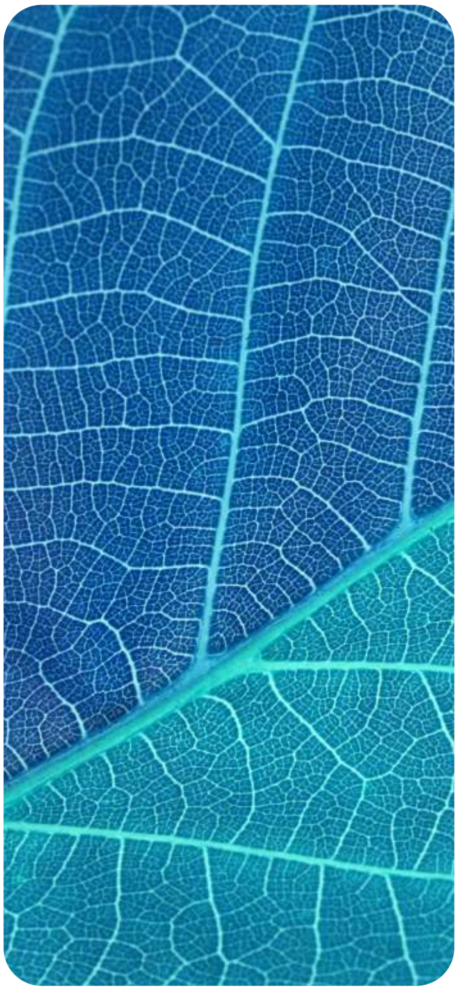
Best practices to sustain family wealth across generations



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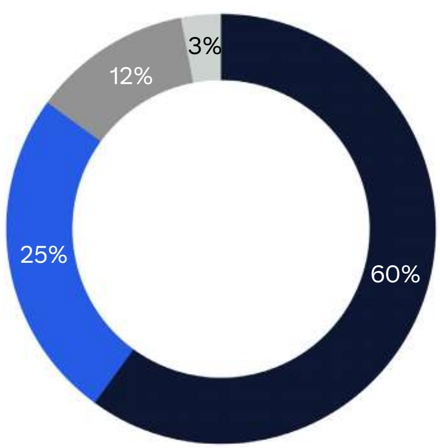
Foreword

As a phenomenon, the dissipation or loss of family wealth is as almost old as wealth itself and prevalent throughout the world. Indeed, almost every culture has a longstanding saying equivalent to the adage of "shirtsleeves to shirtsleeves in three generations." In recent decades, research has shown the tendency of great wealth to fail to survive beyond the third generation. According to one study, 70% of wealth transfers fail by the third generation.[1]

But why should this be so? Explaining the phenomenon is more complex than identifying it. Contrary to widespread belief, the root causes of wealth dissipation are seldom financial, tax or legal issues. Instead, family matters may be to blame in as many as 97% of failed wealth transfers – **figure 1**. Such matters include:

- Lack of communication and trust in the family
- Insufficient preparation of the next generation
- Absence of shared family values or vision

Figure 1.
Causes of wealth transfer failures[1]



- Lack of communication & trust
- Insufficient preparation of next generation
- All other causes (incl. lack of shared values or vision)
- Accounting, legal, financial & tax issues

How do the families who have managed to preserve wealth across multiple generations differ from those who have failed to do so?

Despite the tendency toward failure, we believe it to be far from inevitable. Anecdotal evidence highlights differences between families who have preserved wealth over many generations and those who have not. Families such as the Rothschilds (whose wealth dates to the 1760s), Rockefellers (1863), Du Ponts (1802), and many others have successfully managed to transfer wealth across many generations.

Citi Wealth has the privilege of serving some of the world's wealthiest individuals and families. In this white paper, we identify seven well defined characteristics or competitive advantages that successful multi-generational families often exhibit. To do so, we draw on our long experience working with leading families worldwide.

If you would like to discuss how to apply some of the learnings and best practices discussed in this paper, we would be delighted to hear from you.

[1] Source: "Preparing Heirs: Five steps to the successful transition of Family Wealth and values" - Book by Roy Williams and Vic Preisser and based on research on 3,250 families as of Jan 1, 2010

1. Family values

Families who achieve successful multi-generational wealth transfer have an intuitive understanding that family values are the glue that binds family members together across multiple generations. These enduring values often transcend differing political or social beliefs. Often, religious beliefs underpin these values.

