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Private Wealth: Origin and Destination
From Entrepreneurship to Family Offices

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The last decade has seen an impressive growth of private wealth on a global scale. In its inaugural ranking of the world's richest people 20 years ago, FORBES uncovered some 140 billionaires. In 2005 the list was a record 793, up 102 from 2004. Whilst private wealth has broadly spread, little insight has been provided on the evolution and influencing factors of the private wealth development process over time, starting with the founder/entrepreneur up to multi-generational families with their family businesses and family offices.

Of particular interest is the extent to which relationship dynamics amongst family members influence the creation, distribution, management and performance of private wealth. As wealth creators, owners, and subsequently investors, families often take an entrepre-neurial stance in the running of their company and the family's other financial assets. However, outside managers – non-family – have an increasingly important role to play in the owning family's business and financial interests.

Introducing the Family Office

In this article, we present a model for the stages of development of private wealth through the vehicle of a family owned business. Further, we show how the development of the business leads to the establishment of an entity to manage the family's financial interests: the family office. We present highlights from an in-depth study of 12 of Europe's largest family offices, illustrating aspects of these institutions which are of great relevance to managers, working directly and indirectly with and for family owners.

Origin: Entrepreneurial Dream

It all begins with an entrepreneur…
The entrepreneur, the original founder and manager of what will become a family business, controls all levers of power on the levels of ownership, management and family standing behind this newly created business entity. He/she provides the founding myth for the family that captures the core family values and a vision to be referred to across generations. The family business will play a significant role in the dynamics of a family for generations to come. The business is in fact part of the day-to-day living of the family, and is a platform for interactions within the family and with outsiders.

And then other family members become manager-owners
Moving to the next generation, as both family and business grow, we see increased demand for participation of other family members in the firm. They are perceived as a ready source of trustworthy talent that understand the business. Through these actions, a degree of management control is being passed on to the younger generation of the family. Later, as the founder retires from direct involvement in the family business, siblings find it necessary to share power and control over the business with each other. While there is a growing need to formalize some aspects of the family business governance, in general, they are limited, since the relationship of family members still remains close.

And we then have managers and owners…
In the later generations, not everyone in the family is, or wants to be, involved directly in the running of the business – while

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they might all be owners, only some are managers. Whether rising family members become managers in the business is in great measure determined to the extent active efforts were made to consistently involve them in the business from an early age. Further, the greater generational distance from the original founder translates into a rising need for a separation of power and control over the family's financial affairs, including the family business.

The framework presented here becomes a useful tool to think about and plan for the role the family business plays in the family, as well as to the extent of contact and involvement with the owning family takes place and in which forms.

And starts turning into a family-in-business…

Over time and generations, the businesses tend to be the "glue" holding together the family branches appearing after the founding generation. When the original business declines in importance over other business and financial interests, it means finding "glue" other than the family business to keep the family together. The business is part of the family's history and tradition and it's difficult to see it simply as an investment forming part of the family's overall wealth.

While the business is a family enterprise, at the individual level, once we get past the founder, not everyone in the family is or wants to be involved directly as manager in the business. In such situations there is a clear need to think strategically about the family's financial position and design a new structure and a plan of action – they have now become a family-in-business.

Who governs?	Which family members?	Where is the power?	What's the culture?
One Owner-Manager	Founder	Power Concentration	„I“
Few Owner-Managers	Siblings	Power Sharing	„US“
Owners and Managers	Cousins	Power Separation	„US and THEM“

Figure 1 Typology of Family Businesses

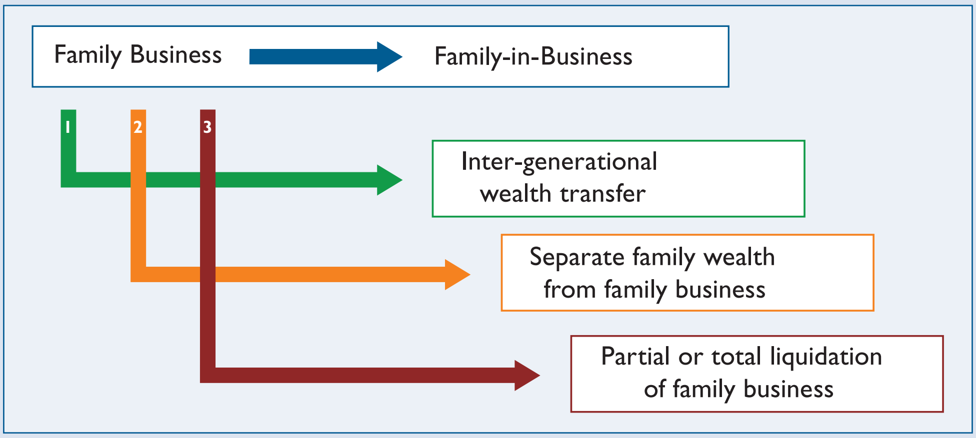

Figure 2 Transition to a Family-in-Business

Destination: Maintaining and Growing Private Wealth

A family-in-business needs a platform to capture the wealth – business and financial – and to address the broader needs of current and future generations.

