The Skorina Letter

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Building the World's Best Investment Management

The Family Office: Fast and Flourishing

According to Forbes, there are a record 493 new billionaires on the latest "Richest in 2021" list, of which 10 hit the jackpot through SPAC mergers and 60 from IPOs. Sooner or later, some of them will establish a single-family office.

They will be in good company. Oprah has one. Gates has one. The Pritzkers and Waltons have half-a-dozen. But why would someone who has just made a fortune want to hire a room full of advisors to tell them what to do with their money?

Probably because, just like the rest of us, most newly-flush fortunaires worry about their wealth and how to manage it.

Even John D. Rockefeller had worries.

The Rockefeller family office and philanthropic endeavors are legendary role-models for modern philanthropists and family wealth managers.

But, as Ron Chernow points out in "Titan", his definitive biography on Mr. Rockefeller, John D. worried constantly about his wealth and his philanthropy. So he created a structure and hired experts to deal with the demands on his fortune. His office became the template for most contemporary, large American family offices.

Making It versus Keeping It

All family offices, including the Rockefeller's, start for the same reasons. There's a need to organize the personal side of an individual's life and now there's money to pay for help.

But as the family grows so does the stable of houses, cars, planes, travel, and staff. And taxes!

Entrepreneurs and business titans mostly made their money from shooting the lights out on a single venture. Blavatnik, Brin, Dell, Gates, Zell, Zuckerberg, went "all in" and won big. Their recipe? Highly-concentrated investments, risk-taking, innovation, and sheer audacity.

But preserving a legacy is different. Wealth is created by entrepreneurs, but maintained through diversification, sophisticated risk-management, and prudence. The psychological profile of the former does not easily transform to the latter.

Successful entrepreneurs build competitive advantage into their businesses, but that advantage doesn't naturally transfer to diversified investing. It's a different mind-set and a different set of skills.

Time and Money

The more complicated life becomes, the more issues there are to deal with.

A family office usually begins with accounting, administration, and personal services. But there's also taxes and estate planning to deal with, and property management, and philanthropic support. And more taxes.

Sooner or later, most founders and families start thinking about managing their assets in-house. But building an investment operation is like any other new business, it takes time and energy. For those still running an operating business, do they have the bandwidth to manage two very different enterprises in tandem?

An investment function exists to make money and protect assets. It's a serious business and attracting the right talent will pay for itself many time over.

However, it's not an inexpensive proposition. Quality CIOs earn mid-six to low-seven figures. This is Wall Street money, but most corporate owners are accustomed to paying operating wages, generally much lower. Is a family willing to hire someone and pay them that much?

According to one recent survey, family offices managing one to two billion in AUM, employ four to six professionals and carry a payroll of two to three and a half million dollars.

Family offices with over four billion in assets employ on average twelve to sixteen professionals with compensation expenses of five to seven million dollars and up.

On top of that, consultants, technology, and infrastructure, can run anywhere from a few hundred thousand to several million a year. So be prepared.

Speed and Specialization

Family offices often develop specialty expertise to gain an edge.

One European client of ours has deep economic and environmental knowledge of forests. They know their trees.

Another client cultivates early-early-stage venture capital opportunities. There's always room for an agile and entrepreneurial private investor.

They can also move fast.

Mr. Eli Broad, who died this April at age 87, was famous for making quick decisions with his family office investment staff. If it took him longer than ten minutes to make up his mind on an investment pitch, he passed.

Keeping the Legacy Intact

Mr. Stuart Lucas, program director for the wealth management program at the University of Chicago Booth School of Business and senior investment officer for his own family's office spoke with us a few years ago about building and preserving the family fortune.

We circled back with Mr. Lucas recently to hear the latest on family office developments and the concerns of family members attending his program.

Skorina: Stuart, at ChicagoBooth you help families manage their wealth. What are some of the lessons you have learned from your own past and from teaching the course?

Lucas: Perhaps the most valuable things we bring to our family office and to the other offices we serve are rigor, discipline, and accountability.

For example, in my family office, no one professional has sole authority to make investment decisions. For 25 years I have shared responsibility with my sister-in-law. One of us usually takes primary responsibility for an investment under consideration while the other plays the skeptic.

Early in our careers I worked at Wellington Management and she at Capital Guardian. We bring that rigor to our analysis and debates and we have a well-developed accountability system to update others in the family on financial matters and assure them that we are adding value.

Skorina: I read an article the other day by two professors at the London Business School which argues that family office governance is not only the oldest form of administration but may also be the best. What are some of the advantages to a family office?

Lucas: There are good reasons why family offices have been around for a millennium and more.

Entrepreneurs have networks, innovative skill, and they are generally great judges of people. They know their industries and the disruptive forces at work. And they can move fast.

