nurture trusting, open professional relationships with family office staff. Ensure the office has solid governance, led by capable owners. Give it clear goals, measure its performance, and guide it wisely. Treat the family office as an organization that creates value in important ways.

Your family, its businesses and key activities may change over time. However, your family office can remain adaptive and effective, evolving with the family's changing needs, and allowing smoother sailing.

With compliments on your success, and best wishes for you and your family.

Using this guide

This guide explains how to design, implement, and operate your family office, as well as how to overcome challenges. You will learn about the questions you need to answer, steps you need to take, controls you need to establish, and the roles in your family office. You can also return to this guide over time to help:

– adapt your family office to a changing environment
– improve your operations
– meet the needs of your evolving family
– support your family's strategy

Figure 1: Set-up process for a family office

1. Design

- Why – the right option for us?
- What – services?
- Who – team?
- Where – location?
- How – in vs outsourcing?
- Design concept

2. Implement

- Kick-off family office implementation
- Business plan
- Legal set-up
- Key hires
- Infrastructure
- Partner selection

3. Operate

- Role of family
- Governance levels
- Family office corporate core
- Investment governance
- Risk management

4. Evolve with the family

- Strategic role
- Family enterprise
- Family strategy
- Family governance
- Strategic functions
- Pitfalls and challenges

You will hopefully find this guide useful, whether you are:

– part of a wealthy family needing to better manage your complex assets and activities across generations
– an entrepreneur who has sold the business and wants to set up a new organization to manage your wealth, and structure resources for new ventures for you and family members
– a family office that wants to review your performance and adjust its strategy, governance, services, and structure to meet the family's changing needs
– currently receiving services from a multi-family office, and considering setting up your own team with new skills that can better serve you
– running a traditional family office focused on managing investments, and seeking to explore the best practices of other families.

What is a family office?

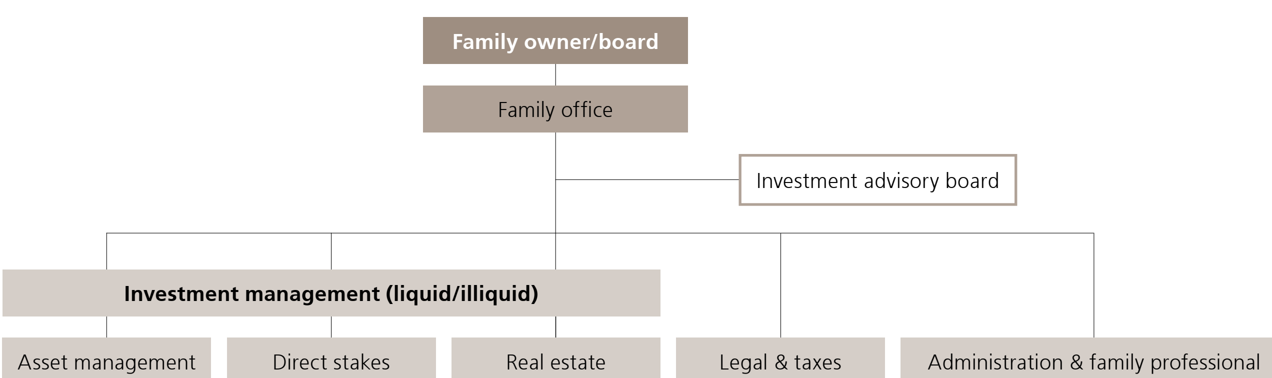
First, let's define what we mean by a family office. In this guide, family office means a professional organization or private office dedicated to managing the affairs of one significantly wealthy family. We will make it clear when we are referring to other types of offices, such as multi-family offices.

What does it do?
A family office generally manages assets such as liquid assets, real estate holdings, and direct investments. Its activities include managing the personal fortunes of family members; and often providing various accounting, legal, educational and personal services tailored to family members' needs. In its basic form, a family office's activities cover three main areas:

- **Investment activities** – such as constructing portfolios, choosing managers, providing strategic and tactical advice, and reporting and communicating. Assets can be liquid financial or longer-term illiquids, such as real estate and company participations.
- **Legal and tax** – such as administering wealth structures, succession planning, tax and legal, accounting, insurance, and business management.
- **Administration and family professional** – such as paying bills, accounting, managing property, and concierge services. The office can also support the family's philanthropic activities and engagements in social enterprises.

Family offices usually provide services to family members through a blend of in-house resources and external expertise. Although a family office will typically retain specialist advice in several areas, the overall control and coordination always remains with the family office. Figure 2 provides an overview of activities in a typical family office.

Figure 2: Example of a typical family office



Shapes and sizes
Family offices come in many different shapes and sizes, depending on the family's needs. Staff can range from one or two employees to 20 or more. The team can comprise everything from a part-time assistant, business manager, Chief Financial Officer, or family lawyer; through to dozens of specialists in investments, real estate, tax, legal, accounting, and high-value physical assets.

Sophisticated family offices
The most sophisticated family offices help families meet their strategic goals, such as establishing new sources to create significant wealth, developing the next generation, and uniting the family through proper family governance. For some, the family office is the main vehicle for strategically overseeing all family affairs, including its business.

The business model
Managing a family office follows a traditional business model; so, it requires a quality strategy, governance, team and infrastructure, and efficient execution. The office's focus is to support the founding family, which makes it a uniquely specialized service business.

Module 1

Design

Designing your family office

What are my options?

The first step in designing a family office involves reflecting on your options. Is a single family office the right thing for you? The following are the alternative types of family offices that could come into consideration:

- **Single family office** – A company that manages the wealth and/or affairs of a single family. Usually owned and operated by the founding family for their own benefit.
- **Family-owned multi-family office** – A company that manages the wealth and affairs of typically two to six families. Owned and operated by the founding families for their collective benefit.
- **Commercial multi-family office** – A third party-owned business which serves multiple families – usually ten to fifty, or even more for some of the larger operations.
- **Virtual family office** – An office that outsources most or all of its activities, accessing people, products and services when it needs them. It typically employs one or two people, and can be headed by a family member or an external professional.

To help you decide which type of family office is best suited to your family's needs, here are some factors to consider.

Family wealth

Generally, the wealthier the family, the more viable and sustainable a single family office becomes. Families with lower wealth are more likely to choose a virtual family office or a commercial multi-family office.

There are different views on the minimum investable assets needed to make it worthwhile setting up a successful single family office with a dedicated team. Some say you should have at least €100 million (or the equivalent in US dollars) in assets under management, others say more. However, single family offices with fewer assets can still be effective by limiting their mission and scope of services, applying effective outsourcing and focusing on their area of expertise

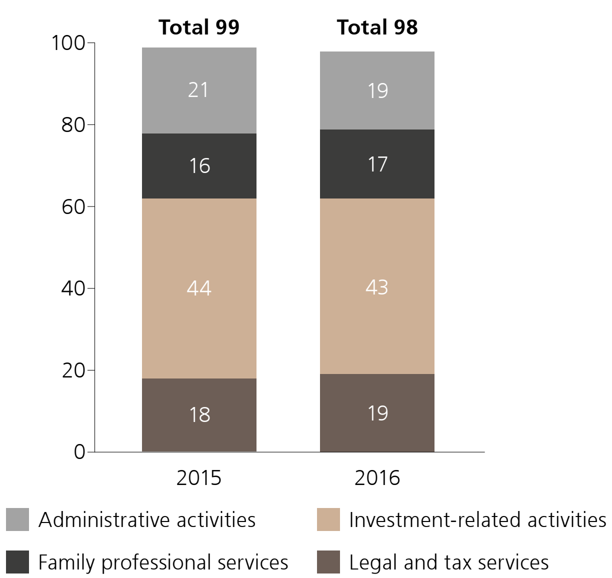
The average size of single family offices has generally increased in recent years, due to increased specialization across asset classes, growing regulation, and large upfront infrastructure investment costs.

Initial and recurring costs

Setting up a single family office means paying set-up costs – such as infrastructure, office and people expenses – and recurring operating costs. So your family's ability to sustain these costs is critical in deciding whether to go ahead. When some families consider the viability or sustainability of carrying these costs, they opt for the convenience and predictable cost of being customers of a commercial multi-family office rather than running their own.

What is the cost of running a single family office? We can draw conclusions from UBS' annual Global Family Office surveys. Average costs, expressed as a percentage of assets under management, are typically around 90 to 100 basis points. In absolute terms, operating costs can run from hundreds of thousands to several millions, depending on the scope and size of the office's activities. Figure 3 shows the average costs of running a family office.

Figure 3: Average cost structure of a family office (in basis points of assets under management), multi-year participants



The most important cost was "investment-related activities," accounting for 43 basis points. External manager fees accounted for 22 basis points of the investment costs.

Family complexity
The larger and more complex a family becomes, the harder it is for virtual family offices and some multi-family offices to cope. "Complexity" in a family system is primarily driven by the number of active family members, generations being served and geographical spread, as illustrated in Figure 4. Other factors such as the nature of business, assets or legacy issues can increase complexity.

A family with large commonly held fortunes and members living worldwide may find a single family office is the only option that works for them. For smaller families with needs limited to investment services, estate planning or simple concierge services, a multi-family office or a commercial multi-family office may well be the most sensible and cost-efficient solution.

Customized services
Many wealthy families want a service that is exclusive to them, without competing with other families for resources or priority. Furthermore, they want the services and the delivery to be fully customized to their needs. Both of which can be difficult for multi-family offices to cater to.

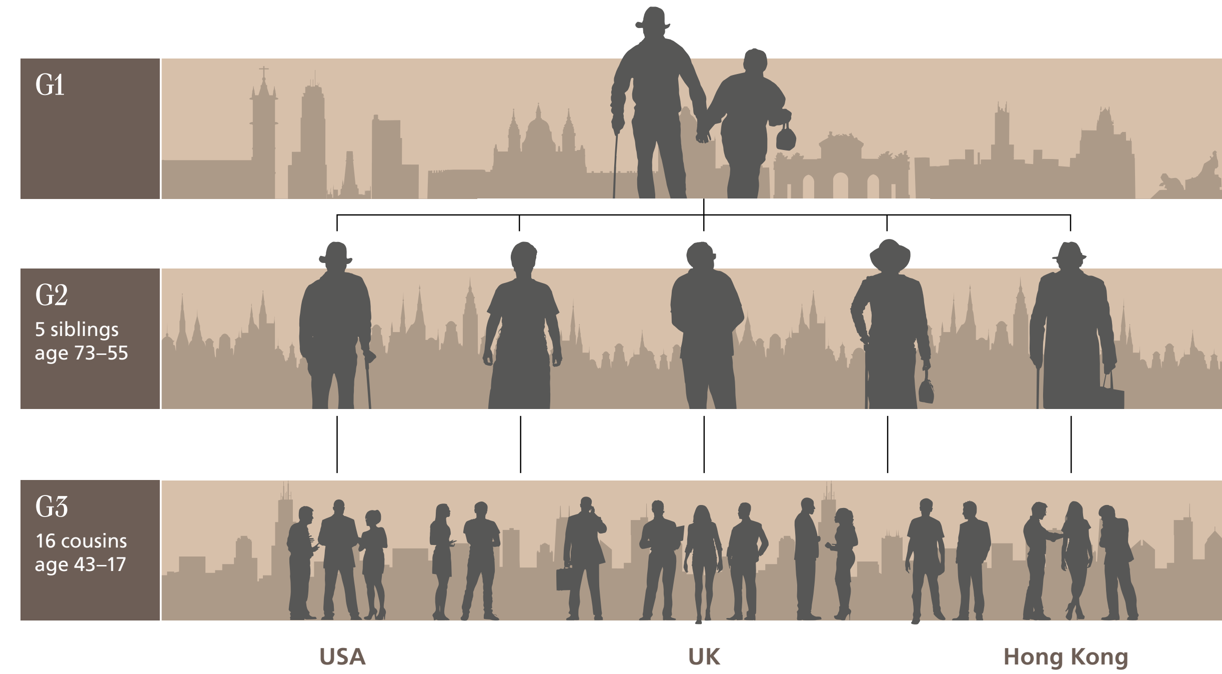
First, the nature of a multi-family office means that clients accept that there will inevitably be some sharing of bandwidth and priority. Second, as the number of families served by a multi family office increases, the narrower and more standardized the service offering will be. It is just not possible to manage the larger platforms without limiting what is on offer. For example, the ability to troubleshoot or to take on exceptional projects such as the management of a business start-up is more typical of the dedicated single family office.

Family hub and purpose
A great strength of the single family office is creating a managerial hub or central nervous system for the family. This goes beyond cost effectiveness, performance, or efficiency of asset management; this is about a sense of purpose, greater alignment, and cohesion among the family.

The complexity of business and wealth structures for a family that has become spread across the globe requires coordination from a guiding intelligence that understands the family as a whole and how it integrates with its business operations and other assets. Single family offices have an opportunity to gain insight into the family affairs in a holistic fashion, integrating issues in various arenas, and to provide services accordingly. This integrated approach adds not only quality and efficiency in the handling of family affairs, but also some protection against unforeseen consequences.

Families that have sold their core businesses usually look to the family office to steer their new financial, entrepreneurial or philanthropic ventures. The dedicated single family office can also take an important role in strategic, wealth creation or cohension-building initiatives, such as
- organizing family governance and communication
- coordinating education for family members
- promoting wealth creation by e.g. administering an entrepreneurship fund
- coordinating philanthropic activities

Figure 4: Increasing family complexity



Despite wealthy families being such a well-serviced group with providers seeming to cater to every possible need, some families still go beyond what can be readily found. Specialized interests, unique experience, specific expertise, exotic investing, or transactional support may motivate the creation of an "own" team, and a single family office tends to be the right choice.

Confidentiality and risk management
Some families opt to set up a single family office as they see this as the only way to keep information on their private and financial affairs limited to the absolute minimum amount of professionals involved. The larger the organization, the more people will have an insight into their private and financial matters. In a single family office there is only one client group and a limited amount of professionals involved. For the single family office, protecting the family members' financial and private affairs – and keeping its information confidential – must be central to its culture.

A single family office can also take on a larger role in the broad risk management of the family affairs. Reputations are vital to families, and the office can help protect privacy and confidentiality.

The tool in Figure 5 shows ten influencing factors alongside the typical characteristics of different family office types. You can use this tool to help decide which type of office is right for you. The factors are arranged as gradients and aligned with the office types at the bottom. By "dialing in" on your needs for each factor, you will start to see which type of family office fits your family best.

Figure 5: Types of family offices

‹50 mio	**Family wealth**	›500 mio
50 bps	**Cost**	120 bps+
Low	**Confidentiality**	High
Limited service offering	**Range of services**	Broad service offering
Not customizable	**Customization**	Totally customizable
Shared resources	**Dedicated services**	Exclusive
No	**Soft issues**	Yes
‹10 people + 1 gen	**Family size and complexity**	›100 people + 3 gen
Limited insight	**Family overview**	Full overview
Not possible	**Special projects**	Capacity

LOW ← → HIGH

Virtual office **Commercial family office** **Multi-family office** **Single family office**

Weighing the results
When you have finished using the tool, weigh the results. Is there one factor you and your family definitely need, such as expertise in a certain area of investments? Or do you need to consider a number of factors?

Which type of family office suits your family best depends on its preferences, priorities and circumstances. For example, what do you want to achieve? What factors are most important? What is the most cost-efficient solution?

This section has presented the types of family office you could consider. The rest of the guide focuses on the single family office.

Case story: Going virtual

A Geneva-based entrepreneurial family had been a satisfied client of a multi-family office for a decade. The family's liquid assets were USD 150 million – gained from selling the founder's business – and owned by the founding couple. As the family grew, the founder wanted a more tailored and coordinated service.

The family decided a single family office was too expensive. So they chose to have a virtual family office, set up by a second generation family member with experience in banking and finance, who subsequently became its Chief Executive Officer and Chief Investment Officer, allocating the portfolio's assets among several different asset managers. An administrator controls the flow of funds, and all other services are outsourced. The office currently serves generations one and two. Every month, the founder and the "family officer" review its allocation of assets.

What should our family office do?

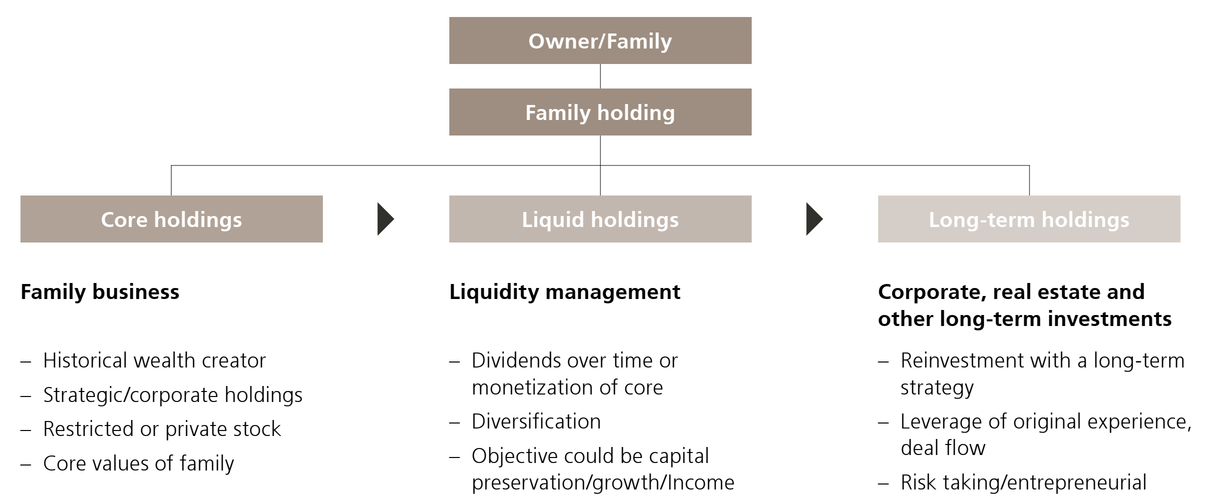
To choose which services your family office should provide, your family must answer these questions.

- **What is the current situation?**
- **What is the family office's purpose?**
- **What are your strengths?**
- **What are your needs?**
- **How will the family office be funded?**

In this section, we look at each question in turn.

What is the current situation?
The first step is to map your current situation by answering these questions: What wealth do you have, how is it owned, and how do you manage it? Who advises and supports the family? What do you need to improve?

Figure 6: Mapping the current situation – How is your wealth structured?



The mapping of your current situation will enable all family members to reflect on what the gaps are in the current set-up and what they would like the new family office to accomplish. How can the coordination and consolidation of family affairs be improved? How can a professional team take over the role of the founder?

Figure 7: Mapping the current situation – Who advises and supports the family? What do we need to improve?

Equally important is the qualitative question regarding your current advisors and support providers. Who should be retained? Put on terms? Replaced? Can the family office fill this gap? Figure 8 contains a useful detailed mapping example that demonstrates how the family can evaluate, vet, and upgrade the family ecosystem.

Figure 8: Gap analysis – What are the gaps? What role could a family office play?

Family wealth functions	Managed today by	Current gap/weakness	Proposed family office role
Investments			
Liquid investments			
– asset allocation	Founder	Not systematic	Manage process to guidelines
– traditional investments	Bank A, B, C	Overlaps, no diversification	Oversight and control
– manager selection	Bank A, B, C	No process	Coordinate process, expertise
Financial accounting	Company bookkeeper	Confidentiality, global view	Dedicate resource, full role
Real estate	Property manager	Cost control	Oversight and control
Direct stakes	Founder/Family	Driving performance and exits	Analysis and decision support
Corporate finance/deals	Founder/Family	Opportunistic, no strategy	Execution and transaction support
Risk management	None	Significant risk to key assets	Dedicate resource, full role
Global custody	None	No oversight and decision basis	Selection, oversight and control
Foreign exchange management	Company CFO	Not sustainable	Dedicate resource, full role
Legal and Tax			
Financial planning	Company CFO	Confidentiality, sustainability, needs separation	Dedicate resource, full role
Tax planning	Big 5 firm	None	Oversight by family office
Trust management	Trust firm A	Small firm, no international capability	Family office select new partner
Legal services	Law firm A, B	Coordination between jurisdiction	Oversight by family office
Estate planning	Law firm A	None	Oversight by family office
Insurance planning	Founder's personal assistant	Strategy, cost control, expertise	Dedicate resource, full role
Family professional			
Concierge services and security	Personal assistant	Expertise	Select outsource partner
Management of high-value assets	Personal assistant/Founder	Expertise and capacity	Dedicate resource, full role
Support for new family business	Founder	None today, future succession	Dedicate resource, see above
Family governance	Founder/Family	No systematic approach	Liaise with external partner
Education	Everyone	No coordination	Coordinating role
Philanthropy	Founder/Family	No strategy, low impact	Dedicated resource


Schafer & Sons

What is the family office's purpose?
Your family should discuss and define the purpose of the family office. What is the wealth for? Do you have a solid strategy for your wealth? Why do you want to stay together as an ownership group? How will the family office help you achieve this goal? Who is the family or client group? Who will receive services? Will they all receive the same services? Once you have created a clear mission for the family office, you can more easily choose your services and staff.

Families often set up family offices to:

- preserve family wealth and provide support for inter-generational wealth management in a consolidated, controlled and professionally managed organization
- manage complexity and ensure efficiency in the short term, while improving prospects for eventual successful wealth transfer
- achieve excellence in investment management
- leverage and nurture unique skill sets of the family (e.g. real estate expertise and networks in a specific location)
- support family businesses and pursue new family business ventures
- support entrepreneurship in the family and other strategies for growing wealth
- free family members from the mundane daily tasks of managing wealth
- provide a forum for uniting the family and developing talent
- serve as a hub or an endowment for family philanthropy and social enterprise
- manage the family's strategic planning for multi-generational success

Who is the client?
When a family office is set up to serve the founder, their spouse and their nuclear family, it is clear who the family office client is. In later generations with families of substantial size, not all family office services may be offered to all family members. What services are available to various family members is essential to clarify and communicate, particularly as it may have funding implications.

What are your strengths?
Family offices usually reflect the family's skills and culture. These skills play a major role in determining the activity focus of the family office. For example, a private equity investor may choose to focus most of the investment activities on company participations and staff the family office accordingly. A hedge fund investor may have special expertise in structured debt and mezzanine solutions and decide to make this a main activity focus. A family with a long-standing tradition in philanthropy and having sold its core family business may set up the family office with a focus on philanthropy.

