

# DESIGNING THE FAMILY OFFICE IN A NEW ERA OF PRIVATE WEALTH

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**W**HEN SET UP PROPERLY, a family office (FO) can be a powerful tool to meet the financial needs of the wealthy. It can deliver customized services in such areas as investment, tax, estates, trusts, and lifestyle management. Given sufficient scale and expertise, an FO can also access lower investment fees, provide greater customization than that of many banks and wealth managers, and make direct investments into private equity and hard assets.

Perhaps not surprisingly, global assets under management in FOs have expanded rapidly, at a compound annual growth rate of 18% over the past five years, to an estimated \$584 billion. At the same time, the families at the helms of these offices have begun to demand more from their wealth managers. Consistently low interest rates are compelling the wealthy to look for opportunities with higher returns and lower fees. Meanwhile, tightening regulations and greater digital reporting requirements are increasing the complexity of wealth management operations.

In addition, the most sophisticated investors are looking to reduce the number of intermediaries involved, increasingly moving away from passive investing to more active direct-investment opportunities. This shift allows large FOs to reduce intermediary fees, which can be a significant drag on returns, and to focus on attractive niche plays in which the FO can have a competitive advantage.

Setting up a new FO or running an existing one, however, can be quite complex. Tailoring the structure and design to a family's needs and preferences—an extensive commitment of time and energy—is essential, with careful consideration of privacy, succession planning, and governance. FOs can take one of three structural forms:

- A single family office (SFO)
- A merger into, or relationship with, a larger multifamily office (MFO)
- A trimmed-down virtual family office (VFO)

When it comes to the design of these structures, the options multiply exponentially, particularly in the approaches to governance, investment, and service. Families that get it wrong can face pitfalls ranging from disagreements among family members to undesirable risk exposure. Those that get it right, however, can preserve their wealth and lifestyle for future generations.

## The Benefits of the Family Office

For wealthy families that currently rely on intermediaries alone, setting up an FO consolidates, unbundles, and professionalizes relationships with banks and other third-party providers. It provides transparency into the cost of wealth advisory services and offers tighter control over the provider network than other entities do. As a result, it can also generate substantial savings that can help cover the FO’s operating costs. (See Exhibit 1.)

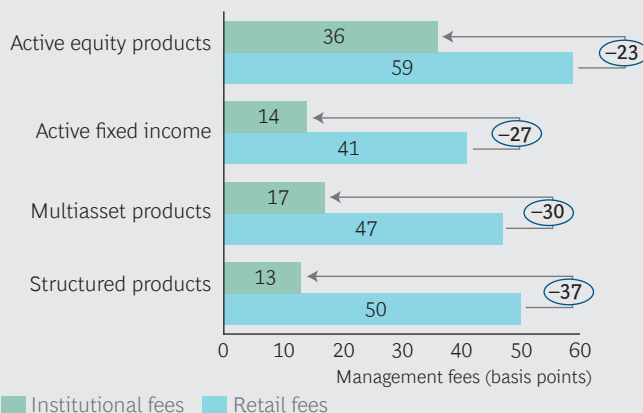
More important, an FO allows the family to retain direct control over the services it provides and to closely align those services with the family’s interests. In fact, an FO can offer a level of customization not possible through private banks, which are often strong in core investment advisory services but have less flexibility when it comes to accounting, wealth administration, and lifestyle services.

FOs also increase a family’s ability to invest or co-invest directly in alternative assets, such as private equity. Larger FOs with the right teams and systems in place can often take a longer-term, more patient view than most traditional private-equity firms and can even be more attractive as buyers to, for example, family owners who might prefer to sell to another family—thus unlocking investments that would not otherwise be viable. They can also assert a high degree of control over the choice of the companies in which they invest on the basis of such criteria as their industry, location, and social responsibility. In fact, the need for such control has led many FOs to expand into direct investment. As Patrick De Maeseneire, the CEO of an FO known as Jacobs Holding, comments, “We try to differentiate ourselves with an investment horizon of at least 20 years, larger equity tickets, and a focused approach on three sectors where the heritage of the Jacobs family lies: branded foods, branded food service, and specialized services with a high human component.”

Whether newly created or already well-established, FOs provide important benefits. But the level of complexity with regard to setting up, running, and growing the enterprise rises as the number of family members, beneficiaries, and clients increases. It is easy to make mistakes: A failure to agree on service levels, for example, can cause

### EXHIBIT 1 | Family Offices Bring Significant Fee Savings

PRIVATE-BANK CUSTOMERS AND FAMILY OFFICES PAY FEES THAT TEND TO BE MIDWAY BETWEEN RETAIL AND INSTITUTIONAL FEES



Sources: BCG global benchmarks and expert interviews.

family dissension, and an inability to create a clear succession plan can generate conflicts as the number of descendants grows. In addition, families may not establish sufficiently clear performance metrics and reporting procedures for the FO management team, resulting in a lack of adequate investment oversight, poorly defined investment aims, or a lack of performance benchmarking. Moreover, the absence of long-term incentives and career development plans can make it hard to hire and retain top talent. Perhaps more seriously, an FO may not create the necessary risk models to align market risk exposure with the family's preferences, resulting in unanticipated losses.

