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IMPACT OF COMMUNICATION IN FAMILY OFFICE INVESTING

by Stephen Campbell

There are numerous headwinds that family offices face when managing investment portfolios. One that is frequently overlooked by practitioners and family principals alike is the role and impact of effective communication. This paper lays out a framework to identify risk factors that could ultimately give rise to unintended and negative portfolio consequences.

When assessing a family office's readiness to effectively manage portfolios, a number of factors come to mind. Does the office have: sufficient staff; experience in the asset classes, sectors and types of investments to be undertaken; access to research and analytics; have they formulated a thorough and consistent investment process (see Campbell & Bailin 2014). Objectively evaluating each area allows the family and executives to determine whether the foundational elements of a solid investment program are in place, thereby filling in process gaps, and outsourcing or hiring/securing resources as necessary.

One area that is often overlooked is the communication strategy surrounding the family office investment process. Absent a thoughtful and systematic approach to communication; family offices often fall victim to interpersonal dynamics that may negatively impact portfolio performance. Infrequent interaction with the principal(s), lack of

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understanding and intent, an absence of a common "language" all contribute to a lack of comprehension, collaboration and trust. Left unchecked, these factors often inhibit solid decision-making and undermine role clarity and a common sense of purpose to the business of family investing. The inevitable consequence of these missteps can result in mistrust, an "us and them" mentality, firing of staff or advisors, slow/no decision making, and portfolio churning as the family capitulates in the face of uncertainty and exists investments at precisely the wrong time. However, when properly executed, a foundation of trust and confidence can be created that will sustain a healthy and long-term relationship between the family and investment staff.

This communication system consists of four main elements:

- Principal Communication
- Investment Team Communication
- Family Communication
- External Advisor Communication

Let's examine each element using a straightforward example of a single family head or principal, and a chief investment officer as the framework.

Principal Communication

Effective communication between the family principal and the investment staff is based on three core elements: 1) Understanding behavioural and decision-making characteristics of the principal; 2) Defining the modes and frequency of communication; and 3) creating a "common language" that allows for clarity and economy of interactions.

While much has been written about behavioural bias and the impact upon returns, there are still no clear-cut ways in which to objectively assess such biases. This leaves us with the challenge of truly understanding the behaviour of principals under conditions of uncertainty. It's fairly easy to ask if they will exhibit "loss regret" in the face of a 15%, 25% or 40% decline in an investment but such responses are situational in nature and often impacted by other factors (total wealth, performance of other investments, previous portfolio losses...the list goes on).

How then does a family office investment team divine such an understanding about their principal? Two practical approaches may be applied. The first involves, examining the past behavioural responses of the principal in a range of business, personal and investment settings. Develop a candid picture of behaviour under varying conditions (failure, loss, success...) while understanding that this is only a window into the range of possible reactions and influences that may impact their decisions, and that such reactions will change over time. Having created a 'heat map' of potential behavioural responses, validate these observations with the principal and discuss the potentially deleterious impact they commonly have upon portfolio performance. Focus on the 2-3 likely biases that may emerge and create a "common language" around each.

Let's look at one example of how language can serve to drive clarity and address an awkward dynamic. The west coast family office of a very successful technology entrepreneur observed a 'success bias' in the principal. Having created a multi-billion-dollar company, the founder believed that success in this one endeavour would translate universally into a range of new activities - experience and logic notwithstanding. After a series of failed start-up ventures outside his area of expertise, the office and principal came to an understanding as to a threshold test that would be applied to future investments. They named this test after one spectacularly failed investment and when summoned up in a meeting, the principal and staff immediately understood that they were identifying a potential risk factor. No judgment was made.

A second key area is to understand the decision-making preferences of the principal. In essence, how does he or she make their best decisions? Are they data driven, or prefer a quantitative approach, do they like a consensus-based approach, or prefer to see pro and con arguments put forth, do they like to make quick decisions or prefer to reflect and discuss with others outside of the investment team. Keep in mind; the size, importance and potential impact of the investment may alter these preferences.