What are your needs?
Once you have mapped your current situation, defined your family office's purpose, and identified your family's strength, it will become clear what services the family office should provide.

Most family offices start with core services based on managing wealth, planning finances and administration. However, the office can also do much more. Figure 9 shows the most typical family office services.

Figure 9: Typical family office services

Investments	Legal & Tax	Administrative	Family professional
– Asset allocation	– Financial planning	– Accounting	– Family governance and succession planning
– Traditional investments	– Tax planning	– Bookkeeping	– Support for new family business and other projects
– Manager selection/oversight	– Trust management	– Mail-sorting	– Concierge services and security
– Real estate direct investment	– Legal services	– IT	– Family counseling/ relationship management
– Financial accounting/ reporting	– Estate planning	– Office management	– Management of high-value physical assets (e.g. property, art, aircraft, yachts)
– Alternative investments	– Insurance planning	– Management of contracts	– Entrepreneurial projects
– Investment banking functions			– Education planning
– Risk management			– Next generation mentoring
– Global custody and integrated investment reporting			– Communication between generations
– Private banking			– Philanthropy
– Foreign exchange management			

How will the family office be funded?
Family office costs are significant. How they are dealt with can be a highly sensitive and potentially divisive issue. It is advisable to address this early, clearly and to review the funding regularly.

Who will be responsible for funding, both initially and on an ongoing basis? As discussed earlier, setting up a single family office will result in fixed set-up costs (infrastructure, office, and people), recurring operational costs and potentially unforeseen contingencies.

How will you calculate and charge costs? For example, the classic charge for investment services is to levy a percentage fee based on assets under management. For legal and tax services, charges are usually based on time. For family professional services, such as concierge, retainers are the norm. If your family office provides services in more than one of these areas, you will need to find a way to reconcile the charges.

If various family groups will use the family office, will their funding obligations be the same or different according to how they use them? Consider the situation of two joint owners: one with large assets but less need for family professional services; the other with a large family and fewer assets but significant need for professional support. Calculating each owner's actual use may be time consuming and pose an administrative burden. However, it may be the only reasonable and fair way to allocate responsibility for funding the single family office.

To aid your tax planning and make sure you are complying with regulations, you may need advice to ensure what you charge reflects the substance of the relationship.
A common way to charge is to establish a cost plus an arrangement fee of say, 10%, as this complies with transfer pricing rules. Alternatively, you can agree a management fee that is set in advance or based on performance.

Who do we need?

Sourcing and attracting the right people is a vital step in the creation of a family office. Most commonly, family offices have employees with a legal, banking and finance, controlling or tax background. What are examples of typical jobs in the family office? You are likely to find a CEO, CIO, portfolio manager, analyst, accountant, tax specialist, trust officer, wealth planner, general counsel, and/or personal assistant. In addition to the professional qualifications, a personal match with the family and the family office culture is important.

Key hire
Often the first person to be employed in the family office is someone trusted by the family, such as a family member or a professional who may already provide services to the family, the business, the philanthropic organization, or all of these. This person could be the CFO or another manager from the family business; the family's legal advisor; a former financial advisor; or the accountant. Talent referred through the family's network, its operating company, or alternate sources have the great benefit of being proven and pre-referenced.

Families often ask, "What is the best profile for a Chief Executive Officer?". There are Chief Executive Officers with investment, accounting, legal, or even human resources backgrounds. The profile depends on the needs of the business family. If 90% of the family's wealth consists of financial assets, then retain a Chief Executive Officer with an investment rather than an operating background. One common trait that the family office Chief Executive Officer should have is the ability to help the family think long-term about how to achieve multi-generational success. Roles that the family office can take on in this respect will be discussed in detail in Module 4 of this Compass.

Running the office
Family members often act as the head of the family office, especially in its first few years. However, as family offices become larger and more complex over time and generational transfers have taken place, non-family professionals are more likely to run them. Family members then usually perform a non-operating function, such as sitting on the investment committee or supervisory board.

If the family office manages assets itself, it may look to hire experts such as foreign exchange traders, and private equity and hedge fund specialists. This depends on the structure of the family's assets and investments, and the size of the family office and its assets under management.

The family office may also require specialist roles for managing households and property; and other assets such as art, aircraft, and yachts.

Designing the organisation
When staffing a family office, we recommend that you:

- define a rough organizational structure, based on the services you want the family office to perform.
- consider a core organization as a starting point to perform the most important services. You can always expand this when the office is up and running.
- identify a key person in your current environment as the first person you hire for your office.
- consider “cherry picking” talent from your operating company or other trusted sources.
- speak to peers and other family offices.
- place a premium on trust, as family office employees have access to a substantial amount of highly sensitive information they pose a potential risk to family confidentiality. Having trusted advisors/employees working for the family office is important to avoid risks such as fraud, improper use of information and unwanted media attention. Loyalty to the founding family is critical. Therefore, screening, referencing, and background checks are particularly important.

Retaining talent
Keeping talented people is an ongoing challenge for family offices. Over time, it is also important to ensure the wrong people leave the family office. Your people must be experts in their fields. To make sure their knowledge is up to date, it is crucial you provide them with ongoing training. This can be challenging for family offices, as they are often isolated from mainstream professional disciplines.

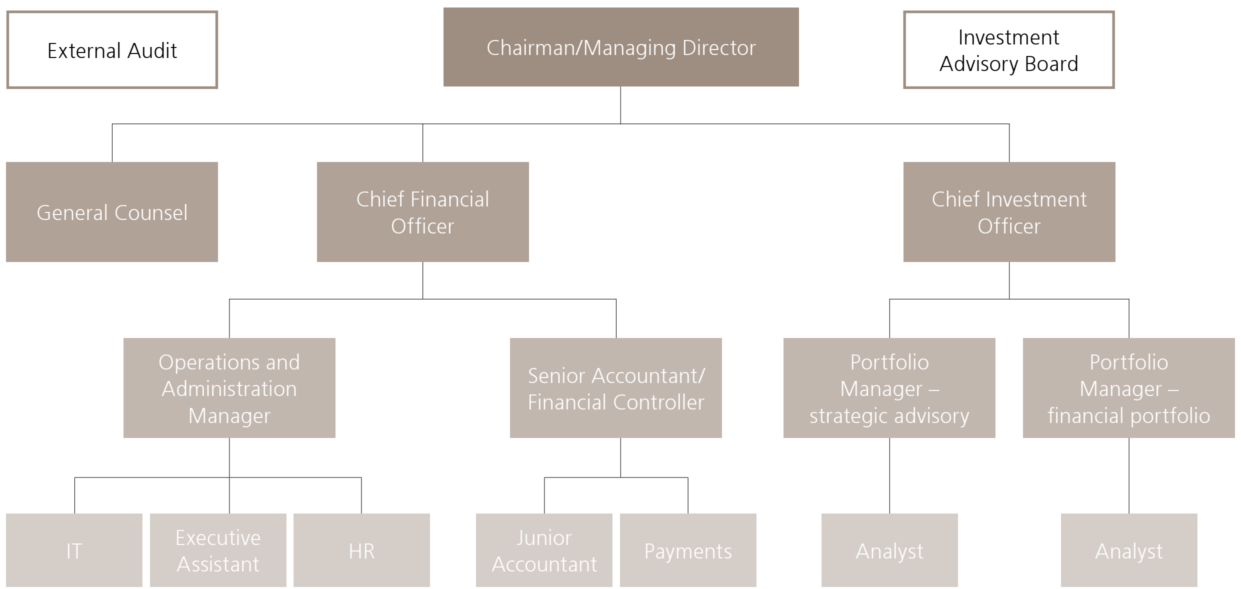
Case story: Starting up

A first-generation entrepreneur built a profitable retail chain with a 50% partner. He plans to retire from daily operations and become chairman of the retail business. At the same time, he wants to start his own family office to manage his significant liquid assets and develop a portfolio of companies in other industries.

He wants to set up the office in the city where he lives and employ some staff from his original business – his legal counsel, Chief Financial Officer, accountant, and personal assistant. He has also found a professional with a private-equity background who can help him source and execute new transactions, and build the companies.
The entrepreneur wants his financial portfolio to secure his family for the future, and act as a resource for future business projects.

The next figure illustrates the organization he would like to create. It reflects a broad range of family office services, from business management to managing liquid assets and administering the various family estates.

Figure 10: Family office organization example

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Where should our family office be located?

The family office is at the heart of the family, its wealth, and its business. So there is always some tension when trying to reconcile competing needs and wishes when deciding on a location for the family office. In the past, the easy answer was wherever the family or its leader lived. However, times have changed. Today, there are more options, thanks to new technology, better communication, and easier travel.

Where does the family live and work?
As noted, the location of the patriarch and family was decisive in the past. This was driven by the need for convenience and control, both of which are improved by close proximity.

How a location works from a travel and business agenda is not trivial. For the office to be sustainable there must be reasonably convenient access for the owners. However, finding a location that is convenient for all the family may be difficult, as families regularly divide their time between properties in diverse locations. This is where technology can help, giving family members easy ways to communicate with the office.

If the family office supports the family's lifestyle needs or manages its fixed assets (such as property), this will usually be decisive, as access and the ability of the office to respond to family requests will be paramount.

How will you maintain control?
Owners can stay in control by increasing contact and giving the family better access. However, controlling a remote enterprise can be difficult, even with modern technology. Stretching communication lines too far can also cause governance problems later.

You should consider giving reasonable access to people who can help govern the office. It is often best practice in a family office's governance framework to seek support from independent, knowledgeable and trusted advisors and board members. These individuals will also need to attend meetings and act as members of supervisory boards, committees and similar groups.

Accessing opportunities
The operation of the family office will require access to investment opportunities, a sufficiently qualified talent pool, appropriate infrastructure and good external providers. The trade-off is usually that all of these come at a cost. Generally, the closer you are to a financial center, the more expensive it will be.

Depending on your family office's focus, it may need to be close to a location to secure deal flow and manage local assets. For example, if managing real estate assets in a particular country is important, you may need to establish your office in that location.

Multiple locations
Alternatively, you could consider having multiple or split locations, especially if your family office needs to perform various roles and achieve multiple objectives. For example, you might base a wealth management and direct investments team in a high-cost financial center, establish administration in a low-cost location, and place family affairs functions where most family members live.

Tax, legal and regulation
Families should take legal and tax advice to determine the optimal location of the family office. What tax will the family office be subject to? What is the tax liability of the location where investments are made? Depending on the potential impact, tax may be a key driving factor for the location of the family office, the choice of type and location of investment vehicles and ultimate holding vehicles, which we will discuss later on in Module 2 on implementing the family office.

The family office must have a good working knowledge of the law governing its area of operations. This means the office may need to educate its people on matters such as minimum regulatory requirements for certain named positions, compliance reporting, and anti-money laundering provisions.

Depending on the country, some family offices have to consider the following regulatory aspects:

- registering with the authority as a regulated body
- having qualified investment managers
- complying with accounting, reporting, and disclosure standards
- having a compliant ownership structure and family office

Regulations also affect the family office's choice of personnel, especially senior management. Several jurisdictions require employees to have certain professional skills before they will grant and maintain permits.

You also need to consider other factors, such as the location's political stability, proportionate and sensible regulation, legal certainty, and accessibility.

Figure 11 summarizes the factors behind choosing the right family office location.

Figure 11: Factors for choosing the family office location

Ownership jurisdiction
- Legal & tax
- Regulatory
- Political stability

Family & business
- Convenience
- Time zones & distance
- Control
- Family needs
- Response times

Wealth management
- Access to markets
- Access to talents
- Costs

Case story: Multiple locations

A family with twelve members in the second, third and fourth generation is served by a family office of thirty professionals, with offices in three locations.

The asset management team is based in Switzerland, where 10 trading and portfolio management professionals manage a €2 billion liquid investment portfolio. Eight dedicated UK-based professionals manage the private equity portfolio of €2 billion. The family office's main branch is in the family's original hometown, and employs 15 people. This office's services cover company and trust administration, accounting, law and tax. The office also manages the family's communal assets and provides lifestyle services to family members.

Additionally, the family office's Chief Executive Officer helps organize family meetings and education for the next generation.


HOTEL
LE REFUGE
METROPOL
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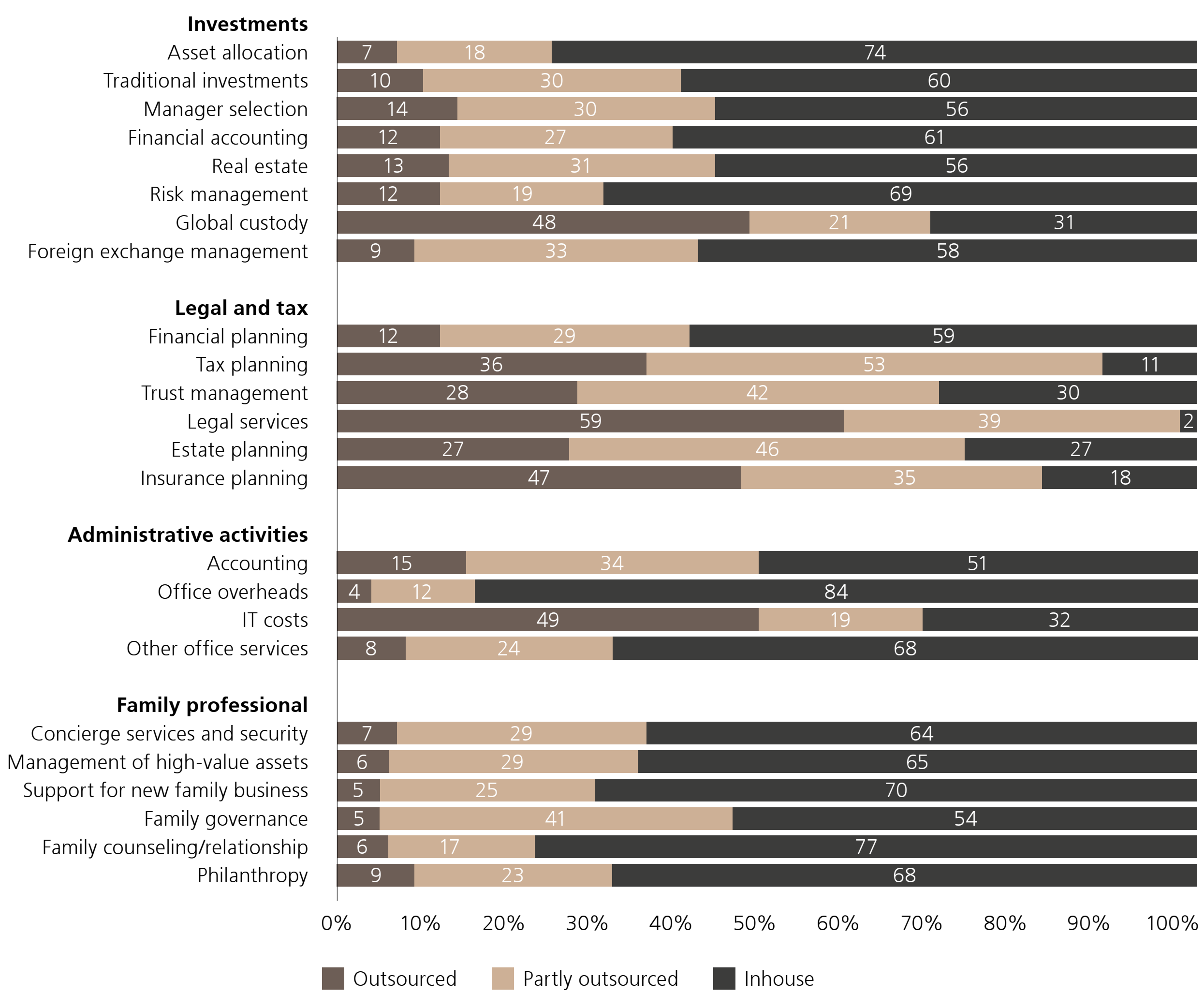
What should we outsource?

Family offices outsource in many different ways. Some outsource everything except controlling and coordinating external service providers. Others do everything themselves. Most choose a blend of external expertise and internal knowledge.

Many offices like sourcing specialist advice when they need it. This is particularly true for legal and tax services, as their affairs are often complex. The figure below illustrates the general outsourcing tendencies across the main family office services, from the UBS Campden Global Family Office Report 2016.

Figure 12: Outsourcing tendencies of family offices

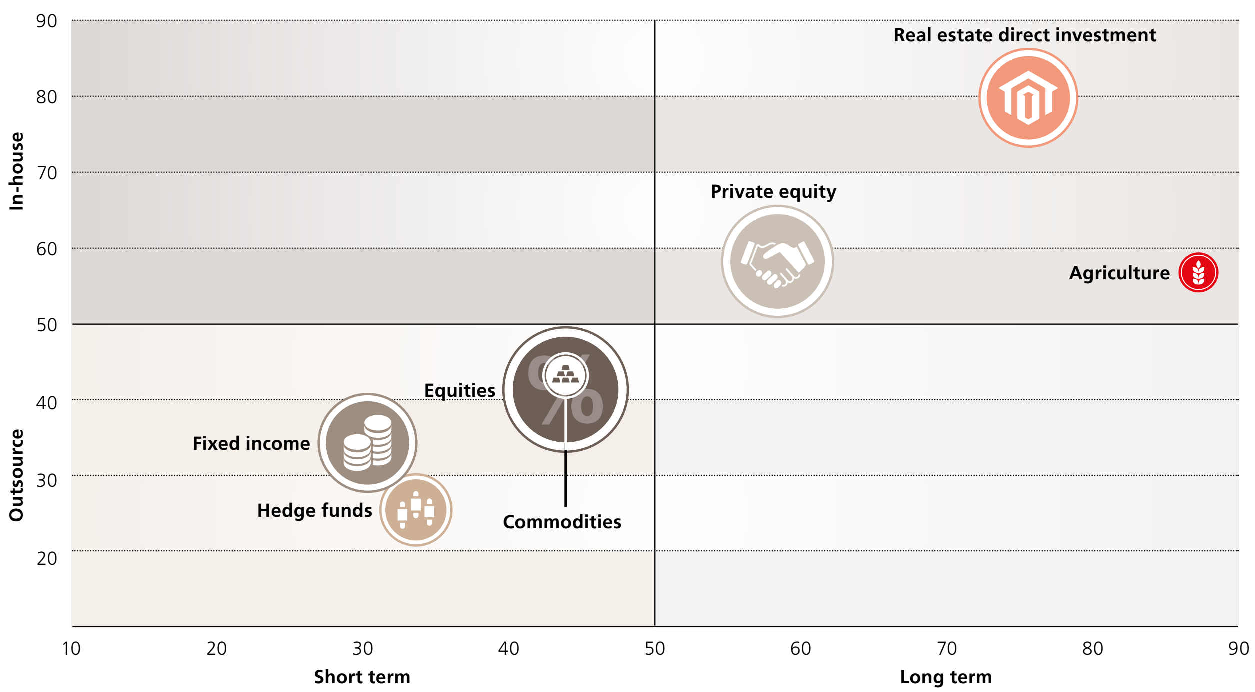


These are the questions family offices typically ask themselves when deciding which services to perform or outsource:

- Can an external specialist provide a service at a better quality, more quickly, and at a lower cost? For example, specialist legal and tax services?
- What do you consider a core skill that is essential to your family office's offering, but which you cannot delegate?
- Does the family office have the skills it needs, for example managing real estate and business ventures?
- Does the family have particular strengths or legacy skills that can be leveraged?
- Do you want to nurture and build specific skills in the family, for example, entrepreneurship, philanthropy, collecting art, and managing investments?
- Do you need objective advice or a second opinion for an important business decision, such as due diligence on an investment opportunity?
- What services can you not outsource due to confidentiality and privacy considerations?
- Does the service require intimate, long and trusting relationships with a broad range of family members?

As Figure 13 shows, family offices are increasingly outsourcing short-term liquid assets, and managing illiquid assets (such as real estate) and direct investments themselves.

Figure 13: Outsourcing tendencies of liquid and illiquid asset classes



Regardless of what the family office chooses to outsource, it will always retain the ultimate control, consolidation and reporting oversight on the family's wealth to the family members.

Case story: Staying focused

Two siblings set up a family office as a way to professionalize the management of liquid assets. They were not active in the management of the core family business and had pushed for a distribution of surplus cash so that they could secure the financial future of their branches independent of the performance of the core family business.

The family office was established in a financial center in another country, with a pure focus on management of liquid assets. The family office was initially staffed with a team of three – CEO, CIO, and an analyst.

Now the office is running smoothly, it outsources asset mandates to different banks and coordinates the financial planning of the family with the help of an international law firm. The family office has established a clear investment process and investment guidelines emphasizing a long investment horizon and low risk approach.

The family office works with three banks providing the necessary investment management, infrastructure, research, and advisory support.

The family's driving purpose is to professionalize asset management and establish a clear boundary between corporate and private liquidity.

Case story: Giving back

A family-owned firm in North America with activities in agriculture and real estate, divested a business line, resulting in liquidity of USD 200 million. To ensure that the new liquid assets are managed professionally, the family set up a single family office. The family decided that the office should invest a large portion of its assets in "impact investments" (investments that aim to benefit society or the environment, while generating a financial return).

The office employed a Chief Executive Officer and Chief Financial Officer to focus on integrated wealth management, family real estate, and financial planning. For the impact investments, the office outsourced the job of allocating assets and choosing managers to a specialist firm. The family office coordinated this work.

The family also published its vision and values, investment goals, and investment criteria: "We pursue a stakeholder approach and will invest to improve the financial, educational and personal growth and health of the family and staff of the group. The family invests in ventures that create human, social and environmental benefits in addition to financial returns. We base our actions on a solid foundation of values such as love, respect, humility, excellence, fun, collaboration, and integrity."

Where do we go from here? Workshops, design concept and project team

Workshops
We recommend that the family conduct a series of workshops that include key stakeholders to concretely answer the design questions raised in this Module 1. It is crucial to develop and document a common understanding of the purpose for the family office at the outset. This will help to ensure that the family office becomes aligned with the family's needs, is cost-efficient, and produces value above its costs. There is a lot to cover, so meetings must be regular to maintain momentum.