## Choosing the Right Structure

Many such pitfalls can be avoided by setting up an appropriate FO structure. There are no ready-made design blueprints or easy choices; instead, the FO must be tailored to the family's—and the family business's—specific needs.

Individuals and families not currently running their own investment operations can begin by choosing between starting their own SFO or VFO or joining an existing MFO. Owners of established SFOs can consider either merging with other SFOs or MFOs or else opening up their own firm to external investors—effectively converting to an MFO.

### SINGLE-FAMILY OFFICES

Large families typically have complex needs and should consider establishing their own SFO. An SFO provides wealth management services through a single service center that uses a variety of providers. It directly manages the family's financial affairs, allowing the family to fully customize its service offering—more than any other type of FO—to its own diverse demands and preferences. In fact, the service offerings of SFOs often extend to providing complex family governance, lifestyle services, philanthropy, and direct-investment capabilities. As one family told us, “Our family's needs and preferences were too distinct to be met by any established provider. This was one of the main motives for setting up our own family office from scratch.”

Families that want to establish an SFO, and that have sufficient assets to do so, should begin by hiring a chief operating officer and a blue-chip investment team. Together, they can select managers effectively and perhaps access new opportunities directly, thus becoming a driving force behind increasing investment returns. The investment team will develop a strategy, an asset allocation plan, and risk profiles to meet the needs of the family in question. It will then review all existing suppliers of the various services on offer to find the right match. Looking inside the “black box” of investment services will also allow the team to optimize the provider network and determine what should be outsourced and what should be handled in-house.

### MULTIFAMILY OFFICES

An established, midsize SFO can improve its operations by combining its strengths with those of other firms to create an MFO. This combination can take one of three forms: informal collaborations, semiformal alliances that share infrastructures and pool resources, and formal commercial integrations.

**Informal Collaborations.** Existing FOs can collaborate without merging or setting up a business venture together by creating an informal alliance. This type of alliance allows offices to tap into such shared resources as global investment opportunities and information, consolidated reporting, and family education tools. Wigmore Association, for example, fosters collaboration among the CIOs of eight family offices with the aim of sharing insights into areas such as manager selection and investment due diligence.

**Semiformal Alliances.** In this model, two offices may come together to form a business venture, though they continue to exist independently as FOs while collaborating to create something new. US-based WE Family Offices, for example, joined Spain-based MdF Family Partners to form the Wren Investment Office in London. Each firm has its own governance structure and shareholders, but investment resources and operational systems are shared.

Sharing costs and splitting revenues allows the founding firms to benefit from investment expertise in many locales, along with cost efficiencies and a team of highly talented investment professionals.

**Formal Commercial Integrations.** Midsize FOs may merge to become even bigger, extending their geographic and product coverage. For example, Stonehage, in an effort to take full advantage of scale efficiencies, merged with Fleming Family & Partners to create Stonehage Fleming. The new firm is one of the biggest independent commercial MFOs in Europe, the Middle East, and Africa: it has over \$40 billion in assets under advisory and more than 250 clients.

This formal integration can be either private or commercial. A private MFO is typically formed around an anchor investor who brings in additional families to scale the operation. This model works best when the families share similar values and have long-established ties. In contrast, a commercial MFO is established to manage the wealth of a larger number of clients. It has the greatest ability of any MFO to spread fixed costs across a wide base of operations and the potential to be operated at a profit. However, commercial MFOs take a long time to develop, and they face the highest regulatory burdens.

Mergers among midsize SFOs present exciting commercial opportunities for their owners because the largest MFOs may be able to offer best-in-class service as well as investments that are similar to—and pricing that is more attractive than—those offered by private banks. This is only possible if an FO can attract and retain talented client coverage and investment teams, however—a task that becomes easier with size and geographic reach.

Perhaps most important today, a merger can help spread the rising costs of regulatory compliance and digital technology across a larger business base. As the CEO of the Investments Division of Stonehage Fleming, Anton Sternberg, explains, “The merger has not only accelerated our geographic reach

and improved services for existing customers of both entities but also attracted significant interest from new customers looking to join.”

Nevertheless, formal consolidation with other family offices may seem unattractive to some FOs because they don’t want to give up control, privacy, and full decision-making power. In addition, members of an MFO will have less flexibility in structuring the office, and the potential for conflicts of interest among investors is increased. The larger the MFO, the broader the investment opportunities, but compromises will clearly need to be made in terms of customizing and personalizing lifestyle services.

### **VIRTUAL FAMILY OFFICES**

Setting up a VFO may be a good choice for three types of families: those that have no wish to grow or merge with other offices (perhaps because they value their privacy), those that are considering shutting down the operations of an existing SFO, and those that might want to rely solely on private banks.

A VFO is intended to provide an umbrella support structure for its investors’ wealth and service needs, handling them with a light touch by outsourcing to external service providers. To become virtual, an SFO must strip its organizational structure to the minimum, retaining just one or two professionals to manage external vendors, negotiate rates, and respond to family requests. The VFO thus effectively becomes a coordination center, which allows the office to keep overhead costs as low as possible. This model is particularly suitable for small FOs that want to maintain both direct control over existing services and a certain level of personalization without the high costs of a more formal structure.