A family office can leverage those connections, insights, and people skills to identify and judge investment opportunities. In our wealth management program we call this strategic investing.

Skorina: How do you build the right organizational structure? Where do you start?

Lucas: The basics are the same whether we're talking about a family or an institution. First, hire good people. That's where you come in Charles.

Then, establish an investment process which encourages fact-based decision-making. This will hopefully reduce the likelihood of stupid decisions.

Too often there is a strong tendency to defer to the family leader or, worse yet, to build evidence to support that leader's view and suppress contrary perspectives.

Every investment decision is a bet. There are so many possible outcomes and so many ways we can trick ourselves into seeing only those that we wish to see.

I also serve on boards which helps to develop my perspective on governance. Until recently, I chaired the investment committee at National Public Radio – a group of thoughtful, collaborative, and highly intelligent investment professionals. Our goal was always to achieve the best outcomes for NPR, not to win intellectual arguments.

Skorina: What lessons from your board work apply to family offices?

Lucas: Actually, quite a few. I'll give you three that I think are key.

One: Investment committees must build trust with their "client", whether an institution's leadership or a family. No trust, no tenure. The family will always prevail in the end.

Two: Committees (and families) should set the agenda and objectives, then let the advisors and investment staff execute.

Managing an endowment or billion-dollar-plus family office involves a lot of moving parts so you need a process that clearly defines the roles of the committee, the advisors, the head of investments, and the staff.

Three: Investment consultants are really important, but you can hire a reputable firm and still wind up with a poor advisor.

The first investment committee I joined hired a well-respected consulting firm. Unfortunately, our initial advisor was not a good listener and felt compelled to win debates with the committee.

We fixed the problem by changing the advisor, not the firm. Now, each time I am involved in a consultant search I insist on interviewing several teams within the firm. This improves the chances for a good long-term fit.

Skorina: You are a Gen4 and your children are Gen5s, far removed from the founders of The Carnation Company, your family business. How does the role of investing evolve with each generations?

[Carnation was founded in 1899 by Elbridge Amos Stuart and sold to Nestlé in 1984 for $3 billion.]

Lucas: That's a complicated and sensitive question. The dynamics of managing inherited wealth on behalf of siblings, children, nieces, and nephews are fundamentally different than managing on behalf of a G1 wealth creator.

Many founders are afraid that money will spoil their children. "Will my success make my children less likely to succeed."

Of course, lots of money and no accountability can lead to trouble. But in my experience both personally and working with other families, if you trust your children and other family members to find productive paths into the world it will almost always lead to better outcomes.

In our wealth management program at the University of Chicago, one G2 – speaking for many of her peers - pushed back on a group of G1 who were bemoaning their children's outlook, "*We try so hard to do the right thing. You do not give us the benefit of the doubt.*" You could hear a pin drop.

So, operating principal number one is to "have faith in your children."

The second is: manage inherited wealth for growth rather than for maintenance. There is a perception that this approach increases portfolio risk. But if you don't grow inherited wealth, taxes and lifestyle will certainly take it all.

Third, manage distributions in moderation with discipline and consistency.

Skorina: So how does a family office overcome the tax and dispersion drag on their legacy? We called it entropy in our earlier interview.

Lucas: Decades ago, when I first started thinking seriously about this, I realized that the fortune my great-grandfather had made four generations back, wouldn't last four more generations, especially on a per-person basis, unless we were very intentional about our approach.

So I reframed the question from "how do we make it last?" to "What do we want to accomplish with this tremendous gift?" I can't imagine that my great-great grandfather intended to create perpetual and never-ending wealth for his descendants. But I try to contribute to a broader legacy of which he'd be proud.

Skorina: Stuart, you have spent decades on the front lines observing family legacies ebb and flow and helping them stem the tide, any final thoughts on this Sisyphean struggle?

Lucas: In the end, we can't beat entropy, but we may be able to fight it to a draw for a few more generations by leveraging the family's combined wealth, both financially and non-financially. Branding, networks, shared values, careers, expertise – all of these are important in the fight.

The family wealth engine must generate a decent return on inherited money. But it also has to include the energy and talent of each succeeding generation, all coordinated with realistic, disciplined spending limits.

Each member of each generation will hopefully produce enough value through their own creativity, careers, and businesses to supplement the returns on the inheritance.

If you can do that, you increase the odds that your wealth will support a productive, useful, prosperous family for generations to come.

But it's not easy.

-- Charles Skorina

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Our insights and commentary come from our clients – board members, CEOs, chief investment officers – and the global investment community within which we work as executive search professionals.

Institutional investors operate at the crossroads of capital, talent, and ideas, shepherding over seventy trillion dollars in global assets. It's a constantly evolving spectacle and The Skorina Letter gives readers a ringside seat.

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