Seeking advice
To make sure you are on the right track, you should seek advice and support from experts. These might include family office consultants, peers with a family office, family office experts at banks, and legal and tax advisors.

Appointing a project team
The output of the Design phase should be a high-level family office design concept that can be implemented by the family office project team.

To implement the design, the family should appoint a project team. This team will create a detailed business plan, set up the legal entity, hire staff, set up an infrastructure, refine the services, and contract with partners.

Who should be on the project team? There is no single answer. However, typically project teams comprise a key hire for the family office, a family member, and someone with a legal background.

Figure 14 is an example of a family's high-level design concept.

Figure 14: Example of an early design concept

Who/What	We are a German family in the 1st and 2nd generation that are owners of a large industrial group. We have built a considerable amount of wealth in addition to the core business: significant excess liquidity, commercial real estate, and a large art collection. Our founder is planning to retire and has to date coordinated the management of these assets with the help of a small group of advisors.
Why	As the assets are growing and the 2nd generation family members are resident in several European jurisdictions, we feel the need to establish a dedicated family office to support us in the professional management of our wealth, coordinate the different advisors, and assist us with succession planning.
Location	We would like the family office to be located in Frankfurt, being a European financial center, having access to relevant expertise (asset management, tax & legal, real estate) considering the origin of the family and the large German real estate portfolio.
Team	We foresee that the family office will start with an efficient core team of professionals with expertise in asset management, real estate management, financial planning, and administration. Only commonly held assets of the family will be serviced by the family office. The family office team will be led by our previous CFO from the family business. Two team assistants will provide professional support as needed to the core team. We want to pay market-based salaries and provide incentives to align employees with family objectives.
In-/Outsourcing	The team should ideally work with external advisors as needed, operate in a lean fashion but keep the overall control and coordination of the tasks. Portfolio management will be outsourced but the asset allocation and manager selection will be kept in-house. Custody, consolidation, and reporting will be provided by a major bank. We will retain a real estate specialist who can coordinate the management of commercial real estate and deploy real estate managers in different locations. An in-house lawyer will provide contractual support for the real estate side as well as coordinate financial planning for the family members, drawing on international expertise as needed.
Communication	We want to have regular communication with the family office team, and set up pragmatic governance routines including an investment committee, investment guidelines, and a supervisory board. We want to have prudent risk management reflecting the conservative values of our family. We are managing our wealth for future generations, providing financial security and reserve resources for the family.
Project team	We are mandating a project team for the implementation of the family office consisting of the future CEO of the family office and our in-house lawyer. We expect this project team to develop a detailed business plan, find a business location, propose key hires, explore infrastructure needs, get necessary tax and legal opinions, and present a final cost budget for our sign-off.

Create a budget
Next, the project team should create a budget for the funding it needs to implement the family office. If enough funding is currently not available, the family office design is probably too extensive for what the family owners want to pay.

In the next module, you will learn about the steps the project team needs to take when implementing a family office.

Round up

Do you need a family office?
- Size and structure of my wealth
- What costs am I prepared to pay?
- Complexity of the family
- Need for a family hub

Choose which type of office is right for you:
- Single family office
- Family-owned multi-family office
- Commercial multi-family office
- Virtual family office

Decide what you want your family office to do. Ask yourself:
- What is the current situation?
- Where are the gaps?
- What are our strengths?
- How should we fund the office?

Consider who you need to work in your family office:
- Define a rough organizational structure
- Consider a core organization for the office's launch
- Identify the first hire
- Value trust above all

Decide where to base your family office. Weigh up:
- Where the family lives and works
- How will we maintain control?
- Locations that offer access to talent and opportunities
- Local regulations

Think about what you will outsource. For example:
- Can external specialists do the work better, more quickly and at a lower cost?
- What services cannot be delegated?
- Do we want to nurture particular skills in our family?
- Do we need objective advice or a second opinion?

Were do we go from here:
- Workshops
- Project team
- Design concept

Implement

Setting up your family office

Kick-off

You have developed a high-level family office design concept and appointed a project team to implement it. The family has agreed on the initial funding of the project team. It is now time to make key hires and set up the family office.

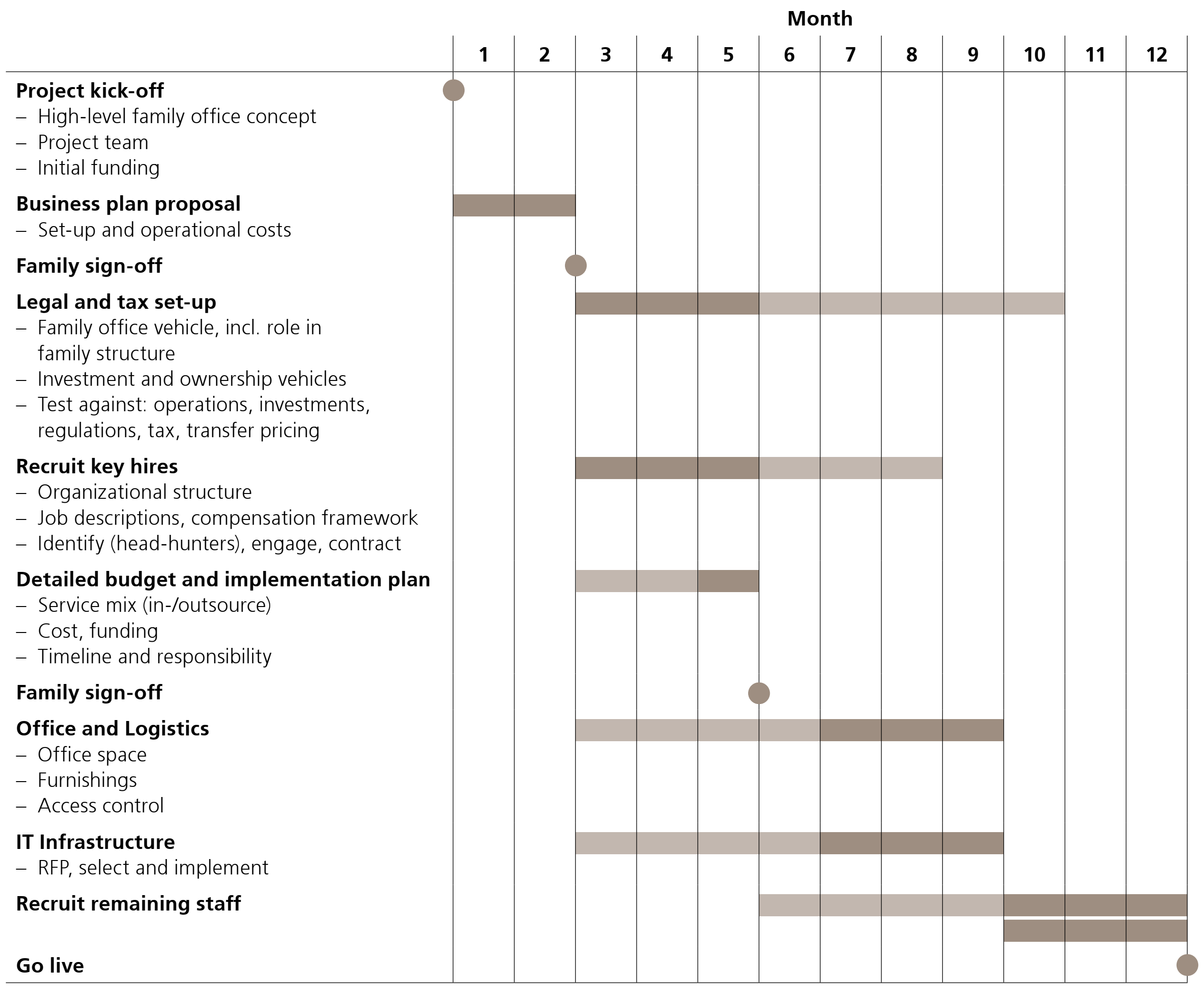
Appointing the project team
Who should be part of this team? In our experience, it makes sense that your team has some or all of the following:

- key family office hire – possibly the future Chief Executive Officer – to lead the team
- legal advisor to the family
- professional with a background in business operations
- a family office consultant
- key family owner, such as a family business leader or family governance leader.

Together, your team will have the legal, operational and family office skills needed to set up your office. Project teams are usually retained temporarily. In most cases, the team members already advise the family or work in the family business.

Planning implementation
To get started, the project team should develop a realistic plan, give responsibilities to its members, and set milestones. At each milestone, the team will update the family and request their agreement for key decisions. Figure 15 is an example of an implementation plan lasting 12 months. Some projects take longer, depending on the office's services, the family's complexity, and whether the office needs bespoke IT or investment structures.

Figure 15: Family office project implementation plan



Project team costs

What are the project team's costs when implementing the office? Typically, the costs will cover the team's professional fees for the next 12 months and charges for getting outside specialist advice, such as legal and tax opinions. During the year, the project team will identify the main start-up costs, such as office leasing, recruiting fees, and infrastructure investments. Generally, you will need at least USD 0.7 million to start a family office of any type. For your design, this figure may be too low, but it is probably not too high.

Starting an office is expensive, so it is essential the family agrees to and signs off on key milestones in the project and on any budget changes. The costs must also be clear to everyone in the family.

Creating a business plan

Now it is time to turn your family office outline into a business plan. A clear plan will help you communicate effectively with the family, hire key people, and convey your vision to important advisors, such as legal and tax experts. It will also help you keep the project on track and in budget.

Defining the plan

Your business plan should show: running costs; activities and services; infrastructure, reporting and control systems; and governance structure. You should consider whether the office will be a cost center or a profit center, and how the family office should be funded. A typical outline of the business plan includes:

- executive summary – including the family context and goals for the family office
- objectives
- governance structure
- activities and services
- information and reporting
- start-up, running costs and funding
- project team and start-up
- staffing requirements
- entry and exit
- appendices: investment guidelines, projected budget.

The project team will refine the business plan once it settles on the legal structures, hires people, finds office space, and chooses infrastructure. For now, it is a high-level business plan.

Start-up costs

How much will starting a family office cost you? Figure 16 shows example costs for a start-up family office with six employees in Zurich.


EL PAÍS

Figure 16: Example costs for a family office start-up in Zurich

Cost item		Start-up costs	Annual costs	Assumptions
Personnel	CEO	250'000	500'000	Assuming CEO is part of project team
	CIO		350'000	
	Analyst		100'000	
	Accountant		150'000	Accounting and archiving
	Operations	75'000	150'000	Assuming operations manager is part of project team
	Assistant		100'000	
Social costs			250'000	Including social costs, insurance, pension
Total			**1'600'000**	
Headhunter		100'000		3 months' salary of identified staff
Travel and entertainment			50'000	
Premises	Rent, services		100'000	125 square meters
	Furnishings	50'000		
	Refurbishing	50'000		
	Broker	25'000		3 months
	Deposit	50'000		6 months deposit
IT and Infrastructure	Hosting		20'000	
	Connectivity	8'000	30'000	Phone, data-line, internet
	Workstations	36'000	12'000	Depreciation over 3 years
Software & market data	Multibank reporting		75'000	3rd party bank
	Trading system		30'000	3rd party bank
IT maintenance			25'000	
External legal & tax		100'000	150'000	Legal and tax opinion, family office incorporation, plus on-going advice
Internal tax and audit			25'000	
General office admin			25'000	
Insurances			10'000	General property, and Directors and officers
Total		**744'000**	**2'152'000**	

Communicating progress
An important role of the project team is to communicate progress to the family, making sure the set-up matches everyone's expectations and goals. This ensures the family agrees to the project at every step. It also establishes good communication and professional processes between the office and family.

Setting up legal and corporate structures

Putting the right legal and corporate structures in place is vital for launching a successful family office.

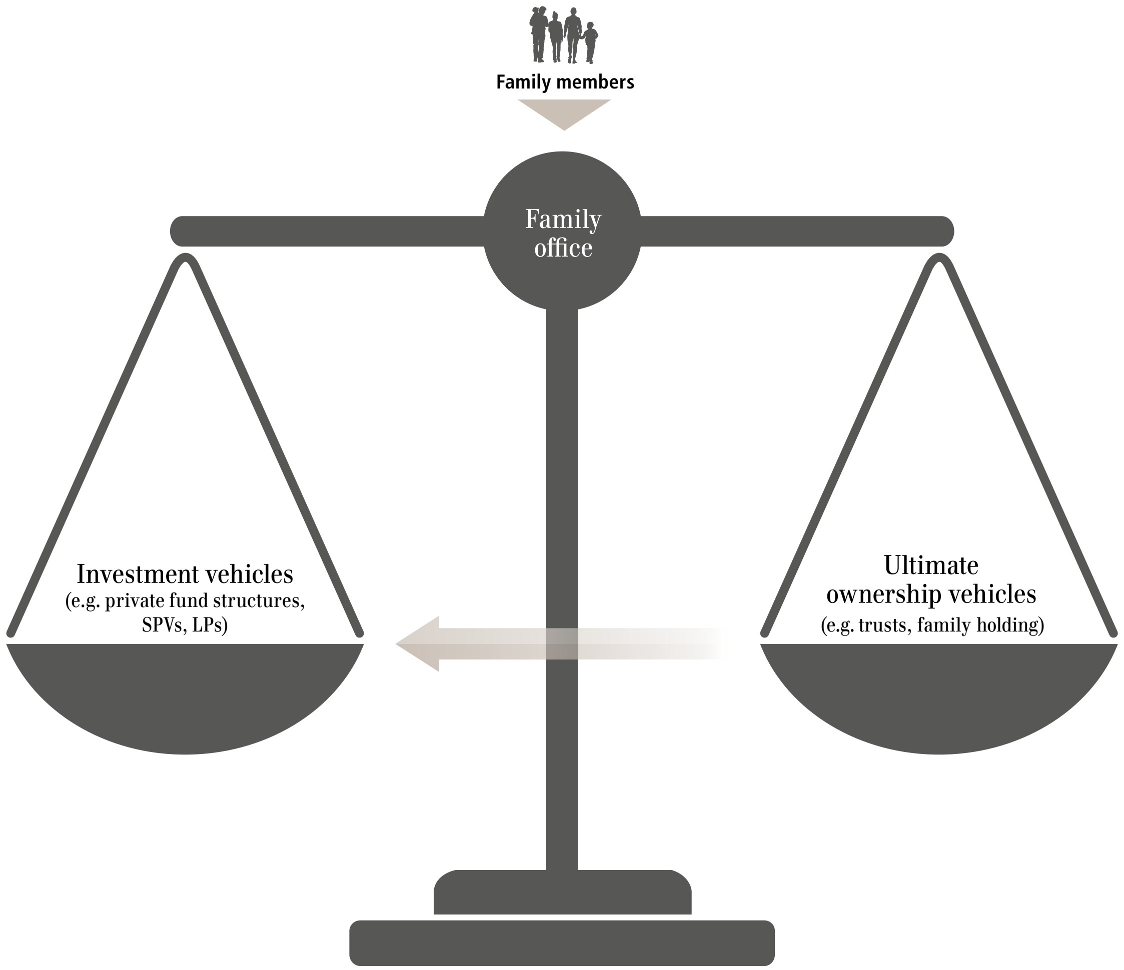
Checking the location
When the family has chosen a location for the family office, the project team should seek legal and tax advice to check it is the best choice. This will ensure you have considered all possible tax, legal and regulatory consequences.

Setting up a legal entity
Now you need to set up a legal structure so you can start hiring key personnel and contracting for advice and services. The project team should seek advice on whether the family needs specialized investment vehicles, and how existing ownership structures of family wealth will work in conjunction with the family office. For example, how will you structure the contractual arrangements between the office and asset owners?

Families must choose legal structures in at least three areas: the family office itself, the investment vehicles, and the ultimate holding vehicles. You should consider the following:

- Family office entities are typically set up close to the family and/or where there is access to professional talent; and taking into account regulatory issues.
- Investment vehicles are typically optimized for tax; asset protection; a favorable regulatory framework; and operational needs.
- Ultimate holding vehicles are typically structured to optimize succession (passing on wealth to the next generation); protecting and separating assets; and tax.

Figure 17: Considerations for legal set-up



Ownership and investment vehicles

- Type of asset class, needs
- Succession
- Asset protection
- Asset separation
- Tax optimization
- Regulation

The family office and business
Many families conduct their affairs through their existing corporate center in the operating business. These are sometimes referred to as "embedded family offices." This way of operating may be common in the early stages of the family office as a matter of convenience. This is also seen in situations of high growth, such as in emerging markets. However, over time, this may not be sustainable or advisable. Confusion may arise between the affairs of the family office and business. This can endanger the family's long-term wealth, as liabilities may flow from one area to the other, and confidentiality might be compromised.

Separating assets
It is best practice for families to protect long-term family assets by ring-fencing liability-prone family operating businesses from the rest of the structure. For this to be an effective barrier, it needs to be a substantive and not merely a formal distinction. It is also healthy from an operating point of view to keep these units discrete and judged on their own merits. It also strengthens corporate governance and prepares the way should the family wish to seek investors, sell, or publicly offer the business. Additionally, it shields the family's affairs from prying eyes in the operating company.

Separating investment vehicles
Depending on the nature of the investment activity, it may also be necessary to ring-fence investment vehicles to protect against possible liability and regulatory flow-through. Regulators tend to respect the right to manage one's own money. However, the situation changes when the particular activity is by its nature regulated or third-party capital is involved. Another area where caution is advised is when co-investing, syndicating, or engaging in other complex transactions which require strong internal governance between the parties and can pose a liability risk (e.g. assuming the position of lead investor could attract significant liability).

Ownership model
Will your family office be solely owned by the family or will you operate an entrepreneurial model giving key employees an ownership stake? If the family fully owns the office, then the office will typically operate as a cost center, and will be funded on a "cost-plus" basis. If (partially) owned by employees, the family office will typically run as a profit center. Both forms require sound contractual arrangements and legal advice.

Case story: Private structure

A southern European family established a fully owned family office in its hometown following the sale of the family business. The family office was staffed with investment teams with expertise to manage funds across various asset classes.

Liquid assets were structured and held in a private fund structure in Luxembourg. The family held the fund units through trusts which were set up for the different family members. This solution provided several benefits to the family members: pooling of interests by family members in a professional regulated entity, tax optimization, asset protection, and facilitated succession planning.

Case story: Embedded family office

Family office services were provided by the family holding company and charged at arm's-length distance to the family members. Family members held the liquid assets directly without using any legal ownership entities. This reflected the view of the founder that the family should take common decisions regarding their jointly held business assets, but that the family members should take control and make decisions individually on the allocated liquid assets. In this context, additional investment vehicles for liquid assets did not provide any additional benefits for legal, tax or asset protection purposes.

Case story: Keeping things simple

A family chose to structure the family office as if it was one operating business owning the assets. The family appreciated the simplicity of the structure and that the activities were auditable within one single legal entity.

Hiring key people

Now the project team must refine the organizational structure, identify and select key hires, and develop consistent compensation structures for the professionals working in the family office.

People are the greatest asset in any organization and this is particularily true for family offices. Lean structures are even more reliant on the individual quality of their people. This can be a game changer and perhaps the most critical step in the creation of a family office.

Refining the structure
We recommend you start with a small team, which you can expand once your office is up and running. Many family offices lose their way after their first hires. Make sure you are focused on the office's main mission and purpose from the start. Laying these foundations will help your office stay focused over time.

For the key hires, you need to draft job descriptions so you can start interviewing potential candidates. As you start shortlisting candidates, think about the combined skills in your office. Complimentary skill sets are critical in small teams. The graph below, Figure 18, shows high-level job descriptions for the most common family office functions.

Figure 18: Brief job descriptions for family office employees

Function	High-level job descriptions	Example of day-to-day tasks
Executive management		
Chief Executive Officer	– Exercises overall leadership and control. Implements strategy and manages performance, costs and risks of the family office	– Implements strategy and key policies. Selects and evaluates key people. Primary family interface/liaison and family office representative
Chief Investment Officer	– Defines and executes investment strategy including asset allocation and policies. Reports and communicates performance	– Leads investment deal team. Selects managers, oversees research, evaluates performance. Leads investment committee
Chief Financial Officer	– Financial control of family office and family budget, accurate reporting (corporate and family), liquidity planning and family funding	– Supervises budget process and general accounting, billing, and auditing. Reviews financing arrangement. Provides transactional support
General counsel	– Control of tax and legal affairs for family office and family clients. Role in transactional deal teams	– Tax and legal advice, estate planning, tax declarations, contracting and transactional support
Investment management		
Portfolio manager – liquid	– Manages portfolio of liquid assets for family members according to set policies. Submits investment proposals to Investment Committee	– Monitors markets, research, implements allocation changes, reviews performance
PM – direct investments	– Manages direct company participations	– Sources and executes deals, active board participations, exits holdings
PM – private equity funds	– Manages and builds portfolio of private equity funds and hedge funds	– Selects funds, monitors performance, reviews benchmarks, controls performance, makes exits
PM – real estate	– Manages real estate portfolio held for investment, speculation and re-sale (transactions, financing, refurbishment, operations)	– Sources and executes deals, supervises property managers, cash flow and payments
Analyst	– Supports CIO and portfolio managers	– Research, sourcing & drafting investment proposals. Transactional support
Finance		
Senior accountant/controller	– Financial control and accounting – family office corporate, family members, asset holding or investment entities	– Manages delegated functions
Junior accountant	– Supports financial controller	– Daily bookkeeping, payments, cash management, supplier control
Human resources		
HR manager	– Develops policies and program for the family office. Recruits and develops work-force	– Compensation strategy, performance measurement, talent development, compliance
Fiduciary		
Company secretary/Trust and company administration	– Administers ownership structures (trusts, Cos, SPVs, foundations, private funds)	– Reporting, returns, compliance, authority liaison. Minutes, resolutions, record-keeping

Function	High-level job descriptions	Example of day-to-day tasks
Operations/General		
Office manager	– Controls the operation and maintenance of office infrastructure. Insurance management	– Upkeeps functioning of infrastructure and IT. Selects providers
Archive and records	– Centralized record-keeping and archive for the family	– Data and document management
Physical asset management	– Safekeeping and maintenance of specialized high-value assets (real estate, boats, aircraft, art) – Manages art, antiques & jewelry collections – Manages fleet of aircraft for family use – Manages family real estate – not held for speculation or re-sale	– Due diligence, valuations, restorations, insurance, storage, transportation, museum loans – Maintenance, crew, insurance, sub-charter, regulatory, payments, usage allocation – Maintenance, staff, security, insurance, legal/permits, tax, payments, family usage allocation
PA – lifestyle and concierge	– Organizes family members' travel, homes, leisure activities	– Organization and bookings, payments, security
Philanthropy	– Coordinates family philanthropy projects (vision, strategy, structure, implementation)	– Selection and monitoring of projects, due diligence, payments
Family governance*	– Organization of internal family meetings and education events. Upkeep of regular communication channels – Promotes business or social entrepreneurship in the family by supporting start-ups	– Venue organization, agendas. Education program management, coaching of family members. Family intranet, update calls, newsletters – Practical mentoring and coaching, financial support in form of loans or donations

*Family governance functions may not justify a dedicated headcount and tasks are distributed among other staff instead

In the appendix, you can find examples of more detailed job descriptions for the Chief Executive Officer and the Chief Investment Officer.