Family values are frequently illustrated and reinforced by telling stories to the children of the family. Children or young adults' actions are then celebrated by the family when they exemplify desired behavior.

When asked about family values, family members give responses such as: "work hard, leave the world a better place," and "we are fortunate and take care of those who are not." However, successful families do not simply articulate such values, they live them. They work hard and demonstrate genuine passion for philanthropy, business, creativity, community, and family. They also recognize and accept that not all family members will always subscribe to their values. They tend to be non-judgmental and draw inspiration from their values in both good times and bad.

2. Family vision

Successful families also spend time reflecting on the purposes for their wealth and define a shared vision for their future. Having common goals that they wish to accomplish collectively adds engagement and energy to everything the family does. It makes each family member part of something greater than they could achieve on their own.

Conversely, not having a family vision can have dire consequences for family wellbeing. It leads to random outcomes, as if you don't know where you are going, you typically end up nowhere. It results in indifference and lack of engagement from family members, as without vision there is less motivation to be informed and to contribute to the family enterprise.

Finally, the absence of vision leads to conflicts because individuals start pulling in different directions and tensions mount.

However, family visions should not be cast in stone. Life happens, external and internal forces of change evolve, and families need to adapt to new environments and the aspirations of rising generations. Therefore, it is essential to review the family vision regularly to ensure that it continues to bind and guide family members, or to adapt it if needed.

3. Communication

The best-prepared families understand the need to communicate effectively among themselves. They create numerous opportunities for discussion, healthy debate, learning, and decision-making, often starting at an early age. Older family members listen actively, frequently adopting a Socratic method of posing questions to younger family members to encourage them to think critically. Indeed, these families sometimes "practice" communication, including constructive confrontation that will serve them well in all realms of life.

To foster interaction, successful multi-generational families create a variety of forums. These can range from informal dinner table gatherings to thoroughly planned annual family meetings. Often, families will engage external experts to provide advice on family dynamics, group process, and education. Depending on the forum's content, multiple generations or beneficiaries and stock holders may participate. An ability to "agree to disagree" is frequently in evidence, even after engaging in vitriol.

Ultimately, these families recognize that they are coming together for a greater purpose and are able to make effective decisions on behalf of the whole family or family enterprise. Perhaps more importantly, they seek "consent" from other family members rather than consensus. Consensus around important decisions is often unattainable or can result in sub-optimal decisions. "I may not agree with this decision but I nonetheless support how we arrived at it," is a commonly expressed sentiment in such families.

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Families cannot assume that the interests of previous generations will be shared by the next.

4. Sound governance practices

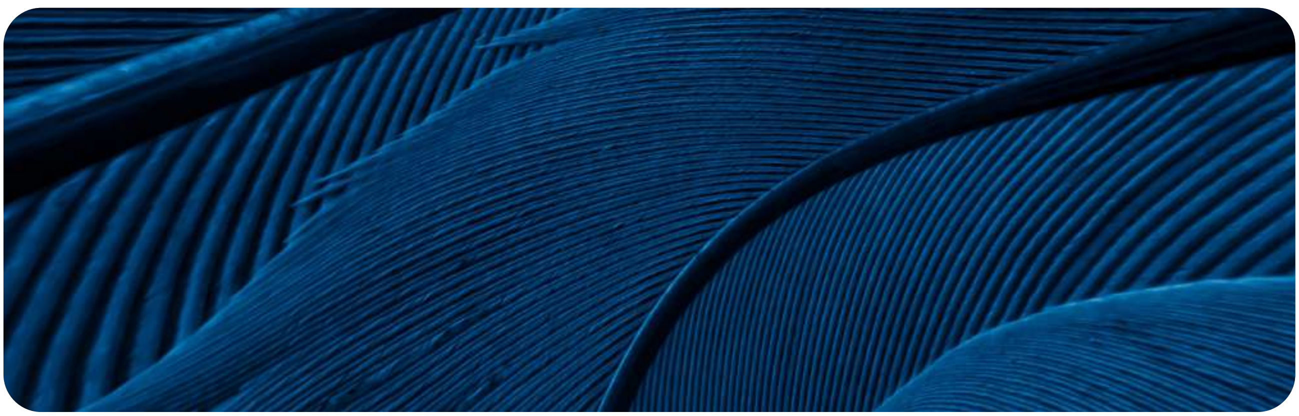
Successful multi-generational families embrace sound leadership and decision-making practices. They insist that their enterprises — whether businesses, investment companies, foundations, family offices, or family councils — be led by the best and brightest, regardless of bloodline. They make effective use of boards of directors, often bringing family members and external advisors together. They avoid the practice of guaranteeing board seats to family members and instead follow a formal nomination, interview, and voting process that may or may not involve family members. In short, family matters are handled in a deliberate and business-like manner. Most believe that giving direct and critical feedback to family members is essential to reinforcing results and accountability.