VFOs can be established quickly through existing specialists, are relatively simple to set up, and allow investors to switch providers fairly easily. They offer advantages similar to those of other FOs, including greater transparency of fees and a close alignment with family interests, since families can retain some degree of flexibility in

their choice of providers and services. However, investors will typically have to be satisfied with lower levels of service, and they will lose some of their ability to customize products and solutions.

## Finding the Right Design

After the appropriate structure has been determined, investors can begin to make the design choices that are most suited to their unique needs. They must carefully manage the dynamics of wealth structuring among family members, for example, determining how costs are allocated, how portfolio businesses are supervised, how family wealth is distributed, and how this wealth will eventually be passed down to the next generation. Each of these factors will feed into the ultimate design of the FO. (See Exhibit 2.)

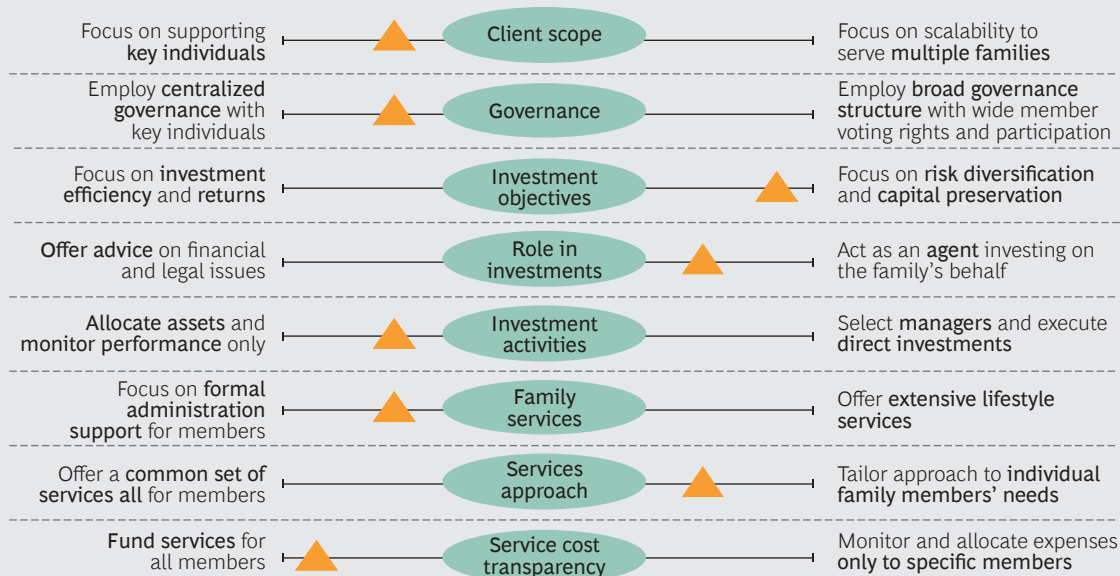
One of the most important choices will be to determine the level of investment control. Families can choose to focus only on asset allocation—specifying just the broad asset class, industry, or geographic exposure they want vis-à-vis the desired risk-return profile. Or, they can go a step further and choose asset managers that align with their asset-allocation preferences. In the third alternative, they can take full control, buying

bonds, real estate, or portfolio businesses directly. Each choice will require a vastly different skill set for members of the FO management team. They will need to determine the mix of locations, currencies, and industries in which to invest; review the historical performance of—and perform due diligence on—portfolio managers; and, ultimately, determine every detail of the assets to buy and the transactions to execute.

Another key choice will be to determine governance. The founding member of the FO will have to figure out who will make each type of decision: the head of the family, selected family members, or a formal FO council. The founder will also have to determine how decision-making power will be shared among the family members, the managers of the underlying wealth-generating businesses, and the FO executives.

Officers in charge of running the FO must also decide the extent of the services required and the degree to which those services should be tailored to individual family members' needs. As founders age and families expand into multiple generations, for example, many may look for support for the younger generations in succession planning or in new business ventures. In

### EXHIBIT 2 | Family Offices Have a Variety of Design Options



▲ Example of design choices made by one investor

Source: BCG framework.



addition, some services, such as personal security or lifestyle, may have to be provided in-house because of privacy issues.

Finally, choosing the right location for the FO is critical. The owner's nationality and residency status will play a large role in determining which jurisdiction to choose, and the jurisdiction, in turn, will play a large role in designing the legal structure.

## Talent Drives Success

Ultimately, the success or failure of an

FO—regardless of structure, design, or location—will come down to hiring and retaining the right investment experts and operating staff. Legal structure and systems are not enough, on their own, to generate outstanding performance. Whether an FO employs two people or twenty, it must ensure that the individuals are not only highly qualified and experienced but also extremely trustworthy. They must also be a good fit with the culture and investment style of the owners—because they will, ideally, advise the family for many years to come.

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