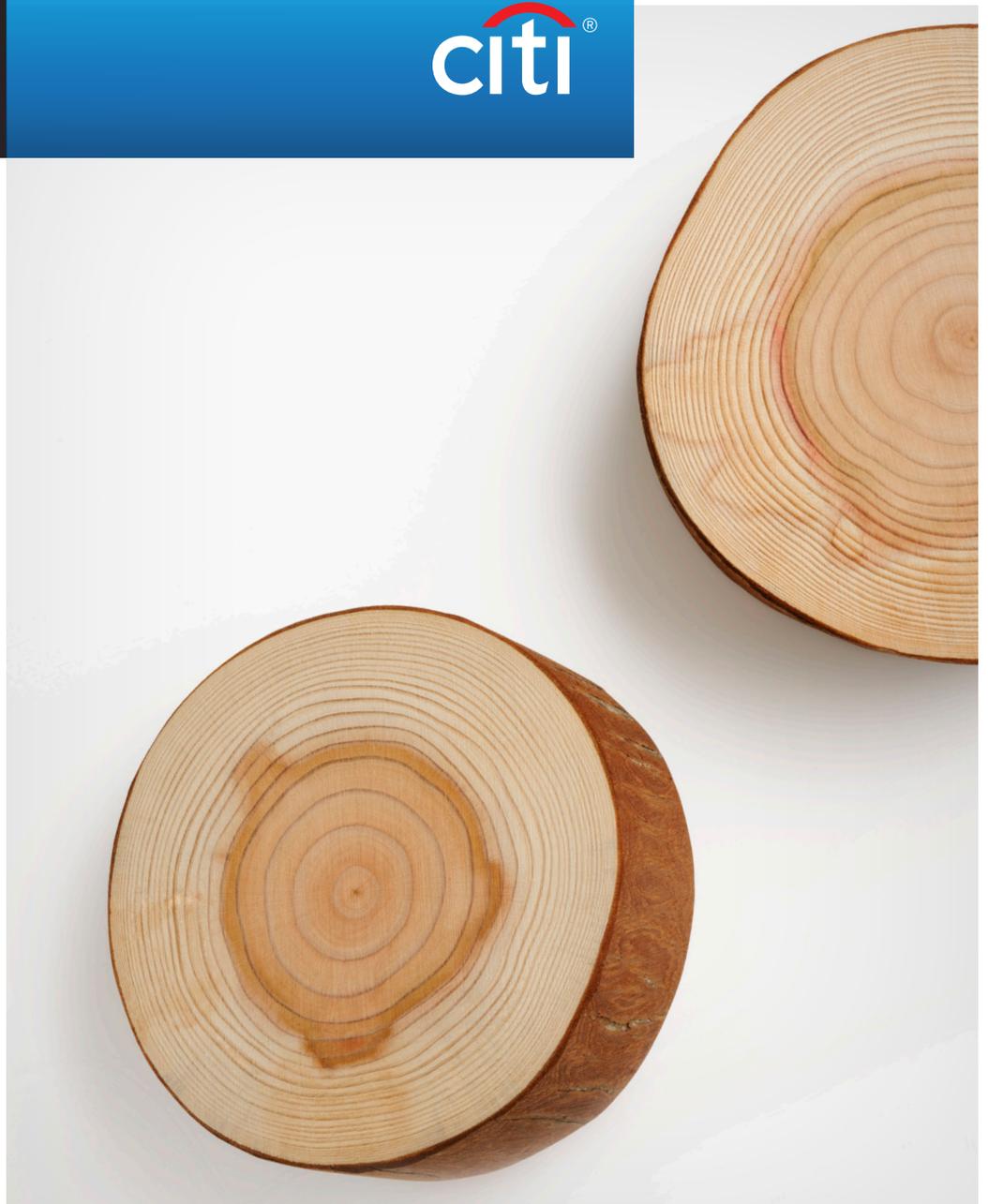


Private Bank



A guide to sustaining family wealth across multiple generations

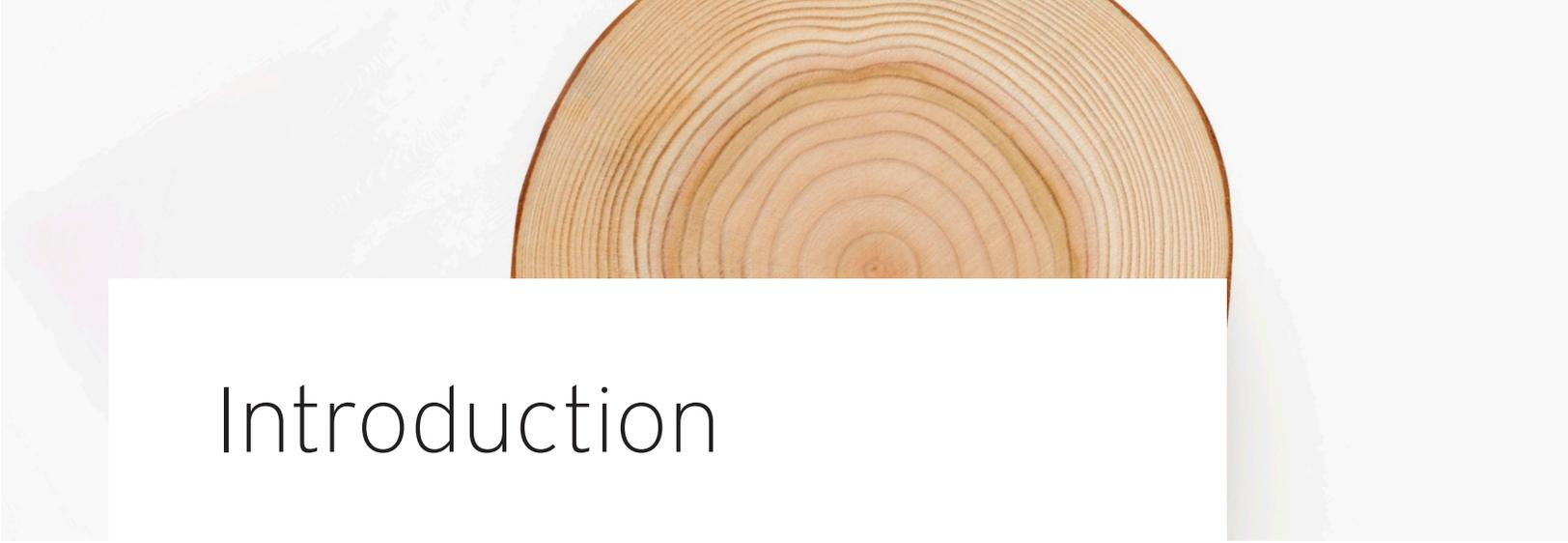
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Introduction

Having achieved great wealth, families often embark upon estate and wealth management strategies designed to preserve their wealth for future generations. However, despite the best efforts of family heads, attorneys, tax advisors, and wealth managers, most families see their wealth largely dissipated after three generations.¹ This inevitably raises the critical question: “how do the families who manage to preserve wealth across multiple generations differ from those who fail to do so?”

The dissipation or loss of family wealth is neither a new phenomenon, nor unique to Western cultures, and its causes are complex. Most often, its causes can be traced back to such factors as:

- Concentration of wealth in a single business, sector, or geography
- Excessive use of debt
- Taxes
- Excessive consumption
- Growth in the numbers of family members drawing down wealth
- Divorce
- Inadequate preparation of heirs
- Poor decision making

How do the families who manage to preserve wealth across multiple generations differ from those who fail to do so?

¹ James Hughes, 'Family Wealth', 2010

Anecdotal evidence suggests identifiable differences between families that preserve wealth over many generations and those who do not. Failure is far from inevitable. Families such as the Rothschilds (whose wealth dates to the 1760s), Rockefellers (1863), Du Ponts (1802), and many others have successfully managed to avoid wealth dissipation.

Successful multi-generational families often exhibit six well-defined characteristics or competitive advantages:

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.

Successful families work hard and demonstrate genuine passion for philanthropy, business, creativity, community, and family.

2. 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.

3. 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.

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

4. 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.



5. 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 estate tax efficiencies.

Exceptional families understand that reacting rashly in a time of crisis often results in the worst decisions.

6. 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.

Conclusion

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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Previously, he was Chief Investment Officer of a Seattle-based family office, and has held senior investment and technology roles with Fidelity Investments in Europe and the United States. Stephen was Founder and Chief Executive Officer of two financial technology companies, and has led investments in numerous early-stage companies.

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