Single Family Offices in Action - How the Richest Families Manage Their Wealth

– *Wharton Global Family Alliance*

Wharton Global Family Alliance (GFA) conducted a research study on single-family offices (SFO) and family wealth management practices. SFOs manage the financial portfolios of rich families and often provide other associated services. The research found that SFOs not only play a major role in managing investment portfolios but also in guiding the family's philanthropic initiatives and maintaining a core set of values across generations of the wealthy families. Raphael Amit, Academic Director of Wharton's Global Family Alliance noted that the study's main contribution was - a better understanding of why do families set up SFOs. The research found that SFOs were primarily formed to manage investment portfolios, but to do so in a customized way that helps to achieve the families' objectives. The research found that increasingly SFOs were more focused on managing investments and non-financial services were not considered important. It was found that a family must have an asset/investment portfolio of at least $100 million for the SFO to be a viable option, which typically costs $3 million a year to operate.

Managing Trans-generational Wealth – Present day SFOs emerged during the middle of the 19th century with the creation of private banks and trust companies for the families that made money in the Industrial Revolution. The survey found that present day SFOs also operated for entrepreneurial families. More than half of the survey participants were found to be involved in business operations, while about three-fourth of them were majority stakeholders in the holding companies. Their level of involvement in business varied according to geography. While in USA, only two out of every five families surveyed were involved in the family business, the number was almost double for Europe and even higher for other parts of the world. The median SFO in the study served four households and eight family members.

According to majority of respondents, the most important objective for the SFO was trans-generational wealth management. Consolidation of accounts, tax and estate planning services turned out to be the second most important objective for the SFO. The study found that most SFOs collaborated with banks and other investment managers to safeguard and grow the family's wealth. Two-thirds of the European SFOs performed asset-allocation in-house compared to little less than half of the American SFOs that did the work in-house. European SFOs did most of their financial administration in-house. American SFOs in contrast outsourced most of their financial administration work. Some SFOs were also found to provide concierge services to the family. However, most focused on managing investments.

Governance and Accountability – On the governance front, the study suggested formulation of mission statements and operating agreements, that would define the following:- i) the goals of the family office, ii) the family's requirements that the family office is expected to meet and

iii) the family's financial and time commitments to ensure smooth operation of the family office. The study report suggested explicit governance practices for family offices to hold the professionals accountable. These include setting up pre-determined benchmarks, regular evaluations and clear reporting of outcomes.

More than half of the respondents chose a professional from outside as against a family member, to head the SFOs. Further analysis found that richer families favoured an outsider to manage their wealth. Majority of millionaire SFOs had family members as their heads whereas only about a quarter of the billionaire SFOs had family members as heads. *"Governance is very important…. interestingly enough, when we compared the Americas to Europe and the rest of the world, U.S. offices have the weakest governance,"* Amit commented.

The study found that in the Americas, the average size of SFOs was 8.7 employees compared to 13.2 in Europe and 11.8 elsewhere in the world. The study attributes the larger size of European family offices to the maturity of family wealth in Europe, with more generations and family members to manage. It was also found in the survey that investment professionals were willing to work at SFOs for less pay than they might earn elsewhere in return for a more relaxed and flexible work environment.

The study concludes with the following recommendations for families that operate SFOs –

- SFOs linked to families with a strong sense of purpose tend to perform better. Therefore, it is important that the family not only invests its assets but also its enthusiasm in the family office.

- Families must strive for excellence in all aspects of their office and separate the work functions to improve performance. Specialists must not be deployed for general work. Setting up separate companies for various specialized areas of asset management and concierge services, and a foundation for philanthropic activity is advisable.

- There is a strong need for families to simplify their corporate structures. Many SFOs were found dealing with more than 80 non-active holding companies which created problems in supervising and decision making.

Source:*Knowledge@Wharton, May 14, 2008.*