But what is a family office?

A family office is an entity which takes care of the day-to-day management and administration of the collective assets and business affairs of one or more families. Its long-term goal is to preserve and grow the wealth for current and future generations. For the family-in-business a family office takes on the rallying role previously served by the family itself.

Why are Family Offices Established?

To transfer assets across generations

Family offices have served as vehicles for intra-family and intergenerational transfer of assets. The most common example for the establishment of an office is the retirement of the original founder(s). Family offices can be established on behalf of heirs, so as to have the structures necessary to manage inherited assets in common, rather than liquidating the assets and dividing the proceeds.

To improve family governance

A family office could be a strategic decision by family members to create a formal distinction of the family wealth from the assets of the family business. Financial risk diversification is a primary motivation. Also, separation can be done in the spirit of improving transparency and corporate governance of the family business.

Manage cash inflow from liquidation of family business

The third source of funds is the sale of, at least, a portion of the family business, leading to a sudden increase in overall liquidity. To illustrate the importance of trade sales as a liquidity source for family offices, the aggregate reported assets of the family offices interviewed according to their source are € 30 billion. Out of this total, 71 % results from the complete or partial sale of the family business. In comparison, only 14 % of assets come from historical family wealth. The remaining 15 % is liquid wealth from other investments.

What Determines the Structure of a Family Office?

Our research identified four key factors shaping the structure and operations, as well as its governance and investment allocation.

1) Type of clientele

The primary determinant of the office structure and operation, as well as eventual investment decisions, is the type of clientele it serves. Two factors characterize the clientele: the number of family members; and their "generational spread" – the distance between the latest generation of family members served by the office and the founder's generation.

2) Who is involved in the family office?

Family member involvement can in itself be a goal embedded in the establishment of the family office. Generally, more entrepreneurial individuals prefer to be more involved either in the running of the office or in the investments undertaken, and in several of our cases, the family office becomes a new "family business" for family members to run.

3) Connection to family business

The fresher the experience or involvement of the family members in the business the more they are involved in the family office. For example, when they are still holding significant portions of the business, participating in its corporate governance, and/or as part of the day-to-day management team. However, in situations where the business is a distant memory, there tends to be less interest from family members in involvement in the family office and more demand for life-style management.

4) Family background and circumstances

The establishment of a family office often is the result of a transitory phase in the history of the family and the family business. While reassessing their current circumstances, families can discover that they are very different from those of the time when the current governance arrangements were put in place. Thus, they find it necessary to reconfigure their link to the family business and with each other.

One of the family offices interviewed sold off a minority portion of their family business specifically because they felt that running the family business was becoming "burdensome and did not give us the managerial autonomy we cherished." Thus, they undertake investments as a family for "fun" in order to realize their "entrepreneurial will as a family."

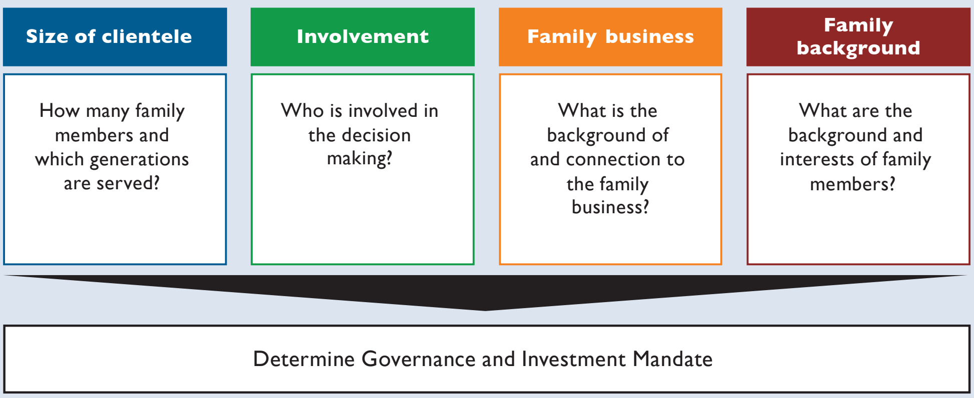

Figure 3 Factors determining the investment pattern and structure of a family office

What Types of Family Offices Exist?