Competence and family fit
Family offices usually recruit through their professional networks or a recruiting firm. Your family's networks might include business peers, investment connections, past colleagues, and executives from the family business. Families typically look for hires with prior experience in the finance industry, management, or a profession such as law or accounting. In addition to technical skills, a personality fit with the family is very important. The family needs to trust the individuals and allow them into their inner sanctum and thinking. So, families need both competence and trust, which is not always easy to achieve and trust is a difficult element to recruit for. After the project team has evaluated and pre-selected candidates for key positions, we recommend involving a few family members in the interview process.

Ensuring integrity
As the family office represents the family to the world, integrity is a vital quality of any team member. Family offices must rigorously reference-check people, focusing on their integrity in addition to business credentials. The office should remain rigorous about integrity throughout its life.

Chief Executive Officer
The ideal Chief Executive Officer for a family office has strong professional skills and broad general abilities. This person should feel comfortable being involved in various projects at the same time. Look for wide-ranging capabilities, such as technical and interpersonal skills, attention to detail, and the ability to work strategically. If your Chief Executive Officer is interacting with the next generation, they will also need teaching and communication skills. This is because senior family office figures are often seen as mentors to, and connections between, family branches and generations.

Previous family office experience
What weight is given to previous family office experience is debatable and dependent on the seniority of the role. Previous experience of working for a family enterprise can be useful, but for those at the top, experience with the particular family creating the family office is the trump card. This direct experience with the owning family is to be valued more than experience gained with another family, even if analogous. Besides that key high-level family interface, the majority of positions in a family office should be on professional merit.

The personal touch
It may be difficult to attract certain talent to a family office as the career path is seen as limited. However, family offices can offer an attractive working environment that is a welcome change from large organizations. There is direct responsibility, stability, smaller teams, less bureaucracy and a very identifiable client/owner group. Additionally, people can enjoy working in an organization with a personal identity, rather than serving faceless public shareholders. This can be gratifying for the right candidate, particularly if the family is iconic.

Creating a compensation framework
You need to develop a rational compensation framework, as it will influence your family office over the long term. So, it is vital you seek professional advice on what is legally required and allowed in your operating jurisdictions. You also need to consider how the compensation framework will operate. The goal is a framework that operates within the law and allows you to attract, motivate, and retain talent fairly. Your challenge is to balance the framework across professional disciplines that work, think and compensate differently. For example:

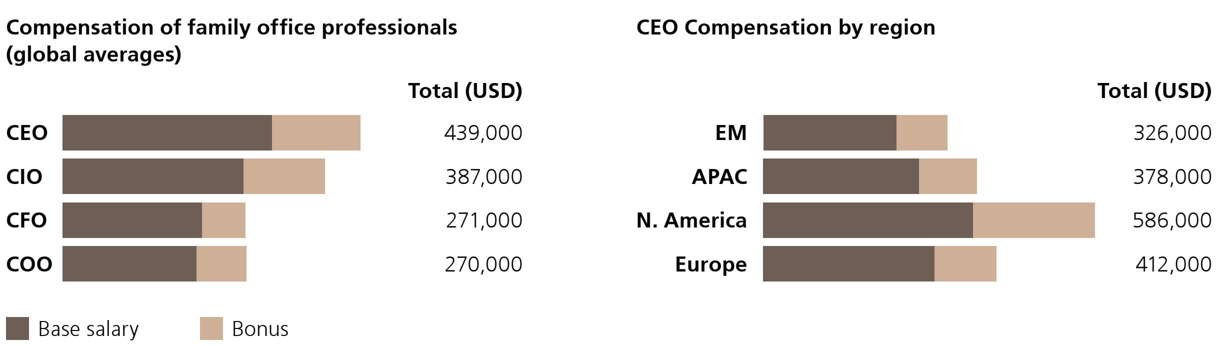
- legal and other professional or administrative services measure value as time spent at a set rate. These professionals are typically paid a base salary plus bonuses based on billed hours.
- investment professionals measure value on the performance of assets under management. They are typically paid a base salary plus bonuses based on how well the assets perform.
- private equity professionals receive a base salary plus bonuses based on profit from exited investments.
- investment bankers receive a base salary plus bonuses based on mergers and acquisitions deal volumes.
- concierge or lifestyle employees receive a base salary plus bonuses linked to client satisfaction.

It is tempting to offer whatever it takes to attract the best people. Will you do the same for all staff? And if not, how will you justify the differences? Generally, compensation for people in family offices is in line with what they would receive in their profession. So, it makes sense to benchmark the role to the professional market in that region, then decide what you want to offer. You may want to compensate in the upper quartile but not necessarily at the top.

Some family offices consider paying a premium, as they cannot offer people opportunities to advance their careers; and because they are removing the candidate from the professional mainstream. However, before paying a premium, consider the attractiveness of the overall family office offer in the context of some of the non-material aspects previously discussed.

Figure 19 provides insights into the base salary and incentives for top family office staff, and the significant regional differences.

Figure 19: Compensating family office staff



Source: UBS/Campden Global Family Office Report 2016

Non-cash benefits
To attract, motivate, and retain talented people, non-cash benefits are important. Healthy packages with generous benefits (such as pensions, medical insurance, and cars) – and the opportunity for people to balance their work and lives – are attractive. People may also value the chance to escape the mainstream corporate rat race, and be loyal to family owners they identify with.

Paying bonuses
To motivate and retain people, bonuses are important. Family offices use various types of bonuses, including a 13th month's salary and guaranteed, performance-linked, and discretionary bonuses. Often, the role dictates which type of bonus is suitable. For example, a concierge professional or personal assistant will have a different base from that of an investment manager. We find that most family offices will pay discretionary bonuses based on various factors. Very few offices use purely formulaic bonuses. We have seen offices calculate investment manager bonuses in three ways: on a percentage of portfolio performance; on portfolio performance above benchmark; and on realized profits on private equity deals.

Participation and entrepreneurial structures
Some family offices use participation and entrepreneurial structures to compensate key staff. These structures encourage team members to become personally involved in the family office and align their interests.

For example, senior staff may invest their own money alongside the family. However, this may frustrate senior employees who do not have the resources to do so. It may also create a conflict of interest for a family office executive with a shorter-term investment horizon, compared to the family's longer-term ambitions.

Additionally, key employees are sometimes given a stake in the family office or, more rarely, in family group companies.

Deferred compensation
Since the financial crisis, the global financial industry and family offices are increasingly measuring performance over longer periods (three to five years) and deferring some compensation elements to a future date. Typically, this involves deferred payment schemes, phantom stock (a contractual agreement to pay cash in the future tied to the market value of shares), and non-cash benefits. Deferred compensation schemes are attractive as they help align interests, manage risk, and provide the opportunity to claw back some remuneration.

Long-term incentive plan arrangements typically pay people part of the award in immediate cash, with portions vesting in a few years. An employee benefit trust is one extreme form of this, providing a long-term vesting payment on retirement. The ownership of the assets of the employee benefit trust is never transferred to the employee outright in the short term; the assets are owned by the trust and are subject to trustee discretion until vesting, which gives the employer some control.

Case story: Team players

An entrepreneur searched his network to hire professionals for his new family office. The focus of the family office would be to conservatively manage excess liquidity arising from the operating business. Funds would be invested in reputable private equity funds and, to a lesser degree, promising new businesses. He also wanted to centralize administration for the family's real estate expenses in various jurisdictions, and schooling and allowances for the children. As his children would soon start careers in different countries, he wanted to establish structured estate planning.

The entrepreneur planned to be active daily in the family office, but wanted to develop an organization that would eventually operate well without him.

So: whom to hire? The Chief Executive Officer position was offered to the Chief Financial Officer of the operating business who had been planning retirement. Instead, he was persuaded to take on running the family office. The Chief Executive Officer was suggested to transition with his personal assistant, capable of taking over a number of administrative tasks in the family office.

The entrepreneur and Chief Executive Officer agreed on three job descriptions for roles an executive recruiter would fill: an investment manager for the liquid assets; an investment manager for the private equity investments; and an accountant to manage the family's bills and expenses. The Chief Executive Officer initially supervised and outsourced the legal work relating to estate planning and tax returns in different jurisdictions. The entrepreneur oversaw the new ventures, with initial support from the Chief Executive Officer.

The recruiting firm presented five candidates for each position. Within six months, the entrepreneur and Chief Executive Officer offered roles to candidates, which were accepted. The recruiting firm also advised on market pay levels and compensation structures. Specialist legal advice was retained to ensure that the contract documentation with the new professionals included the most rigorous clauses on confidentiality and ethics considering the delicate nature of the work in a family office.

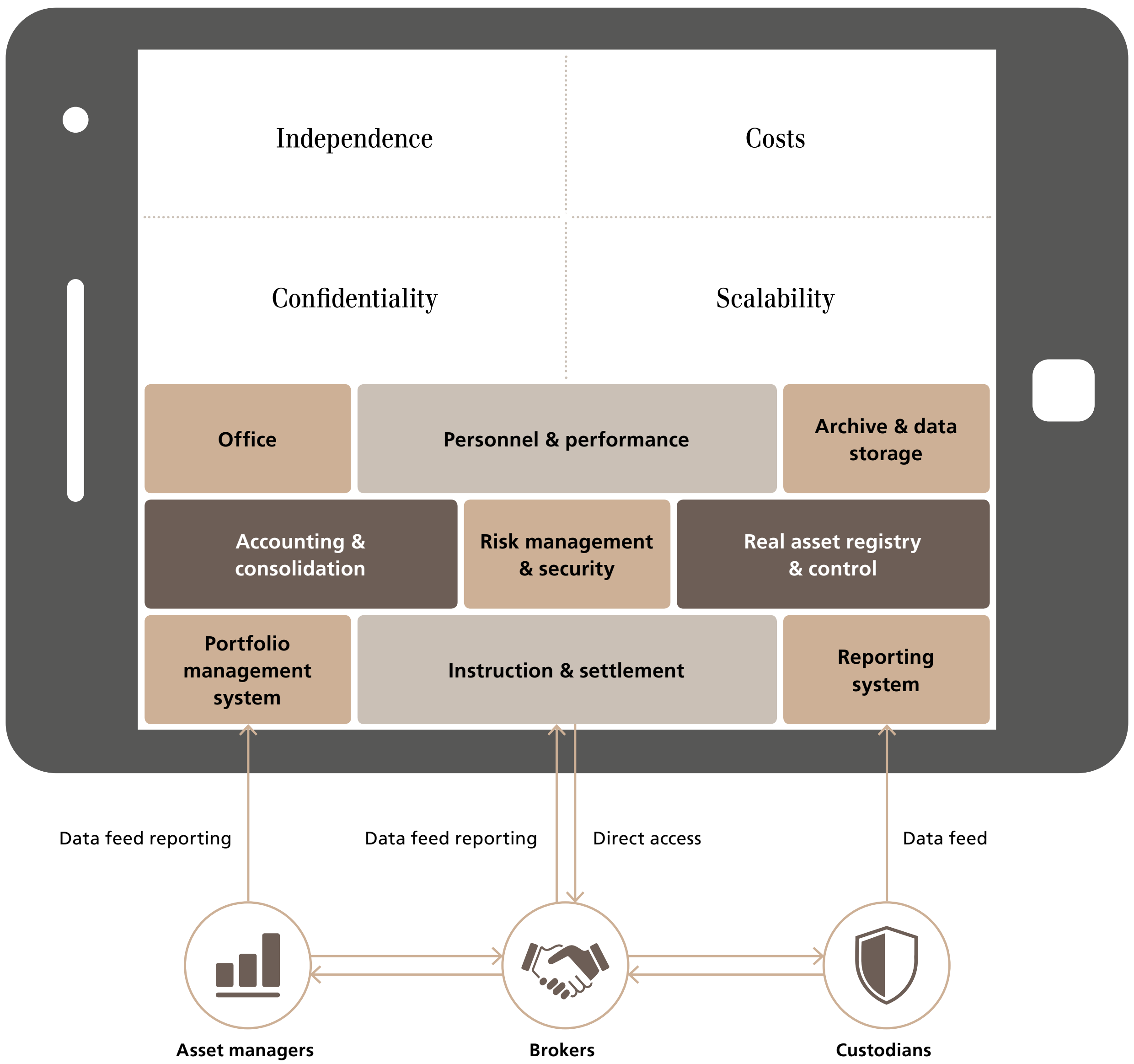
Getting the right IT infrastructure

Information technology (IT) is an essential component of any family office. Properly managed it will increase control, efficiency, long-term information retention and improve decision-making, while giving the family more transparency of its true wealth. It is the cornerstone of any build offering concrete benefits but also challenges.

Counting the costs
IT comes at a high cost, and the pace of development means the initial investment inevitably needs to be followed by further investments just to keep up. The professional skills required to design, operate, maintain, and continually develop systems and information architecture are not cheap or always easily obtainable. You need to decide whether you establish these skills within your organisation, seek them outside or a combination of the two.

IT also represents a potentially very damaging and quickly evolving cluster of risks. In addition to cybercrime, IT faces rapidly changing risks to family data, confidentiality, reputation, and information architecture. The level of preparedness to meet these threats and the cost of doing so must be factored into your planning. Also, consider that the typical financial or administrative staffer is probably not up to the challenge and at the very least may need to be bolstered by external support.

Figure 20: Frequently used IT systems in a family office



Strong foundations
Your family office needs office infrastructure like any other company. You may be able to use your existing family business' office solutions, as it makes sense to leverage and clone what already works. This is a great way to fast-track development, and to get expert input. However, you may not be able to continue this long-term, due to confidentiality and asset protection.

You probably acquired people or service providers around your private work long before contemplating a family office. You must consider these pre-existing structures. It makes sense to conserve and build on what already works as far as possible. But existing infrastructure must be properly integrated into the family office.

Accounting and tax
You will need specialist IT for consolidated accounting, tax, and estate planning. This may include software for accounting, ledger, consolidating, writing reports, and preparing tax. If you are operating across various jurisdictions, you will also need to integrate different standards, regulations, and practices into your IT. This can be challenging if you have multiple IT systems.

Archiving data
If part of your family office's objective is to create a secure repository for key family data for the future, you need to exploit some of the electronic solutions available. This will allow you to create a massive record which is almost instantly accessible. With the ease of scanning and converting the data to electronic format, this could extend back into the depths of family history. We recommend you develop a data archive plan.

Aggregating data
Output is only reliable if you have high-quality input. Filtering is critical to ensure that all the data produced by various systems does not add to the confusion, but rather supports efficient management and decision-making.

Family offices can choose to use data aggregation services, software, or tools to filter and improve the quality of the data. This can be introduced at various levels – investment, operating company, or global wealth picture. It can be a stand-alone system or integrated into IT tools.

Choosing investment tools
Your family office may need special IT tools to support its investment activities. But which suite of tools is best? How much of this can you bring in or develop yourself? You can choose between doing everything in-house, outsourcing entirely, or combining the two. To meet your unique needs, you may find you have a mix of in-house and outsourced tools, which include effective off-the-shelf solutions.

Generally, you can better control anything you do in-house. However, you will need to build capacity in your team and control operational issues, which can be costly. You will usually have less control when you outsource, but you will need a smaller team. Even when using outsourced solutions such as custody and multibank reporting, you will need some internal capacity. Outsourcing will also shift the operational responsibility to the provider and fix the costs to the contract amount. The challenge is to ensure that the service provision remains at the promised level.

The real wildcard is in-house development, where the family office creates its own systems from scratch. This is only advisable where IT is a core strength of the family; or if your needs are so complex that no external solution could meet them. Developing tools in-house can be costly and incredibly time-consuming. In the end you are tied to one developer, will pay for any further development and might be unable to obtain maintenance skills in the market because the system is unique.

Figures 20 and 21 show the main IT systems that family offices most often use. Figure 22 shows how asset size generally drives the family office's choice of IT.

Figure 21: Main IT investment solutions

Global custodian	– One custodian bank consolidates the reporting from the assets managed by several portfolio managers (and/or other custodian banks in the case of multiple custodians). – Cost effective solution that has the attraction that the operational issues are borne by the custodian holding and servicing all the assets. The best custodians are well-established, regulated, and have long experience servicing large institutionals. – Advantages of global custody: • cost effective 24/7 access to updated, consolidated information on all securities • transparent overview in uniform format • assets can be managed by the custodian or other portfolio managers/banks • overview can also include non-bankable assets such as RE, mortgages, art collections • additional services by global custodian typically include performance and risk analytics, cash management solutions, and investment accounting
Multi-bank reporting	– Consolidation of the reporting by several banks or asset managers, typically monthly, allowing the family to get a consolidated view of all the asset managers. This is usually a static report (one point in time) and does not require custody of the assets. Provided by some banks and specialist reporting providers.
Specialist proprietary software	– Software specially designed for the family office market. Some systems are intended to provide a solution from front to back office, with capabilities from reporting and investment accounting to portfolio management and settlement. Other products are more focused on one aspect such as reporting. There will be an installation cost and varying annual license fees depending on how many workstations are required.
Trading tools and execution management	– Capabilities around portfolio management and trading systems, required should the family office wish to bring much of the investment in-house.
Portfolio management	– Core of operational structure, as well as acting as books of record. Provides NAV and P&L reporting, cash management and reconciliation, corporate actions, and third-party integration.
Execution management	– Direct market access trading connectivity, functionality, and market data.
Order management	– Direct market access trading connectivity; settlement and rebalancing; compliance; allocation and modelling.
Risk management system	– Stand-alone tool rather than risk functionality incorporated via custodian, specialist software or reporting service.
CRM	– Tools to manage information of family members (if large and complex family).

Figure 22: Approach to reporting, managing risk, settling, and archiving

Up to USD 50mn	50–100mn	> 100mn–500mn	> 500mn
– Manual consolidation and reporting, using standard software such as MS Excel or Access – Manual risk and performance monitoring. Risk management usually performed at basic level – Records on paper or archived on a hard disk by person doing the reporting – Settlements done manually (e.g. fax, phone, email)	– Semi-automated, with a consolidated reporting system from third party providers – Risk analytics available to varying degrees depending on provider systems – Records still in semi-paper form, online platform with higher back-up levels possible – Settlements done manually (e.g. fax, phone, email)	– Global custody and prime brokerage from third-party provider or a highly tailored installation of a third-party reporting system – Performance and risk monitoring done electronically based on fully automated platform – Records available online with highest level of back-ups – Online settlement process	– Possibly global custody or more than one custodian and prime broker or an installation of a third-party reporting system, or in-house developed proprietary IT system – Performance and risk monitoring done electronically – Records available online with highest level of back-ups – Online settlement process

Future proofing and review
With the high level of initial and ongoing investment that the fast pace of IT demands, the goal is to ensure that your infrastructure is as future proof as possible. This is easier said than done but a rigorous review cycle can improve the odds.

Disciplined use of output
The most sophisticated systems can easily give you a false sense of security. However, the IT tools are only as good as what you do with the output. Disciplined and structured processes for analyzing and acting on the information is essential to maximize the value of the data. This is analagous to the discipline required for effective risk management – data must be recorded, analyzed and acted upon in a structured way. Only once it is properly analyzed can the data guide forward-looking action.

Case story: Outsourcing services

A large Middle Eastern business family with substantial cash wanted a family office to professionally manage assets, and provide the right professional structure for estate planning across the large family.

The family outsourced global custody services to a third-party bank, which ensured the office's performance was objectively reported. The custody service arrangement included full reporting and online risk management and trading tools. The family office combined these IT tools with another third-party portfolio management system. This system, which was from an independent software vendor specializing in family offices, enabled forward modeling and stress-testing.

Choosing partners

Your family office needs to manage, coordinate and control a range of external service providers. These providers can include law firms, private and investment banks, asset managers, accounting firms, independent software and hardware companies, and recruitment firms.

Retaining advisers
Most families of the scale to consider a family office are well served in a number of areas. In addition, many of their operating entities will have access to high-quality support. This is an excellent opportunity to conduct a quality review of the family ecosystem. Retaining well-performing trusted advisors is preferable from a legacy and continuity perspective. However, you need to ask critically whether they are up to the family office challenge, which may be radically different from their previous experience in terms of activity and jurisdiction.

Law firms
High-quality legal support is essential to the family office throughout its lifecycle: from advising on its location and creating the structure and contracts; to supporting transactions, tax, and estate planning; all the way to liquidation and wrap-up.

The continuity of legal advice is important, due to legacy issues and complexities which may have grown over time. The challenge is whether law firms truly can advise across the entire piece or whether there is a need for supplementary advice in particular jurisdictions or areas of activity. Good in-house legal advisors have the skill to know when and where to source and how to manage additional legal expertise required in new jurisdictions and specialist competence areas.

Banks
Investment and private banks play a central role in developing the family business and family office. Banks are a key partner for investments, offering skills and access to finance; and services including global custody, consolidated reporting, analytics, direct trading, and research. To avoid expensive in-house IT solutions, you can buy off-the-shelf IT investment tools from banks. Your family office can also call on investment banks for sourcing deals, financing, advising on corporate finance, and executing transactions.

These days, family offices demand more from their banks. As such, elite banks now offer global investment opportunities, multi-shoring capabilities, specialist products, deal flow, and investment banking solutions. A family office typically works with one to six banks. Some of these banks perform specific roles that match their strengths.

