

FROM BACK OFFICE TO EXECUTIVE SUITE – THE EVOLVING ROLE OF THE FAMILY OFFICE

Family offices have received increased attention and endorsement in our field over the past decade. Initially, the family office emerged to meet a very specific set of needs for business-owning families. However, as offices have become more widely adopted, a range of designs have been implemented – some successfully, others not. While our understanding of the evolution of family businesses from generation to generation has increased dramatically, the equally important changes in the family office have not been evaluated as fully. In particular, there has not been an application of the most useful family business models toward understanding how the family office fits into the overall development of the family enterprise. Our aim in this article is to sketch a developmental framework for the family office and examine the ways in that this framework may be useful to those in leadership roles.

Two years ago we introduced a developmental model of change in family companies which proposed alternating periods of stability and of transition as the business moves from early, simpler structures to more complex ones. This model of structural change is based on a concept from the natural sciences: that while the pressure that drives change is continuous, change itself does not occur in gradual incremental steps, but rather in spurts. Like a glacier, a family enterprise is a growing, working system – constantly interacting with its environment, and balancing movement with stability. Applying this model to the evolution of family offices, we reviewed the histories of our client families in Europe and North America who had implemented some form of family office in the past decade. We found a remarkable consistency in their experiences, with some important lessons concerning

best practices and common pitfalls. Overall, every case went through two stages: a “pre-office” stage, using advisors individually, and a “support service” stage, providing specific assistance for shareholders and their relatives. In addition, in those cases where the family enterprise continued to evolve away from a single-business model to a complex group of companies and investments, the role of their family offices also continued to change. We called this emerging third stage “network integration”.

Stage 1: Pre-office stage

In the early days of a family business, the owner-operator typically uses the company’s staff and his or her own personal advisors to manage tax, legal and banking tasks. If the business succeeds, however, financial management can gradually take more and more effort. This can be illustrated in the case of a successful entrepreneur who built a significant business, relying on the services and expertise of her staff to satisfy the financial needs of her family. Initially she requested that the company’s accountant prepare the taxes for her husband and children. Several years later she had the company’s lawyer establish a trust for her family. Her family’s financial and legal planning were intricately intertwined with the company (See Fig. 1).

As the company grew, the need for service also grew. More family members entered the business. The advisors extended their assistance to the wider family as a convenience and, increasingly, as a perk for family employees and shareholders.

Over time, the pressure built for a fundamental change. In this “pre-office” case, the trigger for structural change came from the company’s attorney. His staff began to complain about spending too much time on non-business activities, and to express concern about the

Research has shown that the development of family companies can fall into two, sometimes three, stages.

This article discusses these stages in detail and shows how they can be useful to those in leadership roles

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Figure 1: The controlling owner family enterprise.

inappropriate mixing of family and business matters. The advisors were often put in the uncomfortable position of deciding how to respond to direct requests for service from family members, some in the company, some shareholders, and some neither managers nor owners. The need for a more formal “family office” was suddenly clear to the leader. She asked her sister, who had accountancy experience, to help get it started. They used their family’s attorney to identify the right professionals, draft some rules for fair usage, formalise the procedures for access and put together a simple design that everyone accepted.

Stage 2; The family office as a support service

The increased interest in more formal (Stage 2) family offices has in part been facilitated by the input of professional advisors and family business educators themselves. As families and advisors listened to the message about the importance of separating the functions of the “three circles” – business, ownership, and family – it became clear that while the business circle had a structure of management and support services to help it perform its functions, and the owners increasingly had boards of directors, the family circles often had no organisational support at all. Many families responded with two efforts: a family council, to handle the interpersonal

aspects of family ownership; and a family office, to handle the financial tasks (See Fig. 2).

The significant benefits of a formal, well-structured family office to these enterprises has been well-documented. They provide technical services to family members, who want to benefit from economies of scale. The professional advice and direct service available to the family members is often far beyond what they would arrange for themselves, and frequently at a lower cost. It is likely, at this stage, that competition will arise between the family and the business for access to cash and liquidity. Owners and directors working in the business are likely to want retained earnings and other resources channelled into business growth and reinvestment. Those not in the business, however, are likely to want access to liquid funds to diversify their personal investment portfolios. The family office can potentially provide essential data and expertise, often through the family council, to help deal with this tension.

Much of the literature generated by advisors from their experience with family offices at this stage highlights the key dilemmas faced by family office staff:

- How does the family understand the fundamental mission of the office?
- Which members of the family are chosen to sit on the family office board or in the investment committees?



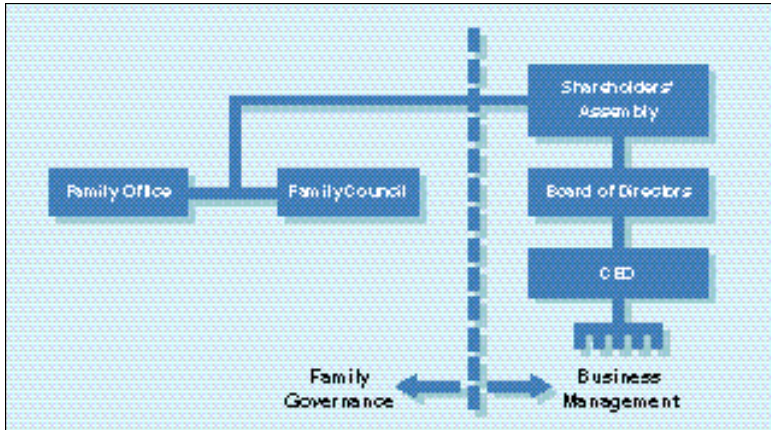


Figure 2: The family office as support service.