Two key elements of effective family governance are grooming future family leadership and having a sound succession plan in place. Families cannot assume that the interests of previous generations will be shared by the next. Often, the third or fourth generations have passions that are unrelated to the family business, including the arts, philanthropy, or social justice. Successful families embrace this diversity and align the personal interests and skills of family members with the need for future leadership. They create educational, experiential, and mentoring opportunities that allow young adults to make informed choices about diverse career paths, while grooming future family leaders. When mistakes are made, they recognize them promptly and make the necessary leadership changes.

5. Shunning nepotism

Families who are able to preserve and grow their wealth actively fight the corrosive effects of nepotism and entitlement culture. Family enterprises are run along meritocratic lines as far as is possible. No employment or board membership guarantees are made to children, cousins, or in-laws. And where family members are employed, compensation is determined strictly according to role, responsibilities, skill, and performance. Prior to their joining the family business, family members may be required to complete a period of successful employment elsewhere. There is also a keen awareness of the negative impact that hiring and promoting unqualified family members would have upon other employees. If advantages are to be granted to family members — such as the use of a family business aircraft — the rules are well understood by all.

Eliminating any sense of entitlement among family members can help to avoid many unfortunate issues from arising. Successful families speak candidly with children about their wealth and the responsibilities that it entails. They openly discuss how good fortune — as well as hard work — have helped create their circumstances. They find ways to teach children about limits and choices. Some purposely deny some of their children's requests or take them grocery shopping to engender sensible attitudes towards money. Some live deliberately beneath their means, eschewing such trappings of wealth as yachts and private aircraft. Underpinning such practices is the recognition that parental behavior — rather than words — is the most powerful way to shape a child's attitude to wealth.



6. Planning

Exceptional families take a long-term view. They think, plan, and act with an understanding of how their actions may impact future generations. While they may have significant concentrated holdings, they hedge the resulting risks using financial strategies, and seek geographic, sector, and asset-class diversification wherever possible. They understand that reacting rashly in a time of crisis often results in the worst decisions.

Investments are most often managed professionally by a dedicated family office, trust company, private bank, or asset management firm. Risk and return parameters are clearly spelled out and most seek modest, yet consistent, returns after tax and inflation. They forecast consumption needs and investment returns in order to define spending limits and appropriate use of debt.

Successful families also openly discuss and plan their responses to health problems, business succession, divorce, and death. Their estate plans, trusts, and investment policy statements allow for a multitude of contingencies and are revised as circumstances dictate. They take full advantage of income, capital gains, and gift & estate tax efficiencies.

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7. Process and practices

Leaving little to chance is another characteristic of successful multi-generational families. Instead, they embrace processes and practices that ensure consistency and reinforce family values and engagement. These include holding periodic formal family meetings where business, foundation, and other matters are discussed. Such activities and events are well planned and purposely draw in cousins, siblings, and multiple generations in fun and engaging ways.

Increasingly, formal family mission statements are crafted. Senior family members solicit and process ideas and suggestions from younger generations. While agreement and consent may not be forthcoming, senior family members take the opportunity to reinforce family culture, communication, and respect.

Finally, successful multi-generational families have well-defined rules governing both permissible and improper behavior. Reward and punishment systems are understood by all. Senior family members impose consequences for actions that are deemed inappropriate, but also reward and celebrate desirable behavior and accomplishments.

Closing thoughts

While there are many uncontrollable events that can diminish family wealth over generations, there are also voluntary practices and behaviors that families can adopt to seek to protect, preserve, and maintain wealth across multiple generations. Understanding such practices and adapting them to the values of the family is an effective first step.

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