Asset managers
The majority of family offices prefer the depth of knowledge and expertise that asset managers provide in specific asset classes over developing internal expertise in everything themselves. The prevailing approach is to outsource tactical allocation and instrument selection to various specialist firms rather than rely solely on one counterparty. A family office typically works with five to ten asset managers

Financial accounting
Most family offices have internal accounting capabilities and bring in experts when they need them. Accounting firms often support family offices when they are setting up and hiring key people, and during times of pressure or crisis.

Audit firms
Not all family offices arrange external audits; however, many value them highly. Families can gain peace of mind from objective scrutiny and when receiving advice on establishing adequate financial controls. This is especially valuable when the family's ownership is complex, with varying interests, involvement, and levels of understanding.

IT
Good IT support is essential. Even if you decide on building internal capabilities you will need external providers who can help supply highly specialized and new IT solutions.

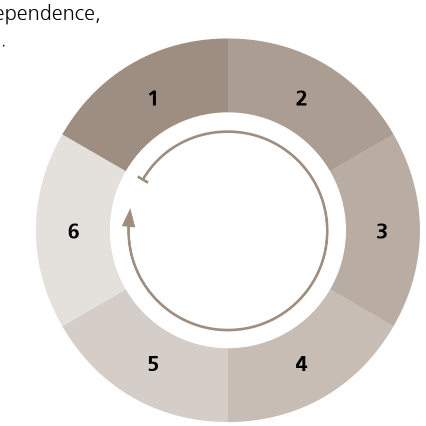
Family advisors
Many forward-thinking families and their family offices which are planning for multiple generations engage advisors to the family and the family enterprise in a number of spheres – from aligning family vision and family governance, creating a family office, to developing and integrating their next generation. Advisors are also able to foster learning and best practice-sharing through peer exchange networks and platforms.

A structured process
When selecting service providers, you should follow a structured process. Family offices frequently use a request for proposal (RFP) process when choosing counterparties. The process specifies your criteria for evaluating providers, your approach, and your due diligence questions. The due diligence questions typically cover:

- organization, team and culture
- investment strategy and process, risk management, and track record
- implementation, reporting, and transparency
- fee proposal.

Figure 23 shows an example of a RFP process for IT.

Figure 23: RFP review cycle



Step 1
List infrastructure requirements based on functions to be performed, considering the factors of efficiency, scalability, independence, costs (and any other considerations).

Step 2
Define **evaluation criteria** to evaluate the best fit.

Step 3
Launch a formal or informal **request for proposal** (RFP) from a few service providers.

Step 4
Review proposals, interview and vet different service providers in a structured process.

Step 5
Perform a **cost-benefit analysis** evaluating qualitative/quantitative factors of the proposals received. **Select providers.**

Step 6
Consider re-launch of a RFP every 2–3 years to ensure their systems are **best practice** and in keeping with the latest market developments. Review pricing and service annually.

Acting on your plan

Congratulations. Your project team has enabled your family office to start operating. The team has created the family office's legal entity, chosen key people, signed the office lease, chosen IT infrastructure, and appointed its main partners. Now it is time to put your plan into action.

The start of this chapter explained why it is important to have a detailed implementation plan where the family can agree and sign-off on major milestones. In our experience, a professional team and an enthusiastic family will help make sure your office is the best it can be.

In the next module, you will learn about the important components needed to run the family office – guided by the family and your management team.

Round up

Appoint your project team, which will typically include:
- Key family office person to lead the team
- Legal advisor
- Professional with business operations background
- Key family owner

Create a business plan, including:
- Running costs
- Activities and services
- Reporting and control systems
- Governance structure

Set up legal and corporate structures:
- Seek legal and tax advice on office location and structures
- Separate assets from family businesses
- Consider separate investments vehicles, if applicable

Hire key people:
- Start with a small team which you can expand later
- Write job descriptions
- Balance skills and personalities
- Ensure integrity
- Create a compensation framework
- Consider non-cash benefits; bonuses, participation and entrepreneurial structures, and deferred compensation

Get the right IT:
- Consider starting with systems already established in the family business
- Specialist IT for consolidated accounting, tax and estate planning
- Choose investment tools
- Aim for "future-proofed" systems
- Use output correctly

Choose partners:
- Law firms
- Banks
- Asset managers
- Financial accounting firms
- Audit firms
- IT support

Module 3

Operate

Running your family office

Managing and controlling your family office

So, let’s recap. In Module 1, you outlined a family office with a clear purpose and mission statement. In Module 2, you formed an executive team, chose external partners, and set up IT infrastructure to deliver services to the family. This module gives you the tools you need to manage and control your family offices.

Ensuring good governance
In the corporate world, good governance is essential. It drives well-controlled, efficient operations, and is an inherent duty of trust to the owners. Governance should be particularly robust in light of the significant responsibility borne by the family office and the need to protect both family wealth and reputation.

Family office governance should:

- oversee activities to ensure they are properly authorized and well controlled, matching the appropriate risk, compliance and cost parameters; and
- ensure the office’s goals and mandate match the family’s vision, including when it evolves as the family changes

Reasons for failure
It is surprising how many wealth owners lack effective control of their family offices. We often see CIOs or investment teams running the family office with minimal oversight. Why do families take such risks with their wealth? There could be various reasons:

- The family’s role is poorly defined, encouraging a misplaced belief that a family member’s mere involvement is effective governance
- Wealth owners resist controls or restraints on “their” money and want freedom to act as they please
- Lean, cost-sensitive organizations oppose the formality of governance layers and the perceived costs that come with compliance and oversight
- Families may avoid oversight due to privacy concerns
- Family office teams are often focused on the investment activities, with little capability or capacity beyond their specialist process
- There may be confusion about the different levels of governance in a family office and their interrelation

Applying governance
Governance is misperceived by some as an impediment to business. However, properly applied governance enables safe, well controlled action that is in line with strategy. Effective governance provides the owners with a process for oversight, direction and discipline, which leads to higher-performing family offices.

Clarifying the family's role

The governance of a family office is more complicated than for a typical company. The prime difference is the role of the family – it is the main client, the owner, and is often involved in the day-to-day management of the family office. The overlap and blurring of these stakeholder groups can be confusing and a source of conflict. The well-known family business maxim, "Treat business like a business and treat the family like a family" needs further consideration when the family *is* the business.

Choosing the right approach
The stage of the family in its evolution and complexity is material to the appropriate choice of governance. When the first generation founder is involved in the management of the family office, governance routines are usually less formal. Many family office executives serving such a founder emphasize the need and importance of excellent communication over formal measures.

However, in later stages, when the family office serves a more complex family with multiple generations or branches, it is advisable to install formal governance mechanisms. These should include at the minimum a formal management board, investment committee, and investment guidelines. Formal governance ensures that the complex family as a group - hopefully with one or a few clear family leaders - are the stewards of the family wealth and make the key decisions. Not putting a clear group decision-making mechanism in place can lead to either leaving these decisions to non-family professionals or may result in inaction.

Considering family roles
The family must also consider the role played by individual family members within the family office. A skilled and committed family member prepared to get involved is a great benefit but can also complicate matters. The advantages are quick, direct action and involvement of an owner in the thought process. Difficulties arise in the accountablitiy of those family members involved in the family office vis-à-vis the broader family group. Depending on how family members are selected for roles, there may also be concern about the family member's suitability for the role.

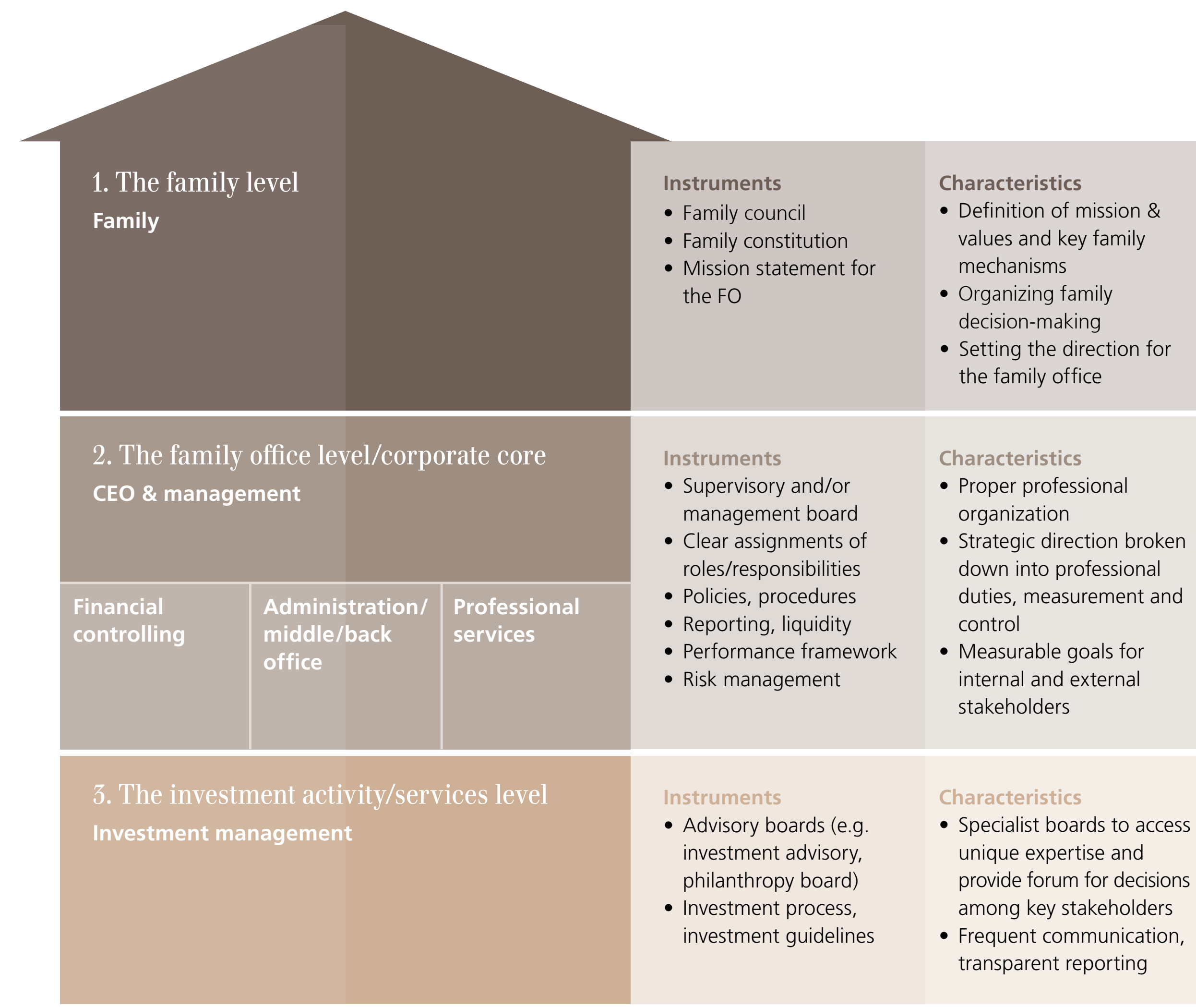
So, the family must establish how it will manage family members. How should they report back? What are their authority limits? This is particularly relevant for family offices that represent the many interests of large multi-branch families.

Informal guidance
Informal guidance from a family member has the advantage that it can enable rapid action by the professional team and provide critical clarity or nuance to instructions. However, the disadvantage is that such guidance is unrecorded and open to interpretation, which may result in difficult "that is not what I meant" discussions.

Addressing the right level

Another source of confusion is the poorly defined use of the term governance. As the family office stands at such a unique nexus of family affairs, governance needs to be specified at three different levels: the family, the family office corporate, and the activity/service level. The different governance instruments used at these levels are illustrated in the figure below.

Figure 24: Governance levels in the family office



Integrated Governance

Each family has its own governance structure with decision-makers and processes. Ideally, you should clearly separate governance between the family, the family office, and the operating business.

What is important for the family office is that the links between these entities are thought through, well-structured, and the role of the family office is well defined. The goal is to maintain independence yet achieve good coordination, so that the entire family enterprise system functions as an integrated whole.

The family needs to answer these questions:

- How will the family office interact with other family governance and ownership structures?
- What is the family office's role regarding the operating business, and how can it act as an effective bridge between the family and the operating business?
- How will the family ownership group communicate, consider and approve the family office's decisions and activities?
- How will the family office ensure excellent communication mechanisms and maintain trust with the family ownership group?

Governing the corporate level

The corporate vehicle which houses the family office should be designed with efficiency and governance in mind in terms of composition, organizational structure, and operating parameters. The family office, like any professional organization, needs to have a clear strategy broken down into professional duties and measurement and control processes. The family's preferences and experience, and the regulatory environment, will drive this.

Answering questions

The corporate level's governance structure should address these questions:

- Have we clearly communicated the family office mission and strategic plan?
- Have we clearly assigned the roles and responsibilities between the board of directors, management team, and professionals?
- Have we specified the key goals or outcomes?
- Are the key goals linked to measurable outcomes?
- Are we measuring performance against these goals?
- How do we perform control and surveillance functions?

Governance and Control Mechanisms

You can adopt different measures, depending on the size of your family office operations and what you feel is reasonable. Measures typically involve the following:

- **Mission statement** – This should be clear enough to allow you to set goals, operate, and measure performance.
- **Company founding documents** – These are the legal documents you need to create your family office. They define your office's composition, decision-making powers, authority limitations, and roles and responsibilities of the board of directors. They also align with your office's mission statement and strategic plan.
- **Board of directors** – The board should guide, oversee, and strategically direct your family office. Where appropriate, the board delegates its responsibilities to the executive team, committees, or employees.
- **Authorizing documents** – These include resolutions, powers of attorney, contracts of employment, and committee terms of reference.
- **Executive/management team** – The team is responsible for daily operational control. It organizes the family office's internal structure with clearly defined roles, responsibilities, and accountability with appropriate reporting lines.
- **Guidelines, policies and operating memorandum** – Family office management should draft and implement an operations manual with clear operating policies and procedures. The board should formally approve these policies. The policies can include investment and risk guidelines, HR (such as employee contracts and compensation), account/mandate limitations, outsourcing policies, succession planning, data security, and confidentiality.
- **Standard operational processes** – These include investment, internal control, budget approval, and reporting processes.
- **Committees** – These ensure that each specialist subject receives focused attention and that delivery takes place to set schedules. Here are some important points to remember:
  - Clearly define the committee's formation, scope, and duties.
  - There are various ways to establish committees, such as specialized by function/activity, asset class, subject, or geographical focus. Examples of committee types include management/executive, investment, audit, finance, insurance, risk, third-party business, legal, education, aircraft, and equestrian.
  - Management and investment committees are the most common committees.
  - Committees can oversee decisions closely. However, they can be slower to act and lack personal accountability.
  - Family members can have positions on committees, which helps them gain understanding.

- **Financial control** – Manage costs through a strictly controlled budget process.
- **Audit function** – Governance and company law may require the appointment of independent external auditors. Many families seek the extra comfort of an objective verification of the office's operations. For the families that require additional control to the external audit, you could consider establishing an internal audit function. This should operate independently from line management and report directly to the board of directors.
- **Code of ethics** – Executives and officers need documented acceptance (by contract or policy) of ethical and regulatory constraints. These areas include conflicts of interest, front running, insider trading, prohibited activities, and fraud prevention.
- **Compensation framework and performance management** – This involves aligning your reward and performance measurement to support control and service delivery. Many frameworks – such as competencies, key performance indicators, and 360-degree feedback – can help you measure and manage performance objectively. However, if your office's activities are diverse, setting up one system might be difficult. So, it makes sense to seek professional guidance.
- **Strategic planning** – Determine what you need to do to achieve your goals. For example, put your resources to work, set targets, and allocate responsibilities to the board and management for achieving the goals.
- **Balanced scorecard** – This approach aligns business activities to the family office strategy, monitors its performance against strategic goals, and improves communication with the family. It is balanced as it includes non-financial strategic goals and traditional financial metrics.
- **Structured client feedback** – Feedback from the family helps to improve delivery of service and overall satisfaction. Ensuring high satisfaction and trust among the client group is critical to the mission of the single family office. To be constructive, the feedback must be structured, balanced and objective. If not, the dangers are that it is based on a short-term superficial view or expresses favoritism.

Reviewing targets

Family offices often ask how often they should review their targets, and what the best review cycle looks like. The answer depends on your office:

- The performance of core functions – such as investment, tax, and trust administration or concierge service delivery is managed on an ongoing basis. Full reviews are conducted annually, usually by means of a formal presentation to and discussion with the board.
- Financial controls and operational processes are subject to an annual audit with the results presented to the board.
- While performance to target is managed on an ongoing basis and reviewed annually, it is also necessary to set goals for the medium (two to five years) and long terms (five to ten years) and to include these in the regular review.
- The performance, viability, and relevance of the family office should be subject to a full strategic review at least every three years. We will elaborate further on the content of such a review in Module 4.

Putting the pieces together

When putting the pieces of the family office's governance together, make sure everything is coherent and consistent. While the governance must enable the office to be efficient, focused on performance, accountable, and compliant, it must also fit with the family's collective wishes.

Governing the activity level

Whatever activity the family office engages in, it needs to be subject to its own governance and control beyond that applied to the family and at the corporate level of the family office. Given the breadth and diversity of family office activities, the control mechanisms could vary greatly depending on the specific activity. For example, the oversight and control of a real estate portfolio needs a very different approach and process than managing a standard investment portfolio of financial assets.

Investment governance

This section focuses on the governance of investment management – and its applicable principles and decision points – but does not cover the individual strategic asset allocation i.e. the asset class mix that best achieves the objectives. There is not one size or allocation which fits all families. Every family should seek professional, tailored advice on market conditions and how best to achieve its goals. There are a number of surveys which can give you an idea of how other families and family offices allocate, invest, deal with risk, etc. While these are useful, they are no substitute for individual advice.

In Figure 23 and for the purposes of this section, we have illustrated investment management as the primary activity. This is an area which often forms a core activity for the modern family office and has significant potential for harm.

Following best practice

The specificity of the investment activity requires specialist governance instruments and processes to be implemented. When managing investments, it is best practice to create an investment committee and write investment guidelines. Alarmingly, our annual survey of family offices indicates that less than half of family offices have a written policy for this headline risk.

The investment committee

Your investment committee is responsible for supervising the family office's investment activities and defining investment guidelines. The committee is your most important check and balance on the office's investment team.

Most committees have at least three members. It normally comprises the Chief Executive Officer or Chief Investment Officer from the family office, family members, and external specialists. It is common for private bankers or Chief Executive Officers of major companies to be members of family office investment committees.

Committees usually meet monthly, with extra meetings when they need them. To ensure your meetings are held professionally, it is good practice to set agendas and quorums, and to keep minutes.

The investment committee typically plays a central role in the regular reporting of the investment performance to the family members, the family board, or board of directors of the family office.

The committee's duties

The committee must objectively challenge the proposals of the investment team and also, on occasion, the family. The worst investment committees are the ones that simply go with the flow. Membership is a significant responsibility and members need to dedicate themselves to being fast and responsive while exercising due caution. They should also be open to challenge, not only for the investment team's proposals, but also their own views as well as those of the family. They must also acknowledge their limitations and bring in external expertise when required.

The investment committee typically:

- reviews investment policies and guidelines periodically, and monitors compliance
- monitors how investments are performing against objectives and guidelines; and reports the overall results to the family, family board, or board of directors of the family office
- defines and reviews investment benchmarks which measure investment portfolio performance
- reviews and selects investment managers
- approves loans or investments above a pre-determined threshold, for example EUR 2 million
- oversees investment risk management procedures, policies, and guidelines
- monitors on a continuous basis the performance of internal and external investment advisors, and retains or ends contracts when necessary
- evaluates its own performance against pre-defined policies and guidelines

Investment guidelines

Investment guidelines are unique to each family, depending on its goals, needs, and risk tolerance. It records the family's decisions regarding key principles of the family investment program, and documents the investment approach and its implementation. You should update it regularly, and use it to guide your office team, the investment committee, and service providers such as banks and asset managers.

Written investment guidelines can make your investment process consistent and disciplined, and help you learn from past investment experiences. Guidelines also document the understanding between the family and the family office, and define the investment team's roles and responsibilities.

Developing your guidelines

You should develop investment guidelines that reflect your family's goals, investment objectives, expectations, and attitude to risk. They can help to ask the family questions in a structured way. It is also a good idea to appoint a specialist advisor who can guide you and explain your choices and issues to consider. Your family needs to decide on the following:

- **Scope and purpose** – What assets are covered? Who are the stakeholders?
- **Objectives and liquidity needs** – What are your short and long-term goals? What are the planned in- or outflows? Are there liquidity constraints?
- **Return expectation and time horizon** – What performance benchmarks should the family office use? Over what period should they be measured?
- **Risk management** – What risk measures should you apply, such as standard deviation, value-at-risk, or the Sharpe Ratio?
- **Strategic asset allocation** – What asset mix is required to achieve objectives within the risk limitations?
- **Reference currency and currency allocation** – What is the most relevant currency for reporting? How will you allocate currencies? Will you speculate on currency to drive performance or hedge currency risk?
- **Implementation and delegation strategy** – What are the operational roles and responsibilities? In- vs outsource? What custody arrangements do you need?
- **Manager selection process** – What should the criteria and process be? What number of managers? How will you score and evaluate? What benchmarks should you use?
- **Monitoring, reporting and review** – What type, frequency, level of detail, and format of reporting will you use? How will you choose your performance benchmarks for monitoring?
- **Governance structure** –What governance bodies will you need? What are the supervisory roles and responsibilities to ensure accountability and control?

You can find a sample of investment guidelines in the appendices.

Creating your investment process

A good investment process can make sure your family office implements the investment guidelines professionally. Rigor in designing a well-controlled process with clear accountability is essential for risk management and can have a positive impact on performance. Every family will have a different process, depending on its staff and in-house and outsourced activities. Figure 25 is an example of an investment process with outsourced service providers.