An effective way to understand principal behaviour is to interview (with principal sign-off) business associates, key advisors, and professional services firms who have observed the principal over time. Identify the characteristics of his or her best and worst decisions in order to arrive at a clearer picture as to how you will communicate. Validate these assumptions with the principal and agree upon a base case format that best serves the needs and preferences of all parties. Be prepared to alter the format as the circumstances of the invest dictates.

The frequency of communication is also critical. One problem often voiced by family office staff is access to the principal(s). In a 2016 survey of 75 family office executives by Citi Private Bank, 65% of respondents representing over $450B in family wealth across every region of the world, reported that access to the principal(s) was their greatest management challenge. Negotiating a clear need to have periodic check-in conversations that allow the staff to "test" ideas and informally discuss a potential investment in advance of doing the leg work is essential.
There are however, absolutely no substitutes for formal meetings that allow the parties to review investment returns, changes to the asset allocation model, or obtain approval to commit capital. Discussion of these important topics should never be done "on-the-fly". The form of these meetings should be consistent with the preferences of the principal but also meet the needs of the investment staff. Often, these meetings are modelled from the way in which the principal conducts executive meetings in their business. One parenthetical note, every investment recommendation should be summarised and signed-off (literally) by the principal. This helps with both selective memories, and in reassessing the assumptions that formed the basis of the recommendation.

Team Communication
Regardless of team size, frequent, candid, and thoughtful communication is essential. The form and substance of the meetings can be dictated by the management styles of the leaders. At a minimum, they should be organised around the life cycle of the portfolio, separating out potential investments that may be made, examining existing position performance regarding risk and return factors, and assessing total portfolio performance about the asset allocation, underlying risk exposures, and exogenous factors and outlook. Regular meetings should be scheduled which dovetail with the analytical work of the team so that the group has substantive content to discuss.

Three group dynamics to be alert to in this process include: "groupthink", the impact of over-powering personalities, and emulating the principal.

Groupthink is a byproduct of the desire of a group to reach consensus. It often occurs as the team leader strives to integrate disparate views amongst analysts, portfolio mangers and advisors. It is a natural consequence of otherwise healthy teams motivated to collaborate. However, in an investment setting, it can be catastrophic. Constructive discord often results in considerably more effective decision-making and informed learning. Fostering a civil culture of disagreement and intellectual debate allows the team to identify better potential black swan events, as well as tease out factors, which may not be obvious to all participants. It also serves to educate less experienced team members as to the thought process of more experienced investors.

It is also not uncommon to see one or more personalities dominate the dialogue and decision-making process within an investment team. Those with long track records or a history of strong investment returns may inadvertently cast a long shadow over constructive debate within the team. This often stifles candid information sharing and drives more junior members of the team from the family office. Effective CIOs understand that while the ultimate recommendation may lie with them, every voice has merit and deserves to be heard.

A final observation on investment team behaviour is the temptation of the members to emulate the attitudes, behaviour and views of the principal. Often this is byproduct of a strong principal (personality, image, ego) and the unwitting desire of the team to bond with her or him. While understanding such characteristics of the principal is essential, resist emulating these characteristics in your thoughts and actions. Why? The greatest value of the team to the principal is to complement, augment, and challenge their experience and behaviour. Creating a healthy culture in which diversity of thought is valued is an essential characteristic of high performing investment teams.

Communication within the Family
Multiple constituencies and their varied needs for investment information can often challenge family office executives. Principal(s), children, grandchildren, siblings, cousins, as well as beneficiaries of trusts and family foundation board members each have specific needs, interests and varying levels of comprehension.

A well thought out investment communication strategy has three core elements: a.) Understanding your constituents; b.) Aligning the form and objectives of communication with each constituency; and c.) Scheduling regular meetings, reports and touch points.

Most often, generation, beneficial ownership, or role within the family is used to identify family constituents. Typically, family principals will have visibility over consolidated assets and liabilities, while adult children may see trust, business or foundation assets as appropriate. Deciding who sees what information should be based upon 'need to know', as well as the need to educate and inform. For example, increasingly families will conduct an annual meeting where family business, investment and foundation information is shared at a high level with a wide range of constituencies. Quarterly meetings with company beneficial owners (yet another constituency) can augment with more detailed content. Finally, the principals may meet monthly with staff for detailed review and approval of key matters. Younger family members may also be engaged through educational programs that begin to model the means of methods by which the family communicates and encourages participation. In sum, identify each constituency based on their needs and align formal, informal, ad-hoc and educational communication strategies.

