PKF O'CONNOR DAVIES FAMILY OFFICE

The Five Pillars of Family Office Success

Strategies for Achieving Greater Functional Effectiveness

By Gemma Leddy, CPA

Anyone close to the family office world knows the operational landscape has changed dramatically over the last decade. Families, like virtually everyone else, are dealing with more regulatory red tape, more risk and more information than ever before – all while having fewer resources.

In this environment, family offices are looking for any edge they can get that will help them cut through the clutter, reach new levels of efficiency and ultimately improve the effectiveness of their daily operations.

Some families view technology as the great equalizer. And while there have been solid advances in the software and systems available, technology upgrades come at a cost and the reality is there is no silver bullet. To truly gain greater transparency, control and decision making power, family offices must identify and implement best practices and create repeatable processes for carrying them out.

The challenge is many family offices don't know where to begin, who to rely on for guidance or how to overcome the inertia of their current processes. To put family offices on the right path, below is a framework of strategies and avoidable pitfalls in key functional areas to help drive success in this new era of operations.

1. Information as an Asset

With the increasing volume and complexity of information,the most effective family offices have found a way to organize and access information so it becomes a decision-making tool rather than a data storm to be dealt with. Making information an asset begins with a prioritization process. Families must ask themselves, "what is the information we need and how often do we need to access it?" With those questions in place, a family office can begin prioritizing based on real needs.

It is critical to have a view of basic information from cash flow and liquidity to net worth and tax liabilities. The ability to view that information in a connected fashion informs investment decisions, lifestyle decisions, and compliance decisions among others. But it's not just the information you have, it's how you use it and who uses it for that matter. When setting up a system for sharing information, it's important to have a team of trusted advisors who can access and interpret the information. Collaborate with your advisors in key areas from tax to legal to compliance to get their thoughts on the information they need and how to get it to them in an efficient and affordable way.

Pitfall: Don't have unrealistic expectations related to the flexibility and adaptability of a system. Software spend should be a cost-benefit analysis. At a minimum, the system should meet your most pressing needs and optimally be able to efficiently integrate with other systems. It's also not just about the system – it's about the people who use it. Whether an in-house-team or outside experts you need people with the ability to effectively navigate the system and leverage its information. Consider the following characteristics of a good information system before making any decisions:

- **Security** – The information must be private and secure.
- **Accessibility** – There should be controlled access inside and outside the organization.
- **Reliability** – There must be checks and balances in place to ensure information accuracy.
- **Timeliness** – Information should be updated regularly to reflect current state and needs.
- **Relevance** – Stakeholders should have the ability to organize and analyze information how they want to or need to.

2. Communication Is a Wealth Preservation Imperative

While some families look at communication simply as a means of keeping their members and advisors informed; it's much more than that. In many cases it's a fiduciary obligation and the reality is that it is often the most important tool for keeping the family's wealth intact.

Members of wealthy families are stakeholders in businesses and often invest together. That's why it's so important to have clear communications processes in place to drive effective and open communication and ensure values are passed on between multiple generations of family and team members. When thinking about the best way to structure communications and drive long-term success, the following elements are critical. Effective communication must be:

- **Centralized** – At least one member of the family/team should have a view of how the different pieces come together and who's communicating what to whom.
- **Inclusive** – In the most successful families, all the members feel in the loop. They often bring in younger generations early and slowly and expand the amount of information they receive over time.

Family glimpse: One family had adult children in their 50s who had little understanding of their personal or family wealth. Given their lack of information, they were unsure of what questions to ask or even who to ask. They didn't know their net worth, trust structure, spending budget or other vital information to empower them to control their own financial destiny or prepare them to preserve the family's wealth long-term. The situation created uncertainty and stress and ultimately delayed the next generation's ability to become responsible stewards of the family's wealth.

- **Educational** – It's not about communication for communication's sake; it's about communication that educates family members on everything from the day-to-day running of the family enterprise to the values that are being passed on from generation to generation. Practical guidance through charitable work can evolve into other areas of the business/operation.

Pitfall: Overcoming personal opinions. Often people controlling the flow of communication give out as little as possible because they feel like the next generation isn't ready to handle it. This approach is counterproductive to the preparation of the next generation and in most cases creates negative feelings between family members.

3. Balancing Risk Assessment with Advisor Access

Risk management is critical to the long-term sustainability of any family. Wealth preservation is one form of risk management that is often achieved through legal structures, insurance and other strategies. At a higher level, best practices in risk management are characterized by being able to identify key areas of risk that could impact a family and putting a plan in place to mitigate those risks.