Figure 25: Example investment process

Process steps	Underlying framework	Role of the family office	Role of service providers
Definition of – Strategic asset allocation (SAA) – Investment universe	**– Investment guidelines**	– Investment committee to define and approve SAA – Guidelines for selecting external asset managers	– Sharing best practices – Advise on SAA & set-up of framework
Analysis & monitoring of markets	**– Research Reports & Market Outlook**	– Investment team to analyse research & market views	– Provide research/ market views to support TAA decision
Tactical asset allocation (TAA) decisions	**– Investment process**	– Investment team to decide on TAA (define % per asset class)	– Advisory role – Investment Ideas
Decision on portfolio construction	**– Operational manual**	– Investment team to implement (e.g. select specific stocks) – Considering input on manager selection criteria and risk framework	– Advisory role – Investment proposal
Monitoring of investments	**– Control plan**	– Investment team to monitor that portfolio is managed within framework and report back to the owners	– Regular portfolio review – Infrastructure provider (e.g. global custody/ reporting services)

Communication routines and the use of technology to embed governance
Governance needs to be brought alive and complemented by high-quality communication and reporting routines. It should also be supported by deploying the latest technology available. Paper governance and trust will only get you so far.

Any electronic or paper-based report should be supported by live presentation and questioning of the results. The frequency and process for reporting differs depending on the complexity of the asset portfolio, the preference of the family, and the resources of the family office. In our experience most family offices report the investment performance at least quarterly to family members, if not more frequently.

This is a critical opportunity for the family to test the reasoning and get a feel for what is going on. The family needs to engage fully to ensure it understands the investment program and acts as an effective check and balance on the investment team. With many family offices running such lean set-ups, the onus on the family is even greater to provide an additional supervisory level.

For the family office team it is important to create channels to coordinate, communicate and seek guidance from the family wealth owners or their representatives on the board. Formal bodies with regularly scheduled meetings provide expectation of oversight. Communication routines also get the family office professionals into the habit of seeking input before making decisions on issues which may test the limits of their authority. The aim is to create transparency and a level of trust between the family office and the wealth owners.

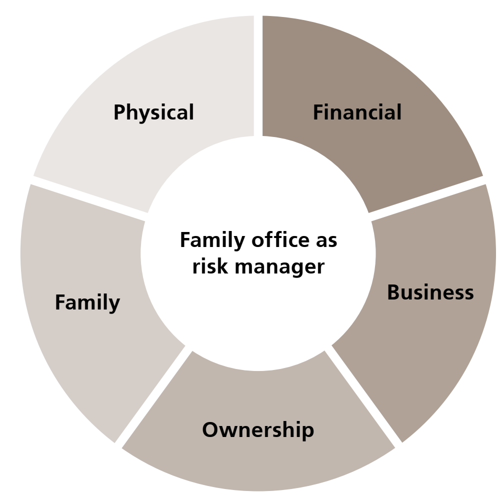
Increasing the quality and transparency of information will improve the quality of decision-making and control. Modern reporting systems enable the creation of a consolidated full wealth picture that at the very least tracks the top three concerns – performance, risk and cost – but can do much more as we discussed in Module 2.

Modern technology offers a new functionality that was not available just a few years ago. It is now possible through reporting and risk management systems to hardwire certain governance aspects into your family office. Limitations on leverage, asset classes, risk budget, quality of assets or counterparty, style and the like can be built into the system There is an opportunity to create an intelligent cockpit, with any breach automatically triggering realtime warnings.

Understanding and managing risks

Large, complex families face risks in many areas. Beyond investment risk, there are other risks that a business family faces, which the family office can help to coordinate and manage. The figure below shows the types of risks that you may consider managing through your family office. Many of these risks can be managed more efficiently in a centralized fashion through the family office. Some, like family reputation, can involve family education and crisis management coordination. Others, like family data and confidentiality or personal security, involve hiring external service providers. The family office can pool all needs together to put the family in a better negotiating position with the service provider.

Figure 26: Managing risk in a family office



Financial
– Asset diversification
– Single stock concentration
– Liquidity
– Poor performance & loss

Business
– Key person
– Liability & litigation
– Tax exposure
– Reputation & operational risk

Ownership
– Legal exposure & liability flow
– Fiduciary risk
– Asset protection & succession

Family
– Reputational risk
– Family conflict & litigation
– Peripheral businesses & new ventures
– Property

Physical
– Assets & collectibles e.g. art, antiques, jewellery
– Family lifestyle e.g. aviation, thoroughbred breeding, hobby business & new ventures
– Medical & travel emergencies
– Kidnap & ransom

IDENTIFY ▶ **ASSESS** ▶ **MITIGATE** ▶ **REPORT**

Risk management process
Families need to first decide which of these risks it would like to manage centrally and then give the family office staff clear directions on how to manage them. It is important for the family to develop risk prevention guidelines and risk mitigation plans for when disaster strikes. As shown in Figure 26, there should be a clear and structured process, such as risk identification, assessment of impact, implemention of reasonable mitigation strategies, and finally, reporting.

Acknowledging limits
The breadth of all the potential risks can be a challenge even for very professional family office teams. Put another way, can an investment professional really deal with ever-changing risks, such as online threats to data confidentiality, information architecture, and reputation? Our annual GFO report suggests that most family offices are not prepared. In fact, less than half are formally managing their headline investment risk, let alone the more exotic areas. It would be advisable to acknowledge the limitations of the team and support them with outside expert firms.

Taking flight
In conclusion, what distinguishes a smooth-running family office? As with any high-performance plane, a distinctive feature is a well-designed cockpit (i.e. governance and operational procedures) under the control of an expert pilot (i.e. head of the family office). There is a map with clear directions and a destination (i.e. strategic plan and investment guidelines). Each instrument gives clear, useful, accurate readings. When the machine veers off course or heads into danger zones, alarms are triggered. The pilot provides clear, timely communication of prevailing conditions to the passengers (i.e. the family wealth owners). The family, having designed and purpose-built the vehicle, cedes control to the pilot, confident that they will reach their destination smoothly.

Case story: Multi-generational family office

A family office serving four generations has structured its activities into three streams of activities, held by a group holding company. First, the core family business is quoted on the stock exchange and 55% owned by the holding company. Second, the group holding company fully owns the family office legal entity. Third, the group holding company is the eventual owner of various investment companies and special purpose vehicles, either totally or jointly with co-investors in certain cases. Finally, various family trusts ultimately control the holding company .

The family office has offices in three locations. It provides family services from the family's home country. A well-known offshore location provides company and trust administration services. To be close to talent and the markets, it runs investment activities from a European financial center. The family office team comprises 40 professionals and provides most services in-house.

The strict legal and operational separation between the activities was done for a number of reasons – logically, distinct activities needed different expertise, organizational confusion would make performance measurement difficult. But equally important are asset protection and confidentiality. Separation of assets is important to prevent liability flow-through from one business to the other or into long term family reserves. Furthermore, the investment activities are regulated and a legal separation is required to prevent regulatory intrusion into the family's affairs. The legal separation of activities was carried out in the 1980s when the size of wealth and complexity of different activities/structures had reached the point of being unmanageable within the same structure.

The family office provides a large range of services – investment management, legal and tax, company administration, management of communal family assets such as family estates, art collection and aircraft. In addition, the family office also performs detailed liquidity planning for family members individually, the group as a whole, and the family office itself.

Detailed strategic planning is done at the group level. The investment team and family office teams prepare detailed strategic plans and assets and activity oversight for consolidating at the group level. Every quarter, it prepares consolidated wealth reports. The family office is the family's strategic and risk planner, monitoring financial, country and political risks, reputational exposure, and physical security. It also integrates publicly available data on the quoted family business entity into its reports.

The family has largely appointed professional management teams for all its activities, and exercises control through board membership in the group holding. The family leader is the chairman of the core operating business and group holding company. The group holding company has a supervisory board of 12, of which the family has five seats including the chair position. The remaining board seats are held by top family office management and other confidents of the family. The core family business, being public, has a supervisory board of mainly independent directors, except for two family members.

The family office entity has a management team, comprising the three location heads, Chief Financial Officer/Chief Investment Officer, and the family office's Chief Executive Officer. There are split legal entities for different jurisdictions.

The family office's operations manual guides the governance of its ongoing operations. The manual details the policy (including comprehensive ethical and confidentiality obligations), process, and responsibility framework. To secure commitment, employment contracts also include key policy and governance obligations. Specialist investment and other committees meet regularly and report to boards at least quarterly. Each committee has specific terms of reference and responsibilities. There are investment guidelines or operating parameters for each asset class and area of activity. For compensation, every family office employee receives a base salary and a "13th month" salary, plus a discretionary bonus based on their performance and client service satisfaction. The investment team has an additional bonus based on portfolio performance. The family office makes generous allowances to pension schemes and medical cover.

Round up

Design control framework:
– Clarify the role of the family
– Address all the levels and their coordination
– Build the link with family governance and broader family enterprise

Build a stable corporate core:
– Answer the key questions
– Select and adopt appropriate governance measures
– Set and regularly review targets
– Ensure coherence and consistency

Govern your activities – Investment management
– Take advice and follow best practice
– Establish an investment committee
– Draft investment guidelines
– Design a well-controlled investment process
– Use technology to embed governance in systems and reporting

Manage your risk
– Understand scope and nature of risk to be managed
– Clarify responsibility and accountability
– Acknowledge limitations and seek support

4

Module 4

Evolve

Endure by taking a strategic role

The family office's strategic role

In Module 1, you defined your family's purpose for setting up a family office and the parameters for the family office design. In Module 2, you designed your family office structure and the implementation plan. In Module 3, you developed the control mechanisms for running and governing your family office. Now in Module 4, you will add the fourth layer of family office design – the long-term strategic dimension.

A strategic family office can be a unique competitive advantage for a wealthy family. This module covers the main activities your family office can do strategically to improve the chances that the family thrives over generations, with the family office at the center of meeting this challenge.

A strategic outlook

Many family offices remain at the operational level, and look like reactive, tactical and execution-driven organizations. This works for a period of time but is not adequate as the family office grows, approaches a generational transition or supports a multi-generational family.

Operating strategically means that the family office plans and responds to the changing nature and activities of the family, its environment, and wealth strategy. Without a strategic outlook, your office will struggle to stay relevant to the family's successive generations. Thriving multigenerational family offices have one thing in common: they help the family think strategically about its future.

Another reason for operating strategically is to ensure that the family office outlives its founder. Your strategic family office will learn how to evolve over time alongside the family. It will be the main catalyst for guiding the family from generation to generation to ensure that the family stays unified, thereby keeping the assets together to preserve and grow the family's overall wealth.

Defining your family and family enterprise

When a founder declares the dual intention of creating a multi-generational family wealth engine and passing wealth to the next generation, the focus of the family office must begin to shift from the founder to include the wider family. As the founder begins to plan for that transition, it's important to think about the family's entire enterprise. Two questions require clear answers:

– How is the family defined?
– What is included in the family enterprise?

Family members
Defining membership in the family can be straightforward in some cases, complex in others. Family members are mostly lineal descendants who are or will become owners, plus their immediate families. Because the term "immediate family" may mean different things to different family members, it requires explicit clarification. These discussions can range from delicate to difficult, but it is unwise to avoid them.

In family groups where there are adopted children, stepchildren or extended family members to consider, there can be differing views of who belongs as members of the family. Some families define themselves narrowly; others, broadly. Your definition will have a long-term impact on your strategy.

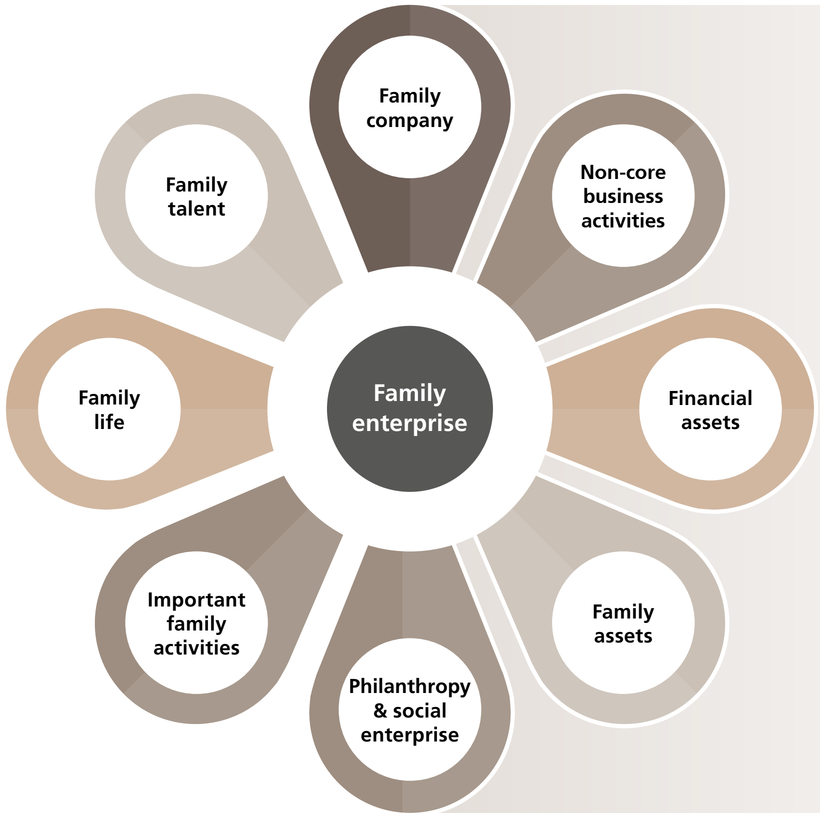
Having a broader definition of family membership allows you to admit more talent into your inner circle. The tradeoff, however, is less financial wealth per person, more complex family relationships, and potentially greater conflict, if not managed well through governance. Take time to consider the advantages and disadvantages of all the possible family boundaries you can draw. Make a list of the pros and cons of your options.

Family enterprise
A family enterprise is the collection of all important shared family assets plus all meaningful activities that the family engages in. These activities define family identity, unite members, and consume time and resources to lead. The family enterprise is what the family wishes to perpetuate into the next generation.

Your family enterprise will also include financial assets (probably managed through your family office); real assets such as family homes, yachts or airplanes; family philanthropy (perhaps managed through a philanthropic foundation you control); social enterprises you support (not-for-profit businesses, hospitals, schools and the like); religious and community activities you are committed to; and any other shared asset and activities that are important to your family. The liquid asset portion of the family wealth managed by the family office (regardless of whether the family still owns operating companies) is an important component of the family's wealth that requires professional management. Therefore, the family office that manages these assets should be treated with the same professionalism and respect that your family extends to a business.

Families differ in what types of shared family assets and activities are managed through the family office. But generally, the family office plays an important central coordination role. Figure 27 shows a typical family enterprise's shared assets and activities.

Figure 27: A typical family enterprise



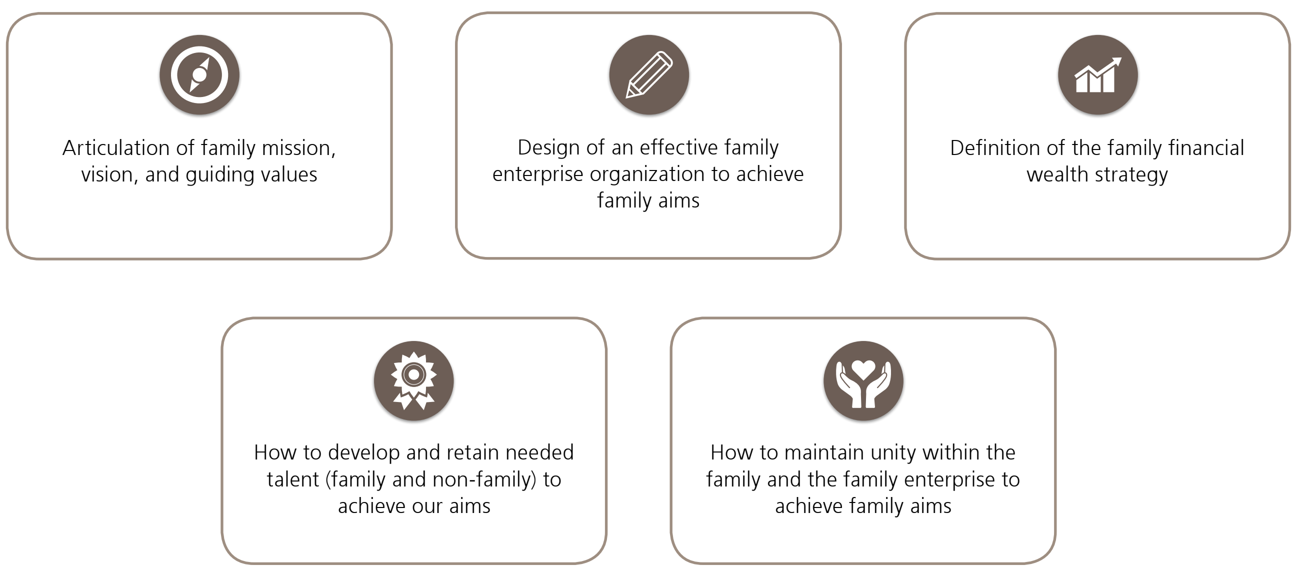
Revealing
- All activities and economic interests that can be continued into the next generation
- The need for these activities to be well aligned, led, managed, and governed to meet family goals
- The need for a broad family mission to perpetuate these activities
- Roles that need to be filled by family and non-family talent

Seeing the big picture
The family enterprise includes the operating business or businesses (if any) that the family owns or controls. The figure above represents the family enterprise diagram as a flower, but some may not see the different petals as inter-connected. Nor do all recognize every one of the petals as formal parts of the family enterprise. Helping the family gain a "big picture" view of the family enterprise is a critical job of the family office (understanding all that the family has created and how all of it fits together (or not) and why each petal deserves good management and governance). Gaining insight into every petal in the flower helps to unify the family, enabling it to make sound group decisions quickly and thereby grow its wealth more effectively. It greatly impacts the future success of the family enterprise. Therefore, it is important for the family office to help the family devise a clear mapping of these shared assets and meaningful activities. Later in this module, we will discuss how to build structures and add management in the family enterprise to support multi-generational success.

Designing your family strategy

So, you have defined your family members, and specified the shared assets and activities. Now it is time to design your family strategy. The family strategy is everything your family will do to secure its future prosperity. Concretely, this means growing the business (if any) and increasing the shared assets so that the family is able to maintain or increase its living standards despite the increased demand on resources. As a family, it means ensuring continued cohesion, identity, and leadership despite the evolution of the group. Figure 28 shows the five main parts of any family strategy.

Figure 28: Family strategy – combination of actions to achieve aims



Step one: Articulating the family mission, vision and values
Articulating the family's mission, vision and values is the starting point for clarifying what it is trying to achieve as a group, why the family is staying together as an ownership group, and what the benefits are. As the family makes the transition from "speaking" in one monolithic voice (the voice of the founder or any strong family leader) to "speaking" in the pluralistic voice of more family members, the family mission, vision, and values need to reflect more voices. The family office can help the founder understand this important evolution and involve other family members appropriately in updating the mission, vision, and values periodically.

Step two: Effective family enterprise organization
In order to achieve the goals defined in the first step, the family needs to build an effective organization aligned with the family's evolving mission, vision, and values. This involves developing more detailed strategies and setting up structures so that the family enterprise can be managed as a whole. The best organizational structures are the ones that work well together and enable decisions to be made in an integrated fashion.

A clear map
If your family does not have a clear map of its family enterprise organizational structure, your family office can help. It can guide and support the development process with professional project management and ensure that the organizational structures are aligned with the family's mission and core values.

Your family enterprise map will reveal the areas where you need to build organizational structures. For example, the family company and any non-core businesses, including philanthropy, might have their own structures. The family office can be a link between these organizations and the family, sharing information and communicating in a timely way. The family office can also organize and support the other structures that the family enterprise needs.

The family office can regularly help the family summarize the current strategies of areas in the family enterprise. If there are conflicting strategies, the family office can identify them. Your family can use this information to align its strategies, allocate resources, and specify how each area of the family enterprise contributes to achieving the family's goals.

Step three: Financial Wealth strategy
The family wealth strategy addresses creating, protecting and consuming financial wealth. The family wealth strategy includes both the consumption and investment side of the equation. It involves the following analyses:

- **estimating the rate of growth of family assets** needed to support the family and family enterprise activities over time
- **determining the right mix of business and other investments** to sustain the family and family enterprise financially; guarding against certain risks; recognizing which assets are likely to grow or decline in value and being aware of industry and economic trends
- **securing the family's control of value streams** through ownership, structured financing, best-in-class governance, effective leadership, and well-understood rights and processes for family owners to exit
- **proposing how to manage the family enterprise's** costs to ensure it is sustainable.

Shaping the wealth strategy
Your family office is well placed to perform the main work behind the family wealth strategy. The family office can gain all the information and develop the relationships it needs to shape the family's wealth strategy by:

- working with and reporting on the dividends from the family's operating companies and other key value streams
- managing the investment of financial assets for individual family members and the family as a whole
- overseeing individual family members' financial planning
- managing and recording the family's consumption
- creating a consolidated wealth picture with forward-looking liquidity planning

An effective family wealth strategy will help you set targets for growth across the entire family enterprise and each sub-component. It will control how family members consume assets and encourage the family to adopt financially sustainable lifestyles. It will help you adopt sound dividend policies, which in turn produce strong balance sheets for the family and the family company. It will also enable you to plan new investments and family enterprise activities that suit your family's evolving needs.

To ensure your investment portfolio and performance targets are suitable, it is wise to plan ahead in five-year periods. A good investment portfolio will always fit well with the family's main characteristics, including its geographic footprint, core capabilities, passions, and financial practices.

Staying in control
Maintaining family control of the business as its ownership group grows is a central challenge for a family in business. Many families have their ownership diluted and struggle to stay in control of the family business over time. You can respond to this challenge in many ways. One approach is to create an "internal capital market" that controls the buying and selling of family shares in the family business.

When a family decides business ownership should remain in family hands, it may invite its owners to enter a shareholder agreement that limits the transfer of shares to family members only. If there are share buyers and sellers, the shareholder agreement stipulates the conditions for selling and buying shares within the family. Buyers can be other family owners or, sometimes, the family company. The agreement typically also covers valuation principles and payment timings.

Your family office is well placed to administrate the internal capital market. Unlike family members, it is a neutral party in these transactions, with no vested interest except for maintaining family unity. Administrative roles for your family office include providing a share valuation once a year, matching sell and buy orders from family members, and settling transactions.

Step four: Developing and retaining talent
The survival of the family wealth is dependent on the continued development of leadership and other useful talent within the family to serve the family and in the different organizations of the family enterprise.