- Who is eligible to receive services?
- How are the costs of the office allocated among family members?
- How do the staff balance the conflicting interests of the company and of the individual family members?

While these questions can be addressed as policy issues within the office itself, we believe that is not the most productive approach. A narrow focus on the technical aspects of the work may lead professionals to overlook how the family office interacts with the broader family enterprise context over time. As the business grows and moves through generational transitions, executive leadership (and the automatic perks that come with senior positions) often becomes increasingly concentrated in one family branch. At this stage the differences in wealth across family branches become significant – an underlying stress that usually remains unspoken. The discrepancy between the “insiders” and the “outlaws” may widen, putting pressure on early agreements about who has to pay for what. Family office staff can find themselves repeatedly in the middle of misperceptions and honest glitches in communication, or more seriously, jealousies and rivalries. Yet many family offices, who understand their embedded role in the overall family system, find a way to respond. The successful offices at this stage all shared at least two

characteristics: 1) sensitive and excellent leadership; and 2) close integration with a well-functioning family council.

An increasing percentage of the families we work with in the Cousin Consortium stage of ownership are facing significant restructuring of their enterprises – the core identity of their “family businesses” is changing. The particulars of the evolution may vary.

- The original operating company may be augmented, or replaced, by a group of operating companies, each with a different ownership structure.
- Other family-controlled units, such as a foundation, may be created.
- The mechanics of ownership may evolve from simple partnerships or corporations to groups of trusts, limited family partnerships, multiple classes of stock, or holding companies.
- The enterprise may become international, bringing new legal and financial complexities.
- One-time significant events, such as an IPO, acquisition, or divestiture, may lead to sudden infusions of (or demands for) cash.

Once again, the “glacial” developmental pressure begins to build. The executive committee of the business and the family council can no longer lead and co-ordinate all this work and the tasks of asset allocation and wealth management move to centre stage.



**Family Office:
Development**

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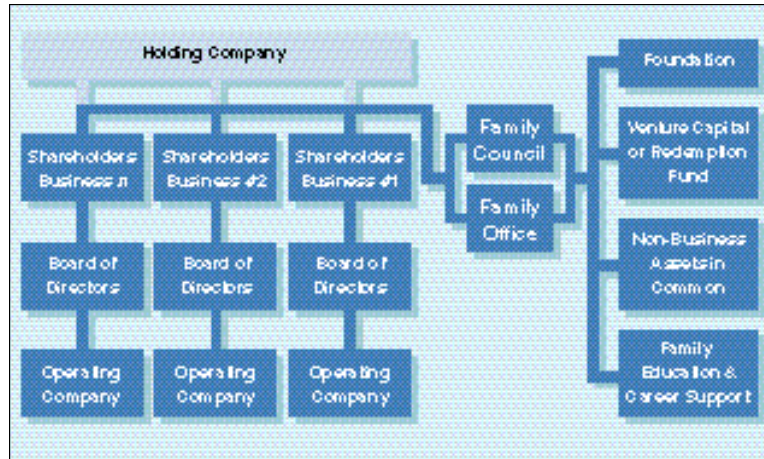


Figure 3: The family office as network integrator.

Stage 3: The family office as network integrator

At this point, the Family Office needs to move from support service to network integration. Family leaders need to recognise its central importance in relation to the family's mission, the business's strategy and the owners' return on their investment. In these owner-investor family enterprises, the family council and the family office become the primary coordinating structures linking all aspects of the operation: wealth generation, wealth management, continuity, philanthropy, and the family legacy (See Fig. 3). When this is the case, the family office reaches a third stage: network integrator. This redefinition raises once again some fundamental questions about resources, structure, and process.

What are its tasks? The family council is the forum for family governance. The family office is the council's information and services arm. Financial services and advising remain the office's core "technology," in addition to new capabilities such as education (from basic financial literacy to value-focused investing strategies), security, career development and guidance, global awareness, and language skills.

Who will staff it? In several cases this was a very sensitive issue. Some family members who had found a meaningful role in the early stages of the family

office suddenly found themselves out of their depth. Likewise, loyal advisors who helped the firm and the family office evolve may not be up to the level of sophistication that the family enterprise office requires and demands.

Where should it be located? Who will pay for it? Running a company is easier to understand than co-ordinating a Cousin Consortium of owners. Placing the Stage 3 family office in the centre of the family's executive suite conveys the message that the owner development tasks are now the core of the enterprise's mission. Analysts and other observers may frown when they perceive that "family matters" are taking up valuable and tangible resources. There is a real challenge for those inside the business to educate those on the outside on the function of this kind of family office.

Summary

Family offices change as the families and the enterprise they serve also change. As more families find themselves in increasingly complex networks of operated companies, investments, joint ventures and philanthropies, the family office can be their most reliable touchstone. To do so effectively, however, these offices need the same level of talent, commitment, planning and organisation as is required by an successful family business. ♦