While one dimension involves segmenting constituents (the "who"), the other is identifying what content is made available (the "what"). Often, investment information is parsed into disclosure categories such as: a) high-level strategy and performance only (much like one would find in a mutual fund prospectus), b.) position-level performance, and c) position level including risk mitigation, leverage, cash flow/j-curve strategies.

'Need-to-know' is paramount when parsing which has access to family information, with, for example, principals having access to all sub-portfolio information, while an adult family member may see only his/her trust.

Delineate which groups or individuals will receive specific reports and participate in investment meetings. For example, some will be informed as a courtesy via an annual or periodic family meeting, while others (spouses, adult children) will require a strategy that fosters their support and understanding consistent with the wishes of the principal

However, information in the absence of comprehension is of little value, and a solid investment communication strategy must include a candid assessment of educational gaps that may exist amongst family members. Where such gaps exist, the team must formulate plans to offer reading, 1:1 sessions, and family education seminars.

Effective family communication strategies foster consensus, education, and information sharing. Develop consistent reporting formats and layouts that become the template for regular communication, and conduct meetings in deliberate and formal fashion in keeping with the culture of the family. A predetermined meeting schedule (regardless of frequency) allows family participants to "hold" concerns and avoids ad-hoc queries directed to staff.

By introducing the family to the investment process and decision-making practices, family office staff can educate members and work toward succession plans based on a common framework. Be careful to separate meetings (and participants) that are intended to make decisions from those that are intended to inform simply. Reinforce 'need-to-know' to foster respect and the confidentiality of individual family members, who may have divergent interests and need for confidentiality.

Communication with External Advisors

The notion of family office staff functioning as "gate keepers" is on the decline. To the extent the principal or family members desire contact with outside advisors, such interaction can buttress the work of the investment team.

One model that is increasingly used is the periodic or annual portfolio review involving the principal/family, external advisors and managers, and the investment staff who moderate the meeting. Often, these meetings focus on three key areas: a discussion of macro-economic and market conditions and forecasts, a review of the asset allocation, performance and risk profile of the portfolio, and an assessment of the positioning of the portfolio on a going forward basis about the broader market outlook. Some families will use this as an opportunity to educate members by taking a deep dive into one or more manager's investment thesis, strategy and performance.

Regardless of the form of such meetings, they can serve a valuable purpose regarding expanding the views of staff and family members, challenging core assumptions, or validating the strategies in place. Investment staff may resist the notion of such meetings, fearing to appear uninformed or vulnerable. Careful selection of the external participants and advance preparation will help allay such concerns. Similarly, negotiating the purpose, intent and potential risk (confidentiality) of such meetings with the principal or family in advance is critical. Consider beginning with a modest meeting during which a single asset manager comes prepared to discuss their fund.

In conclusion, a thoughtful approach to communication along these and other dimensions can serve a variety of interests. It can help avoid misunderstandings, foster trust, develop a common language, and improve efficiency and investment outcomes. Look for models in other family offices that you might emulate or adapt. If problems presently exist, consider bringing in external consultants who might facilitate the formulation of strategies and overcome existing communication obstacles. CIOs and investment teams are well served by focusing on communication as an essential element of their investment process.

Stephen Campbell is Chairman of the North America Family Office Group for Citi Private Bank. In this capacity, he advises affluent families around the world on family office, and investment practices. He is the author of numerous publications on family office investing, family office best practices, and the characteristics of successful multi-generational families. Stephen co-founded and chairs the Citi Private Bank, Global Family Office Leadership Program.

Prior to joining Citi Private Bank, Stephen was Chief Investment Officer of a major Seattle-based family office where he managed multi-asset portfolios, and led venture capital investments. He was previously CEO of two financial technology firms, and has served on the boards of several privately held companies. Stephen began his career with Fidelity investments where he was head of International Technology based in London, as well as head of Technical and Quantitative Research for Fidelity Management & Research Company.

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