Family talent
In today's competitive and fast-changing markets, businesses and other organizations need the best available management talent to survive and thrive. Professional family talent management is about creating the right set of roles for family members, identifying talent, training/coaching, and deploying people in suitable positions. Who will succeed an outgoing leader? Who will play other roles? How do we develop our next generation leaders in a systematic way?

Family members can play a variety of roles within the family enterprise. In some families, for example, family members are placed in positions (board positions, leadership roles) within different family enterprise organizations.

What to watch out for, however, is when families give roles to family members on an ad hoc basis – sometimes based on interest, sometimes based on family political goals. Instead, there should be qualifications and a clear process for the hiring/letting go of family members in various roles. Families that do not have a systematic family talent management plan lose the opportunity to leverage often loyal, long-term thinking, dedicated family talent effectively. Or they find themselves in family conflicts that are difficult to manage.

The family office can play a strategic role in supporting the professional development of family leadership talent. Below is a sample list of possible strategic roles that family members, rather than non-family members, should take on:

Figure 29: Strategic roles for family members

Role	Description	Examples
Responsible owner	To embody the family's values. To understand business well enough to make key decisions for family assets. Willing and able to meet capital calls. Willing and able to forego distributions when circumstances require it.	– Shareholder of joint family assets
Part-time family leadership roles	To attain business and industry knowledge that earns respect within family enterprise. To make key high-level decisions. To gather support of family owners around difficult and critical decisions.	– Board member in company, foundation, etc. – Family council leader
Wealth creator	To be able to spot new business opportunities and execute effective strategies to take advantage of such opportunities in order to create significant new sources of wealth.	– Chairman or CEO of family operating company – Entrepreneur funded by family capital

Not all positions in Figure 29 are leadership roles. Some are not even full-time positions. For example, all family owners should at minimum be a responsible owner. To help family members develop career plans that fit their personal interests and fulfil the family enterprise's needs, you should provide an education program and individual counseling. The development plan for each role should involve:

- **educating the next generation** on your family's history, values and mission – the family's senior generation members can design and deliver this
- **building business skills** such as finance, accounting, and business strategy, through classroom instruction and hands-on experience
- **designing career plans with clear progression based on performance metrics**, perhaps with rotational programs for the next generation to gain experience in various areas
- **arranging for mentors and coaches** to help the next generation solve career and work challenges

Left unattended, the family talent development plan tends not to be well articulated and is often not defined at all. This can be destructive for the family enterprise organization's performance and culture.

Compensation policies

Compensating family wealth creators who help the family grow assets significantly is a sensitive issue. In the operating company, there are often industry norms that determine compensation packages for senior managers. In your family office, compensation may vary, and it can be hard to manage politically.

Underpaid family wealth creators may feel demotivated and seek career opportunities elsewhere. Equally, discord can arise if family members believe wealth creators are overpaid. To help retain talent and unite the family, you should communicate openly and manage people's expectations by creating clear, transparent compensation guidelines or policies that are supported by the family owners. For example, your family office can support its compensation policy by benchmarking and explaining to members the value wealth creators bring to the family enterprise.

Encouraging entrepreneurship

A common aspiration and strategic challenge for many wealthy families is to ensure that most of the next generation become wealth creators, not net consumers of wealth. Not all family members can or should work in the operating business. For some, none of the family enterprise organizations may fit their talents or personalities. For others, there may not be available opportunities or positions. In these cases, family members may need to choose another career; pursuing an entrepreneurial venture could be the best option.

To help, your family office can support and administer an entrepreneurial or venture capital program for the family. The rules for these programs differ, but generally, funds are advanced for a venture based on investment criteria specified by the family and its advisors.

The criteria for investing in a venture by a family member should include a business plan, how funds will be used, permitted sector/industry, outlook for success and the like. For some families, the standard for investing is demanding (for example, an impartial venture capital fund would have agreed to invest). Conditions for funding vary from soft loans to grants.

A committee of family and non-family members could review applications for venture funds from the next generation. Seasoned professionals from the family office may assist through active mentorship and guidance on business aspects, beginning with a review of the business plan and on an ongoing basis as required. This process presents an opportunity for the family office to forge a positive relationship with the next generation and maintain its relevance to them.

Non-family talent

Successful families must partner with and harness the potential of non-family talent. The non-family talent development plan is usually designed and implemented within each organization of the family enterprise. To help enhance the family enterprise organization's performance and culture, make sure you articulate and define the plan.

Step five: Maintaining family unity

Finally, putting everything together, the family needs to maintain unity so that a critical mass of family members stays aligned and moves in the same direction toward the same goals. Family unity does not imply that family owners cannot leave the ownership group. Buyouts of owners happen, or should happen, for any number of reasons. Sometimes buyouts are necessary for the stability of the family and ownership group, allowing remaining owners to achieve enough unity and clarity of purpose so they can preserve a well-functioning family and family enterprise.

Building unity

Left unmanaged, family unity tends to decline over time. Families tend to grow in number and become more diverse in their geographical locations, interests, lifestyles, values, and relationship with the family enterprise. You build and maintain family unity by creating:

- a distinctive and supportive family culture
- effective and fair family group decision-making processes
- a strong family identity among next-generation family members

Authentic family cultures

Family culture is the software that binds family groups together with shared values and emotional bonds. It develops slowly over the years, but needs careful cultivation. Cultures differ across families; however, all must be authentic.

For example, is financial discipline in your family's DNA? Do family members prefer to stay out of the limelight? These are common characteristics in many family enterprises. Do people admire your family for being generous? Many families have built family brands on giving back to their communities and stakeholders. Do family members strive for excellence? Do most of your family members have a strong work ethic? Then you might build a culture around hard work.

To cultivate your family's culture, you must first establish it authentically and then promote it. This comes naturally to some families, but not all. Those that found it easy often speak of strong matriarchs or patriarchs skilled at binding the family together.

Consultation and collaboration
To support family unity during the generational transition, founders – who are used to making decisions unilaterally – need to evolve into a more consultative, consensus-driven and group-based decision-making model. Herein lies the paradox facing all founders who establish family offices regarding how decisions are made. The successful method that built the wealth in the first place must now change if the family enterprise is to outlast the founder. The founder's mentality needs to change and the strategic family office should support this change. Make no mistake, this change is not easy for founders and their family members, but there is no way around it if the wealth is to grow and families are to stay united from generation to generation.

The family office should lead change first toward a consultative model where family members provide input to the founder and then toward a more collaborative model where family members participate in decision-making. As decisions become increasingly more distributed, make sure information is clear and widely shared. Make sure there is a consultative process—time for family members to formulate and ask questions and to consult with advisors and other stakeholders. At the same time, make sure it is clear to the family who has authority to make what decisions.

As the family experiences more involvement in important decisions, it will become clear why members need to become more experienced and capable. It should also become clear why guarding family unity is so important. Family unity is so critical to multi-generational success that families must carefully specify the family governance mechanisms for making effective family group decisions, resolving family conflict, and maintaining family culture. In the next section, you will consider the many ways in which your family office could support your family governance.

Case story: A fresh look

A European family held various minority participations in quoted European companies through an investment holding managed by a family office. The company portfolio had grown over generations to encompass more than 20 companies. The family exercised strategic influence through the family office and company board positions. The family wanted to build and support market leaders with strong business models in industries with attractive outlooks.

Occasionally, the family office added companies to the portfolio, but rarely divested companies. The office used dividends to reinvest, and to provide cash to family members. Typically, the family office distributed 50% of the net profit in the overall holding to the shareholders; and reinvested the rest into the portfolio companies. The holding also managed a portfolio of liquid assets as a security reserve for business and family needs. Family members held shares in the investment holding. A shareholders' agreement ensured the family remained owners of the investment holding.

15 years ago, the family asked advisors to undertake a strategic review of its portfolio and activities. Why commission a review? First, the family felt that the current modus operandi was a result of continuing the same "heritage" strategy as in the past and that it would be beneficial to have a fresh look at all strategic options. Second, the family felt that some stakes held did not make much sense any more, as industries had changed. In some other companies, the participations were so diluted that the family no longer had any real strategic impact. Importantly, the family also wanted to achieve more than just building financial wealth and was considering a set-aside of more resources to build wealth for society at large and to strengthen the family's driving purpose – its reason for staying together as a family.

The family began redefining its vision for what its members wanted to achieve with their combined capital and resources. Over nine months, the family's main decision-makers discussed everything thoroughly. The result? A family values statement; a new corporate mission for the investment holding; and guiding principles for the family and its company. The family also decided to set up a new foundation, holding 15% of the investment holding. This foundation would fund the family's philanthropy in education and scientific research.

For the investment company, which the family office ran, the family decided to focus its capital on fewer participations with higher impact (requiring a plan for divesting), and planned for long-term exits and additional investments in portfolio companies. The family also considered buying out companies with high cash-flow generation. The aim was to better control cash-flow streams, use more leverage, and operate more professionally. The family office created separate teams to manage three activities: significant long-term participations; private equity and buyouts; and asset management. The activities focused on four industries with long-term attractive outlooks, and where the group had expertise.

Thanks to its new focus, the investment company captured new investment opportunities, reinvested in its long-term participations, and paid a steadily increasing dividend. Since implementing the new vision and strategy 15 years ago, the net asset value has increased tenfold.

To ensure the foundation reinforced the family's values, it set up a professional organization to support research in natural sciences and medicine. Family members are on the foundation's board, and non-family experts run the day-to-day operations. The foundation also supports one of the main academic institutions in the country, and promotes young talent worldwide through scholarships. To reflect the family members' desire to engage more in non-profit areas, the foundation created three areas where some members became more involved in the day-to-day operations. At a meeting, the family decided the areas to focus on, who would be involved, and what their roles would be. All members agreed on the outcome.

The family has held family meetings since its founding days. The family, now comprising 30 members, uses family meetings to stay up-to-date with important events, the business, and the foundation, while enjoying time together socially.

For past 15 years, the family has been developing its next generation in an increasingly structured way. First, it teaches upcoming shareholders the basics of ownership skills, and the family's values and guiding principles. Second, older family members mentor others using summer jobs and education. Later on, those with an interest and a talent for family activities receive mentorship.

The family council and the different organizations' boards plan leadership transitions together. Specific leadership development plans are made at the investment holding company's board level, and the philanthropy foundation.

Family governance

To maintain family unity, it is vital you put a strong family governance structure in place. Families must ensure that good, timely decisions are made for the benefit of all. At the founder stage, the business founder (or the founder and his/her spouse) is usually the ultimate decision-maker for the goals and issues facing the family. Later, when the family is larger, decision-making authority on family enterprise issues becomes dispersed among siblings or cousins. Difficult decisions can expose conflicting interests and open fault lines within the family.

Governance groups
Each organization or group in the family enterprise usually has its own governance framework. The family's operating company, family office and philanthropic foundation have their own boards of directors (which is sometimes called a supervisory board).

Family governance structures do not replace the existing oversight structures or directly manage the day-to-day activities for the family business or other family enterprise organizations, including the family office. Instead, family governance enables the family to manage itself and set clear direction for the subordinate groups. Family governance creates the forums where families can make unified decisions on important matters, which are then communicated to the family enterprise.

Family assembly
When families reach the point of transitioning to more dispersed authority in the family in the second generation and beyond, successful families develop a "big family" group to collectively discuss their interests, make family policies, learn about their family enterprise and connect as a family. This group is generally called the Family Assembly.

The Family Assembly comprises all adult family members over a certain age that the family decides, for example 16. Members of the Family Assembly usually meet once a year for a day or two to take important actions affecting the group.

What happens in the Family Assembly? Families establish their direction; different generations learn to work together and appreciate each other; senior generations seek input from next-generation members; and leaders of growing family enterprises receive support for the strategies they want to enact.

The family office can support by helping organize and manage family governance activities. This also helps the part-time family volunteers who usually run family governance forums.

Family council
If the family is large, the Family Assembly delegates planning, organizing, and some decisions to a steering committee called the Family Council. Many families find it useful to have a representative Family Council across generations or branches.

In this instance, the selection of representatives of different family components to this smaller working group is an important function of the Assembly. Family governance rules will ensure that this process is as transparent and fair as possible. The terms of the delegation will enable the subsequent supervision of the Family Council.

When a family is small, for example, with two to twelve members, it may decide to only have a Family Council. Family Council numbers vary, and sometimes includes spouses of lineal descendants.

The Family Council meets periodically during the year to address issues; establish policies; develop plans, such as financial and education plans; organize meetings and activities that strengthen family unity; and support developing family members. Generally, the Family Council has a mandate to:

– develop a statement of mission, vision, and values for the family
– set plans and policies for the family
– help the family stay committed to, and contribute to, its family company and other important family activities
– help ensure the family enterprise's organizations support the family's mission, vision, and values
– create long-term plans for developing family talent and leadership, possibly in partnership with the family office

The Family Council can also be responsible for ensuring the:

– family stays well informed about the activities and performance of its family company, philanthropic and community efforts, family office, and family news
– family enterprise's organizations are aware of the family's interests, concerns, and movements.

The Family Assembly appoints the Family Council and ratifies all plans, strategies and activities that the Family Council proposes. Additionally, the Family Council coordinates with the owners and boards of the family enterprise organizations, telling them what the Family Council is doing and asking how it can help. For some decisions, such as amendments to the Family Constitution, the Family Council must first seek approval from the Family Assembly.

The Family Council can also resolve conflicts. For example, tensions may arise over family-owned vacation homes with no clear rules, budgets for upkeep, implementation plans, and fair ways of deciding who can use them. The Family Council can develop policies for this; and the family office will implement them.

Conflicts can also occur about family philanthropy when family members express new and different ideas about causes to support. To overcome issues, the Family Council can develop a mission and vision for the family's philanthropy, and processes and procedures. Again, the family office will implement them.

The family office and family council
Your family office can play a key role in supporting family governance. It can act as the Family Council's "back office," helping implement its programs and plans. Your office can also help to:

– organize the Family Council's meetings
– record meeting minutes
– organize logistics for family meetings and educational events
– publish a family newsletter
– maintain records of the Family Council's policies, meetings, and other activities.

The Family Council must have a budget to perform its responsibilities, such as organizing family meetings and developing educational activities. The Family Assembly will typically approve the budget of the Family Council and your family office can act as administrator.

However, your family office is much more than just an organizer for the Family Council. It is also a vital partner. For example, it can inform the Family Council about interests and concerns in the family, without revealing confidential information; and suggest ways to keep the family committed to its values and mission. The family office can also offer analysis and advice, and find external advisors that can help the family.

Its support goes further. Your family office can help family members understand information from the family company, family office, and philanthropic activities. For example, one useful report could be to link financial results produced by the family enterprise to the cash positions and financial projections for individual family owners or even all family members. It is a type of overview that only the family office can prepare: a report that states the personal financial implications of the family's collective investments.

One sensitive issue in any family enterprise involves selecting next generation family members as employees and board members for any of the family enterprise organizations. It is important that these organizations select family members that can meet the standards of the organization and that the selection process is unbiased and perceived by the family as fair. To achieve this, the family office and Family Council can help to develop a family employment policy, HR, and supervisory board. Your family office can also update the family on available jobs, the family candidates, and the hiring process.

Finally, if a family does not have a Family Council, your family office can help create one. Or if a family chooses not to have a Family Council, your family office can perform some of its activities by helping the family members develop the family's mission, vision and strategy.

By coordinating communication, facilitating family planning, organizing family meetings, supporting the education and development of family members, and resolving issues within the family enterprise system, the family office earns its reputation as the central nervous system of the family enterprise.

Your family office's strategic functions

To become a strategic organization, your family office can build on its tactical responsibilities and extend them to support the family strategy. Figure 30 summarizes this.

Figure 30: Strategic versus tactical functions of a family office

Tactical activities	Strategic activities
– Investment oversight/management – Personal financial management assistance – Tax compliance – Personal services – home, travel, etc. – Family philanthropy support – Implementing operating systems and business processes	**Supporting wealth regeneration** – Timely strategic investments and exits. Structuring and managing assets for control and value creation – Helping to develop wealth creators, including entrepreneurs **Supporting building family talent** – Organizing family education, development, and mentoring (together with Family Council) **Supporting family unity** – Family governance support – Encouraging (with the Family Council) consistent governance practices across the family enterprise – Organizing family engagement activities to sustain connection with the family enterprise and build family unity

Exploring different options
Ideally, family owners take the strategic dimension into account when they initially design their family office. It is not a disaster if your family office has not been built in this manner. Understand that what the family needs from the family office is an evolving process.

In the initial stages of setting up the office, family business leaders usually consider the tactical issues of looking after wealth. They are probably planning for the whole family, rather than inviting family members to take part in decisions.

The founder is most likely focused on how to build an effective investment organization, instead of one that helps the whole family achieve multi-generational success, because his most immediate challenge is how to generate good returns from his capital. As a result, the initial approach to managing financial wealth is nearly always through estate and tax planning, controlling family budgets, and diversifying financial assets.

As families gain more experience and as the family office increasingly becomes the operational glue that keeps the family financial affairs organized, families normally begin to explore options. They ask, "What else can the family office do for us?".

At the same time, as the family grows in size over time, families recognize that they must do more to sustain their wealth and other forms of family success. They must now grow their assets significantly. They must keep the family united and committed to working together. And they must identify and grow family talent. Since the family office staff have become the family's trusted advisors, it is natural for the family to ask the additional question, "How can the family office help us achieve our family mission and goals?". This is the natural point where the family office should layer in strategic functions in order to stay relevant.

This is a natural evolution. Of all the parts of the family enterprise, your family office will develop the most intimate relationships with the largest number of family members. Because your office oversees each member's finances, it is likely to have the most productive discussions about goals and financial needs. This means the family office is best-placed to help design and implement your family strategy.

Case story: Learning lessons

A South American family owned a large global logistics business. With 50% company ownership, the second-generation matriarch had been a strong unifying force in the family. But as family members moved away and the matriarch aged, she could no longer bring the family together by herself.

The family decided to establish a family office when the third-generation adult siblings wanted to help their fourth-generation children become good shareholders. At first, they considered it a leap of faith to hire a leader with a diverse background as an educator, lawyer, and businessman; even though he fitted culturally with the family and had a long-standing professional relationship with the Chief Executive Officer of the family's business.

The priority of the new family office's Chief Executive Officer was to educate the next generation to be effective shareholders. As a former college professor, he identified professors at local universities who would be good coaches, then matched them with young adults in the family. The professors coached the young adults to develop various skills, from communicating effectively, to managing businesses and investing.

The family office Chief Executive Officer improved exchanges among shareholders by making the family office the new communications hub. His business acumen earned him the family's trust to present company information authoritatively. Now the family office Chief Executive Officer became the family's chief provider of information. He developed websites, held meetings, and wrote a weekly blog to ensure people got the right messages at the right time.

He then focused on uniting the third-generation siblings (the current shareholders), who identified their needs as a group. He held a series of luncheons focused on cultural and economic topics that interested the siblings. They enjoyed getting together and soon began looking forward to each gathering.

The family's eduation program will succeed because it hired a skilled family office leader who focused on the right priorities.

Pitfalls and strategic challenges

Like any other organization, the family office faces pitfalls and strategic challenges that owners need to watch for. Some of these can be fatal – whether in the second generation or in the tenth. It is well known that conflicts in the ownership group are among the worst pitfalls to avoid.

Succession crises and failed leadership transitions are equally destructive. Losing relevance to the next generation is another existential threat. A strategic family office can take timely action to avert disaster.

Figure 31: Pitfalls and strategic challenges in the family office

Pitfalls	Source	Solution
Conflict in ownership group	– Family office becomes battleground: suspicion, no trust	– Family office to remain a neutral steward, efficient and rational – Unify the family owners
Staying relevant to next generation	– Family office loses relevance to next generation – Family needs change, but scope of family office has not developed	– Design new family office strategy to remain relevant to succeeding generations. What are the new needs and vision of the new generations? – Clarity of strategy development and implementation
Leadership transition	– Unclear path of leadership transition	– Develop succession plan for family and family office leadership – Timing based on incoming successor's ability to lead
Misaligned strategy	– Organic, rather than strategic development of the family office and its staff	– Strategic review cycle, frequent performance reviews – Evaluate family office on how well it is serving the driving purpose of the family. Take actions to align family office
Mission creep	– Family office adds on functions without clear purpose	– Review cost and benefits of in-house service provision, evaluate alternatives – Strategic review cycle, frequent performance reviews
Lack of governance	– Poorly defined authority; lean structures erected to minimize costs	– Design appropriate family office governance structure – Design family office cockpit with effective operational controls
Lack of control	– Information and/or analytic errors; no consolidation of information or analysis	– Automate key systems, establish manual checks – Disciplined process to collect, analyze and act upon information
Too high risk exposure	– Poor governance of family office	– Design family office cockpit with effective controls on risk – Family office leads comprehensive and coordinated risk strategy for family enterprise – Design appropriate family office governance structure
Stagnation in talent development	– Family office staff too removed from "real world," have not developed expertise	– Develop HR plan to hire, build, renew/refresh, and retain talent – Constant professional educational training

Ownership group conflicts
Conflict arises among owners with differing interests, views, or goals; when these become entrenched in the family office, it quickly becomes a battleground. Suspicion and erosion of trust among the owners must be avoided at all costs. With this in mind, the family office can insist on its primary role to enable family unity. It achieves this by remaining a neutral steward of the vision, values, forums, policies, and plans on record. When these conflicts flare up, the family office asserts its neutrality and insists that unifying the family owners is first priority and refuses to be distracted by side issues.