Up to now, the main classification of family offices has been according to the number of families they serve – whether they serve one family only or whether they serve more than one family – thus single vs. multiple family offices. Our research changes the categories based on one of our key findings – the extent of the original founder's family office and the distance from him/her of the latest generation served by the family office are both extremely indicative of investment appetite, risk tolerance, and interest in financial matters. Based on this new criteria view, we outline five categories of family offices.

A) Single-member family office

The first type of family office is the single-member family office, generally the original entrepreneur and owner/manager of the family business. This type of office, thus, corresponds to the mindset of a manager-owner in a family business. Here the principal is greatly involved in the decisions of the family office which, in fact, tends to become the new family business.

B) Limited-membership single family office

The second type serves a limited number of family members, generally the first heirs of the founder of the family business. In these offices, greater attention is paid to issues related to governance and the use of formal channels for review and communication. However, because there is still little generational distance between the current members of the family office and the original principal (the source of the wealth), the family members remain quite entrepreneurial and business-savvy and therefore tend to be more involved in the

family office than would family members in later generations.

C) Multi-generation single family offices – generation family offices

The third model of family offices are multi-generation family offices, which, in the words of one of the interviewees, serving such a clientele, was characterized his/her office “as a single family private bank, really.” The distinguishing factor between the previous two categories is that there is increasing distance between the founding principal and the office’s clientele. Further, members served by an office of this type tend to be much less familiar with the family business. Because of the relatively larger number of clients there tends to be even more attention paid to the formalization of decision-making and governance. The increase in clientele means also that there is a large discrepancy in terms of the stage in life of the members, and in turn, of their investment needs and horizons. Therefore, capital allocation has to be rearranged so that it will provide current income for older generations and plan long-term for the younger ones.

D) Multi-family offices and E) Family office services

Our research revealed two other models to complete the taxonomy presented here – multi-family offices and family office services. A multiple family office manages the pooled wealth of members of different families, allocating funds into investments either in aggregate or per family. The last model is composed of the family office services offered by banks for ultra-high net worth individuals that mirror those provided by a multi-family office.

What Does it all Mean?

In conclusion, knowledge about the wealth creators – from entrepreneurs to family offices – provides managers a way of

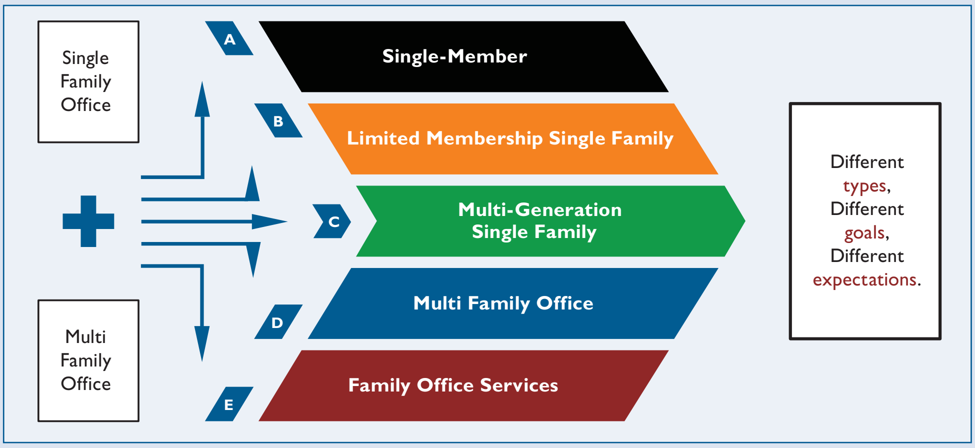

Figure 4 The IMD taxonomy of family offices

understanding a very eclectic, yet very powerful class of investors that are rising on the horizon. For those managers in family business, it is important to be clear about the relationship between the family business and the family office, as well as the concerns and developments within the family. Strategic plans for the firm and performance measurements should therefore be much more attuned to the long-term interests typical of family investors, rather than considering them to be similar to those of anonymous stock-holders. Such managers should understand that developments in the family can lead to a change in the status of the family business. In addition, the large amounts of wealth controlled by families and their offices will increasingly be intervening in markets as private equity investors, either by taking their companies public or by acquiring firms as passive or active investment opportunities. Overall, we are only witnessing the beginning of a long-term shift, in which wealthy families will increasingly become large players in corporate investments.

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