Unfortunately, it's not as simple as creating a checklist. Wealthy families are complex with a lot of moving parts and they need risk advisors who can assess their risks from

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a number of angles. They also must be willing to allow their advisors access to private information so they can get a true picture of their vulnerabilities.

Some common risks include:

- **Fiduciary risk** – As Trustees of foundations and trusts, family members assume additional risk and responsibility to beneficiaries. Trustees are not always aware of their specific fiduciary obligations and very often may not be equipped to carry them out.
- **Investment risk** – Aligns with wealth preservation. It is marked by the level of risk the family takes on from an investment standpoint.
- **Reputational risk** – The way family members act and what that can do to public perception. Today that also translates into social media. It's important to educate children on how to approach social media and how their individual actions impact the family as a whole.
- **Physical risk** – Safety and well being of family members.
- **Information risk** – Relates to privacy and confidentiality. Is your information secure? What systems do you have in place for backing up data, disaster recovery and cyber security.
- **Legal risk** – What is the family's potential for lawsuits and is there a strong legal team in place to identify and mitigate those risks?
- **Compliance risk** – Potential for not complying with laws/ regulations.

Pitfall: Letting fear get in the way of productivity or best practices. It is important that families are careful and vet partners and providers thoroughly but that doesn't mean not letting experts provide the necessary support. There is as much or more risk when a family closes off from outside partners or objective insights on where the family is vulnerable and how to protect itself and its assets.

4. Lifestyle Is More than a Line Item

Some families equate lifestyle with spending habits. And while that is certainly part of it, the elements of maintaining a lifestyle while preserving a family's wealth and minimizing risk are much more complex. A family must have a firm handle on everything from employment practices and outside providers to personal budgets and larger expenditures. The families that most effectively manage their lifestyles stay involved and informed even when outside providers may be managing the process more broadly. Lifestyle choices are specific and personal to each family but there are similarities and best practices. Some of the common considerations include:

- **Staffing** – Is there a set process for finding, hiring and managing competent staff?
- **Spending** – Are there financial and budgeting guidelines in place to ensure responsible spending and a process to identify and communicate with family members who are overstepping?
- **Benchmarking** – People/providers often overcharge when dealing with wealthy families. There should be processes in place to evaluate costs and providers and ensure the family is paying appropriately. There should also be an eye toward tax strategies to ensure structures are most conducive to lowest tax burden.
- **Health and well being** – With concierge care and security consulting becoming more mainstream, families have access to information and expertise no matter where they are in the world, 24/7. To effectively utilize those resources, the family must be aware of potential opportunities from a healthcare and security standpoint and put a plan in place to implement best practices and facilitate better outcomes.

Family glimpse: Families should tap into the expertise of their advisors when making significant lifestyle decisions. Whether they are purchasing art, building a residence, embarking on a renovation or purchasing/ leasing a plane, significant expenditures require expert planning and evaluation to ensure family goals are aligned, long-term wealth is sustained, costs and risks are minimized and tax efficiency is maximized. In one situation a family member wanted to purchase a plane. The family worked with their advisors to perform a detailed evaluation of the family's unique business and lifestyle needs and a comprehensive analysis of the costs and alternatives. Despite the stated desire to buy the plane the analysis showed that leasing was the optimal solution and the family agreed and followed that recommendation.

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5. A Top Team Relieves Pressure

More and more families are realizing that compiling teams of experts in key specialty areas is a critical component of relieving operational pressure and achieving greater effectiveness. But realizing that and making it a reality are two different things. Families must identify the key areas in which expertise is most needed from tax, legal, investment and accounting to risk, security, health and beyond – then decide which of those resources will be internal or external.

The family needs to appoint a de facto CEO, whether it's a family member or perhaps an attorney or CPA, to manage that team. That person doesn't need to be an expert in each of the areas, but they do need to be informed enough to manage those experts and maintain a dialogue with them. Part of being a leader is ensuring the team works collaboratively, not competing for attention. Each member should bring value in their area of expertise that supports the decision-making process as a whole.

With a top team and a process for managing them in place, families have a much better means of making informed decisions that are in the best interest of the family today and in the future.

Conclusion

Family offices are facing a new operational landscape and a new regulatory normal, yet many are still using old processes to drive their interactions and their information. For many, it's time to take the next step in their operational evolution and begin building best practices. Unfortunately, they often don't know how to identify or implement them. Hopefully, the insights above will help provide a clearer path forward and the pillars for success that will lay the foundation for greater operational effectiveness.

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