Over time, family office staff and family members can develop close, trusting relationships. Such relationships are useful but can make it challenging to manage the office professionally. Challenges can arise because:

- some family office staff gain too much influence from their close relationships with certain family members; and these members may demand too much of their attention, distracting them from their duties and from serving others
- family members may protect certain family office employees, making it difficult to reassign them or terminate their contracts
- groups of family office employees may follow family factions, politicizing the office

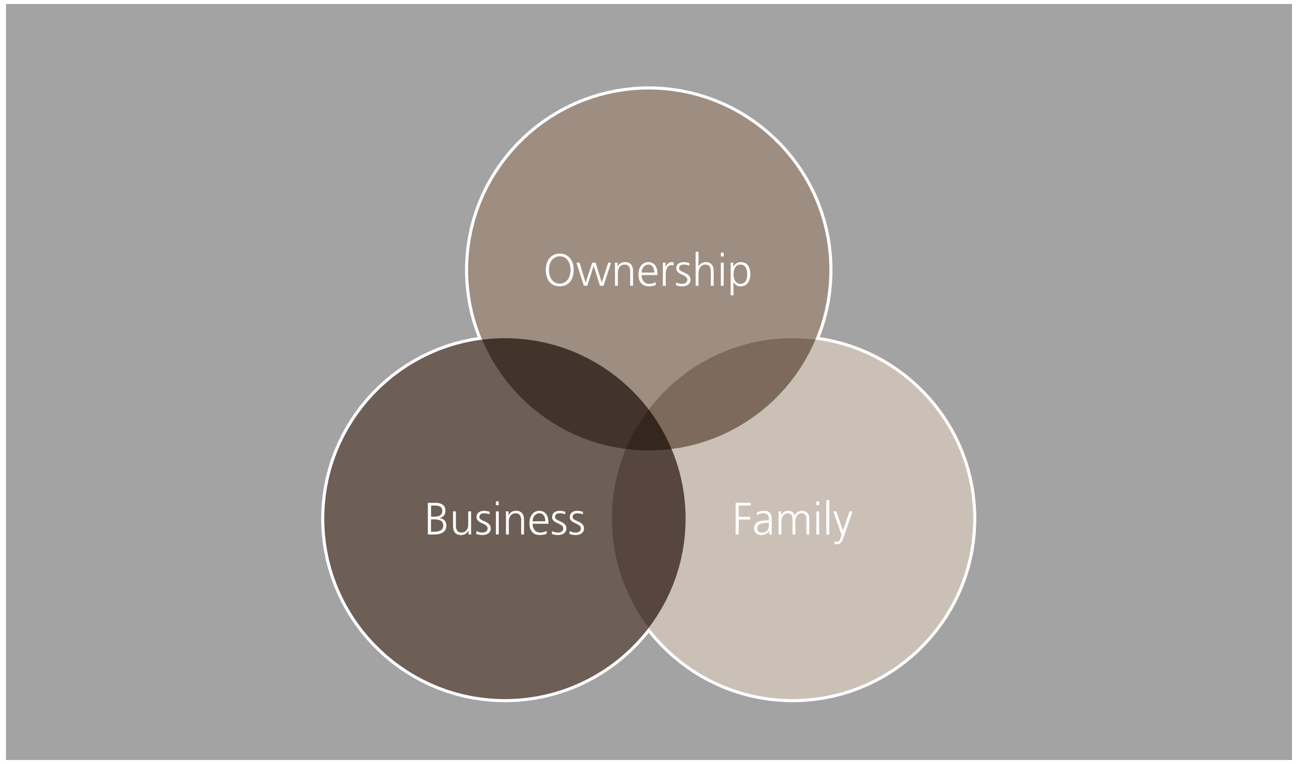
To remain professional and objective, staff must not allow themselves to be biased by personal relationships with family members. Your office's priority is to ensure the welfare of the whole family. It must also keep the personal and private information of each family member strictly confidential, and only share it when absolutely necessary. Your office should also enforce a culture that discourages staff from getting unnecessarily and unofficially involved in family relationships.

The evolving family enterprise
Staying relevant across successive generations is one of the greatest challenges facing family offices. Over time, the family enterprise tends to become more complex, as:

- the family grows, with diverse attitudes and needs among members
- family members move to different countries
- the core operating businesses expands, changes scope, or changes significantly such as moving from private to public
- more financial assets come under the family's management
- more family members work in the family enterprise
- the family foundation grows, supporting more causes and involving more family members

Figure 32 illustrates the three-circle system within the family enterprise. To ensure the family enterprise is a coherent system, the family office can coordinate and integrate each element.

Figure 32: The three-circle model



Source: Tagiuri and Davis, 1982

Staying relevant across generations
Your family office should consider how it may need to evolve over time. Use the family office to channel communications through defined processes. Whenever you need to keep the governance structure flexible and dynamic, use your family office to encourage more stakeholders to engage. Remember too that different generations communicate in different ways.

Is the family office staying up to date? When it comes to managing investments, the senior generation may initially want your family office to oversee investments in all asset classes. Some next-generation members may want to oversee alternative or direct investments themselves. Your family office can keep staffing lean and focus on meeting the family's changing needs.

In tricky family transitions, particularly when an outgoing leader is making way for an incoming leader, the family office risks losing relevance to the next generation. To ward against this, it is critical to prepare well in advance by planning possible transition options. A specific strategy for remaining relevant to the next generation is an absolute requirement. We are always surprised how few family offices accomplish this work. It is easy to get sidetracked or distracted by the demands placed on the family office by the investment activities.

Planning for new leaders
Succession in a family office refers to a leader replacing another. Ideally, you should coordinate it with succession in other parts of the family enterprise. Doing this helps the next generation members feel they fully control the family enterprise and can shape it to their vision. Succession usually takes a few years to accomplish. It is helpful for your family office to understand two different timelines:

- The succession timeline of the senior generation in control, which involves the career plans of outgoing leaders.
- The succession timeline of the next generation, which involves the career plans of incoming leaders.

Effective leadership transitions are tailored to the incoming successor's ability to lead, rather than the outgoing leader's willingness to leave. Your family office can support the succession by helping the two generations agree on the timing and plan. To do this, the family office must cultivate authentic relationships with the next generation, so that they understand their missions and goals. The family office steers the two generations through the generational transition smoothly and minimizes family disruptions and even departures, which often results when a disenfranchised next generation feels cut off from the transition process.

Misaligned strategy
Left improperly managed, the family office develops opportunistically into new activities ("mission creep") and tends not to eliminate or scale back activities that are not useful for the family. Ultimately, families and their family office can become very misaligned, which can be a fatal flaw for both. The essence of a family office is serving the family and supporting members in achieving their individual and collective objectives. Failing to deliver on the fundamental purpose the family envisioned is clearly grounds for existential questions to arise.

A regular review can evaluate the family office on how well it is serving the driving purpose of the family and address alignment needs.

Governance and control
Many family offices have poor or no governance. Authorities are poorly defined and activities are poorly controlled. There is also a tendency to build lean structures and focus on minimizing costs, which at times creates under-performance, allows poor governance, and encourages over-reliance on particular people (key man risk). Investment activities, among other things, can suffer greatly.

A poorly controlled or governed family office can lead to the family having less oversight, less control, and greater exposure to excessive, unforeseen risks. The need to protect long-term family capital makes this exposure unacceptable – something that is only heightened for financial families who no longer have the support of a regular cash flow out of an operating business.

In addition to poor paper governance, many family offices lack control as they are primarily manual and have low automation. As a result there is slow, error prone information gathering and consolidation. There is also no use of technological support for governance (e.g. automated alerts based on investment guideline parameters.)

Developing talent
Attracting and retaining talent can be difficult, as some believe career opportunities are limited in family offices. This can lead to the family office team stagnating over time, due to its members working outside the professional mainstream and becoming accustomed to "the way things have always been done for this family."

Therefore, ongoing professional training and development is crucial to keep up the expertise in the respective field. Management needs to proactively build this into the development plans of all family office staff.

Strategic planning
Proper governance can help your family office overcome pitfalls and maintain control. Longer-term strategic planning can help your family office meet its strategic challenges, which makes sure your office is prepared for succession and leadership changes, and stays on track for meeting the family's needs.

It is good practice to review your family office's overall design every three years, and redefine the vision and set concrete goals. Built to last, the strategic family office does more than stay viable to meet the financial needs of family members. It also helps a family to refine its driving purpose (what is it really trying to accomplish or be) and achieve the big goals that family members are collectively passionate about.

The family office board should review its strategy every three years. When you have assessed the strategy, check whether it is on track, faltering, or failing. You can test the strategy in these three areas:

1. Financial and organizational performance
– Does the family office meet or exceed your goals for building family wealth?
– Does the family office produce value in excess of its cost?
– Is the family office of appropriate quality?
– Is a leadership transition plan in place?

2. Serving the family
– Who is using the services? Track this by generation, wealth, and other important characteristics, such as geographical location.
– Does the family office meet the main family needs for which it was created? Does it fulfill its purpose?
– Is the purpose behind creating the family office still relevant to the evolving family?

3. Succession and family continuity
– Does the family office help the family prepare for succession in material terms?
– Does the family office help unite the family?
– Does the family office help build the right talent in the next generation to secure family leadership?

Your family office can do much more than oversee the family's finances. Over the long term, it can help the family succeed across generations by providing a well-designed wealth strategy, unifying the family, and ensuring the family has the right talent in place.

Round up

Best practice for your strategic family office

- Actively support regenerating wealth.
- Strategically plan for the family and family office, while assessing the value of its services.
- Formalize effective governance practices in forums; and through policies, procedures, regular reviews, and non-family board members, when appropriate.
- Provide quality educational programs for all family members and staff, covering technical knowledge and life skills.
- Communicate effectively, regularly and engagingly with family members of all ages, and internally and externally throughout the organization.

Appendices

Appendix 1: Job descriptions for family office staff

Role description: Chief Executive Officer

Responsibilities – the Chief Executive Officer will:

- Be responsible for managing the overall function of the office
- Oversee the treasury, administration, and accounting functions, including monitoring performance against budgets for the entire group, plus various entities
- Create and supervise a separate function for operations and for procuring goods and services
- Supervise property managers, and ensure best value for service and maintenance contracts
- Be in charge of monitoring all group insurance arrangements and overall risk management, including aviation and marine
- Review all human resources policies throughout the group
- Advise the owner family on all philanthropic projects
- Advise the owner family on special projects

Performance measures – the Chief Executive Officer will:

- Provide the owner with responsive, valid, and consistent data; offer the owner assistance and support
- Ensure the office is managed effectively and efficiently
- Ensure the office meets department-wide goals and group objectives
- Review activity reports and financial statements to determine progress and status in attaining the objectives
- Implement effective controls to set up and continuously improve management of operations and procurement of goods and services
- Evaluate managers' performance for complying with established policies and group objectives; manage an effective team; provide leadership in developing managers to improve their performance
- Manage company operations and ensure production efficiency, quality, and service; oversee the cost-effective management of resources
- Guide, support and approve all company operational procedures, policies, and standards

Role description: President

Background

A family office that serves a three-generation, five-household family is seeking an experienced senior executive to manage it. The President will work with the Family Council (the office's governing body) to determine the family office's strategic goals and priorities. This will ensure the office delivers premium services and hands-on relationship management for each client. Additionally, the President will be an active member of the investment and client services committees. The President will also be responsible for overseeing, implementing, and delivering all services, including managing all daily operations and staff.

Responsibilities

- Develop financial plans for each family member, relating to tax, estate, investment and philanthropic goals, and exposure to risk; coordinate the implementation process
- Educate family members on the concepts underlying creating wealth, protecting assets, and transferring wealth
- Monitor annual and long-term tax-planning strategies for all individuals and entities, relative to the investment activities
- Work with the investment services team to oversee developing investment policies and asset allocation plans for each client
- Develop and maintain relationships with current and future external advisors; coordinate strategies; monitor fees, commitments, and advisor performance
- Determine the proper role for the family office regarding philanthropic strategies for family clients
- Counsel and communicate with family clients on legal matters, as necessary
- Help family clients research and manage large personal or group projects
- Manage the family office's daily operations, including directing and monitoring the staff, setting employment policy, and coordinating day-to-day project management

Technical qualifications

- Minimum of 15 years' experience in the wealth management industry, with broad exposure to tax, estate and/or financial planning
- Experience working with and on boards and committees is desirable
- Proven track record in managing multiple projects, serving a large client base, and mentoring and educating taxable clients on financial matters

Educational qualifications

- BA or BS required.
- Professional certifications, including CFP, CPA, JD or CFA, are desirable

Personal attributes:

- Proactive and flexible leader with a hands-on approach.
- Confident, effective communicator, facilitator, and problem solver
- Motivated with strong listening skills
- Demonstrated high intelligence, integrity, honesty, and discretion

Compensation:

- Competitive annual base compensation plus a bonus

Role description: Investment counselor/ Chief Investment Officer

Responsibilities

- Supervise the management of the owners' individual portfolios
- Monitor developments in the financial markets to understand current and anticipated trends, and anticipate the respective effects
- Design and implement a working investment process
- Provide advice per the predefined investment policies (or the investment policy statement, if there is one), with the aim of maximizing portfolio performance consistent with the owners' individual objectives
- Maintain a good understanding of financial instruments; perform and/or supervise investment analysis and investment and reporting processes
- Lead a team of investment specialists; supervise the day-to-day business; and meet short and long-term financial targets
- Take a disciplined approach to rebalancing client portfolios
- Update the investment advisory board/investment council regularly; participate in regular Family Council sessions
- Ensure client portfolios comply with all appropriate compliance policies and procedures

Qualifications and attributes

- Financial background
- Extensive experience in leading positions within the financial markets industry
- Ability to work in complex environments
- Ability to work independently
- Completed CFA and/or MBA

Appendix 2: Sample investment guideline

This sample investment guideline is for information and illustrative purposes only, and has no regard to the specific investment objectives, financial situation, or needs of any person. It is also not intended as an offer to sell; or a solicitation of an offer to buy any product or other specific service; or advice to buy any product or other specific service, or their suitability.

This document's purpose is to give an example of how an investment guideline for a family office could look. Any figures, references to investment products, asset classes, and statements herein are intended for illustration purposes only. Certain services and products are subject to legal restrictions, and therefore cannot be offered worldwide on an unrestricted basis.

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I. Investment guideline summary

The essence of our investment process is an open architecture approach. This approach enables us to use the best suitable external managers and advisors. External resources include investment managers for various asset classes, and financial advisors helping us choose managers and allocate assets.

The following items outline the general guiding principles of our investment approach. They are likely to evolve over time.

- Main investment goal: capital preservation.
- Strategic asset allocation: the main driver for decisions.
- Tactical positioning: use tactical asset allocation as an instrument.
- Open architecture: use high-quality external investment managers.
- Portfolio structure: appropriately diversified to achieve investment objectives and avoid significant declines in market value.
- Diversification: implemented on multiple levels, such as asset class, geography, and investment drivers.
- Simplicity: keep the portfolio structure simple.
- Leverage: avoid funds that use excessive leverage.

II. Goals and objectives

These investment guidelines reflect our preferences, and describe our goals and objectives for the assets identified below. The guidelines are based on our long-term goals, purpose of wealth, investment objectives, risk tolerance, and investment preferences.

Overall objectives

- Our investment objective is to seek attractive returns and preserve the portfolio's real value over a long-term investment horizon.
- We will achieve this through a carefully planned and executed long-term investment program that allocates and manages the common assets efficiently and effectively.
- The portfolio aims to generate USD 10 million in income for lifestyle needs.
- Investment recommendations should have a sound rationale and be consistent with the clients' specific goals and objectives.

When establishing the investment objectives, we have accounted for the time horizon, possible inflows, expected liabilities, and other factors affecting our risk tolerance.

Investment portfolio objectives

- Invest in global financial assets with a bias to US fixed income and alternative investments.
- We have a preference for liquid and transparent assets outside of private equity holdings.
- Our team makes all investment decisions.
- External consultants will be actively involved in establishing and monitoring the strategic asset allocation and investment objectives of the investment.
- The long-term investment horizon is 10 to 15 years.
- There is an expected outflow of cash of USD 10 million each year.

Return expectations

- Our desired long-term return expectations are as follows:
  - Annualized gross return of at least 6% over a 10 to 15-year time horizon.
  - Annualized return growth over inflation (CPI – consumer price index), investment management expenses, and taxes of at least 4%.
  - In real terms, the investment portfolio shall generate USD 10 million per year.
- Performance will be measured in USD.

Risk tolerances

- Near-term losses shall not exceed 10% in any two-year period.
- Choose institutional quality external managers with measurable track records, organizational stability, and a reputable investor base; and managed based on industry best practices.
- No more than 6% of the total assets with a liquidity constraint beyond 12 months.
- No more than 5% of total assets in one investment.
- Tactical adjustments oriented with market timing are allowed.

Asset allocation

Strategic asset allocation exposure targets are:

	Strategic targets (10 to 15 years)		
Asset classes	**Target**	**Min**	**Max**
Large cap equities	15%	0%	10%
Small/mid equities	3%	0%	10%
Non-US equities	5%	0%	10%
Tax-exempt fixed income	40%	35%	65%
US taxable fixed income	10%	0%	25%
Non-US fixed income	2%	0%	10%
Hedge funds	12%	5%	20%
Private equity/Real estate	5%	0%	10%
Commodities	5%	0%	10%
Cash equivalents	3%	0%	20%

Each asset class must be diversified.

Strategic asset allocation targets are based on our goals and objectives, and the characteristics and attractiveness of the major asset classes. We should review strategic asset class targets yearly, or when significant events affect global capital markets.

The investment target should move within a certain range. It may not be feasible for the investment target to always be in line with the strategic targets for the asset classes in the portfolio. This is because doing so would require constant rebalancing and full liquidity of all investments.

Measuring investments

We measure the investments using these benchmarks:

Asset classes	Benchmarks
Large cap equities	Russell 1000
Small/mid equities	Russell 2000 Value Index
Non-US equities	MSCI EAFE
Tax-exempt fixed income	Barclays Capital Muni Bond Index
US taxable fixed income	Barclays Capital U.S. Aggregate Investment Grade
Non-US fixed income	Barclays Capital Global Emerging Markets
Hedge funds	HFRI Fund of Funds
Private equity/Real estate	Cambridge U.S. Private Equity Index
Real Estate Index to be discussed	5%
Commodities	Dow Jones AIG Commodity Index
Cash equivalents	US treasuries (90 day)

Operational guidelines

- To obtain low-cost coverage, or if we cannot identify outperforming active managers, use passively managed ETFs (exchange-traded funds)/index funds or other low-cost trading alternatives across asset classes whenever available.
- Implement investments in external managers specialized in asset classes, with a preference for those with an institutional infrastructure.
- Maintain a reliable and customized investment reporting system to:
  - track the goals and objectives
  - measure performance, including benchmarks, peers, and absolute return analysis
  - monitor markets, managers, and other relevant risks including, but not limited to, consolidated exposures and liquidity

III. Organizational structure – roles and responsibilities

This section describes the desired organizational structure to manage the investments, and the roles and responsibilities.

The table describes the main participants in the investment process. Please note that our choice of people and organizations is as important as our strategy. We should analyze, evaluate and monitor any external providers and consultants as carefully as if they were investment managers.

Participants	Description	Composition
Advisory board	Professionals with oversight responsibilities and experience	– Trustee – External advisors (such as legal, tax, and investment)
Investment committee	Senior professionals with deep understanding of the investment issues and family circumstances	– Trustee – Family representative
Investment team	Investment professionals, advisors and/or consultants	– Trustee – Family representative – Advisors
External consultants	Organizations hired to help select managers, perform due diligence, and allocate assets	– Advisors – Hedge fund consultant – We will consider additional consultants if they are determined to provide quality advice
Reporting and administration	Administrative professionals	– Internal and external professionals
Reporting providers	External organizations helping the reporting team manage information	– Custodian banks – Independent administrator – Software solution

IV. Benchmark definition

Russell 1000® Index

This index measures the performance of the large-cap segment of the US equity universe. It is a subset of the Russell 3000® Index, and includes around 1,000 of the largest securities, based on a combination of their market cap and current index membership. The index represents approximately 92% of the US market.

Russell 2000® Value Index

This index measures the performance of the small-cap value segment of the US equity universe. It includes Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values.

MSCI EAFE Index (Europe, Australasia, Far East)

This index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US and Canada.
As of June 2007, the MSCI EAFE Index consisted of these 21 developed market country indexes: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom.

Barclays Capital Muni Bond Index

A capitalization-weighted bond index created by Barclays, and intended to represent major municipal bonds of all quality ratings.

Barclays Capital U.S. Aggregate Investment Grade

This index covers all publicly issued, fixed-rate, non-convertible, investment-grade corporate debt. Issues are rated at least ‘Baa’ by Moody’s Investors Service or ‘BBB’ by Standard & Poor’s. Total return comprises price appreciation/depreciation, and income as a percentage of the original investment.

Barclays Capital Global Emerging Markets

The Barclays Capital Global Emerging Markets Strategy (GEMS) Index is based on investing in one-month synthetic money market deposits. It is a global index that measures the total return of the GEMS strategy applied to 15 diversified emerging markets currencies. The global index is formed by adding three regional sub-indices: Eastern Europe, Middle East and Africa; Latin America; and Asia.

HFRI Fund of Fund Composite Index

This is an equally weighted performance index, rebalanced monthly. It accounts for over 800 funds listed on the HFR database. The criterion for inclusion is reporting monthly net of all fee performance in USD with minimum assets of USD 50 million for at least 12 months’ track record.

Cambridge U.S. Private Equity Index

This index is based on returns data compiled for more than 75% of US institutional venture capital assets between 1990 and 2009.

Dow Jones AIG Commodity Index

This is composed of futures contracts on 20 physical commodities. It includes commodities traded on US exchanges, except for nickel, aluminum and zinc. The index relies primarily on liquidity data or the relative amount of trading activity to determine its weightings. All data used for liquidity and production calculations are averaged for a five-year period.

US treasuries

US treasuries are the most marketable money market security. They provide a way for the US government to raise money from the public. They are short-term securities.

List of figures

List of cases


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QUESTIONS

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and Cambridge Institute

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Wealth Management
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Great Wealth
Building on a deep understanding of our clients' mindset, motivations and core values, we create bespoke solutions which are bold, innovative and tailored precisely to their individual needs. The four dimensions of Great Wealth – business, investments, passion, and legacy – form the basis on which we open a dialogue and begin a partnership with our clients across generations for generations, so that Great Wealth endures.

About Cambridge Institute for Family Enterprise
Cambridge Institute for Family Enterprise is a leading education and research institute dedicated to the significant issues family enterprises face. It is a sister organization to Cambridge Advisors to Family Enterprise, a highly specialized advisory firm that helps family-owned enterprises design and implement strategies to achieve meaningful and lasting success. Both global organizations are divisions of the Cambridge Family Enterprise Group, founded in 1989 by John A. Davis, which is devoted to helping families achieve multigenerational success for their families, enterprises and financial wealth.

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