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SFOs in Action: How the Richest Families Manage Their Wealth

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For many of the world's richest families, SFOs -- Single Family Offices -- play an essential role in their investment strategy. SFOs manage the family financial portfolio and often provide other services, such as handling children's college applications, hiring domestic staff or managing the family fleet of jets. About 1,000 SFOs are in operation around the world catering to families with a least $100 million in assets. More than half the SFOs are managing family wealth of more than $1 billion.

Up until now, little has been known about these powerful entities. New Wharton research, however, shows that they play an important role in managing major investment portfolios, guiding significant philanthropic endeavors and maintaining a core set of values across generations of extremely wealthy families.

Wharton management professor Raphael Amit says the survey's most important contribution is a better understanding of why families set up SFOs. For the most part, he says, it is to manage investment portfolios, but to do so in a way that is customized to the families' objectives. "First, and what surprised me most, is that family offices turn out to be private investment offices," says Amit. "The soft responsibilities, like coordinating the education of the next generation, is not as important as the financial wealth management issues."

Stacy M. Dutton, former president and chief investment officer of the Manhattan-based Park Agency, the successor company to the SFO Joseph P. Kennedy Enterprises, says family offices are trending toward more emphasis on managing money than managing the family compound.

"There is a divergence between new family offices being established today -- with their greater focus on investments -- and more established family offices which continue to provide more traditional services to the founding families," says Dutton, who this year became managing partner of Brandywine Global Investment Management in Philadelphia.

The Wharton research is based on a study conducted by Amit, academic director of the Wharton Global Family Alliance (GFA), Heinrich Liechtenstein and Julia Prats from the IESE Business School in Spain, and Todd Millay and Laird P. Pendleton of CCC Alliance. GFA is a collaboration of faculty at Wharton, IESE, SDA Bocconi in Italy, Singapore Management University and family businesses that support the center. The SFO study, titled "Single Family Offices: Private Wealth Management in the Family Context," is based on a survey with 138 responses and 40 in-person interviews.

Amit says a family needs at least $100 million in assets to make it worthwhile to establish an SFO, which typically costs about $3 million a year to operate. Individuals and other groups of families often form similar entities known as multi-family offices (MFOs) which, according to Amit, number in the thousands.

Trans-generational Wealth

Family investment offices trace their lineage back to the Roman major domus (head of the house) and the Medieval major-domo (chief steward). Today's SFO began to emerge in the mid-19th century with the creation of private banks and trust companies for families that made fortunes in the Industrial Revolution. According to the survey, SFOs these days are also operated for entrepreneurial families.

Among GFA survey participants, 58% remain involved in operating businesses and 77% indicated that they are majority stakeholders in holding companies they founded. The level of involvement in the family business, however, varies widely by geography. Only 40% of American families in the sample are involved in the family business, compared to 70% of the Europeans and 89% of those from other parts of the world.

The average SFO in the Wharton sample serves 13 households within the same family group, covering 40 family members and two to three generations. The median SFO serves four households and eight family members, according to the survey. The most important objective for the SFO, according to 57% of the survey respondents, is trans-generational wealth management. The second, selected by 39% of the respondents, is to consolidate accounting, tax and estate planning services.

From interviews, the GFA research found that other common reasons for having a SFO include freedom of career choice for family members; cost effective money management; stable, controlled and scalable asset management; development of trustworthy and loyal employees, and cheaper document administration.

Stuart J. Rabin, co-founder, president and chief executive of Jacobson Family Investments (JFI), manages the investment portfolio of the Jacobson family, which founded a major industrial tools and supplies distribution company, MSC Industrial Supply Co., of Long Island. He also runs a similar company, Nine Thirty Capital, that manages investment portfolios for another group of families.

JFI and Nine Thirty Capital are solely focused on investments, and Rabin says more SFOs seem to be moving in that direction. Family-run investment firms can protect against conflicts of interest and assure that the interests of the family come first, he says. An outside investment advisor "may have other interests. It might be a fee-generating business or a large institution that is interested in selling its own products. [The family] may worry, 'Do they have my best interests at heart?' If the family builds its own investment company, the family is the only client. There's no conflict. The family is doing whatever is best for itself."

The report shows SFOs do not typically manage family funds directly, Amit adds. Instead, they set the strategy and work alongside banks and other investment managers to safeguard and grow the family portfolio. "SFOs complement banks because much of what has to be done is outsourced to the banks. The banks are partners as opposed to competitors."

According to Dutton, partnering with private banks is a positive trend among SFOs. The most important benefit is better access to information technology. "It is problematic for stand-alone family offices to continuously invest in the IT infrastructure needed to generate the investment, tax and budget reports on a sufficiently timely and comprehensive basis to make optimal decisions," she says.

On average, the study found that European SFOs are inclined to outsource fewer activities related to wealth management, especially investment-related activities. In Europe, 63% of SFOs perform asset allocation in-house vs. 47% of SFOs in the Americas. In European SFOs, 70% of financial administration is done in-house while 41% is done in-house in the Americas. Many SFOs also offer so-called concierge services, such as managing homes, boats and planes, hiring staff, managing payments and guiding philanthropy. The SFO also helps keep families together and moving toward common objectives, says Amit, adding that some offices provide psychologists.

Governance Practices to Ensure Accountability

SFOs reflect the families that fund them through their governance structures. According to the report, family offices need explicit governance practices that hold the professionals accountable, such as pre-determined benchmarks, regular evaluations based on set criteria and clear reporting of outcomes. "Accountability plus objectivity contribute to building trust, a key underlying reason to have a family office," the report says. Members of the extended family often participate in family office governance in some way, either informally or through established governance committees, the research found.

Dutton says the most important trends in governance are mission statements and operating agreements. "These trends center on family members proactively making genuine governance commitments based on a shared vision of why the family office exists. What does the family want from its family office, and what financial and time commitments is it willing and able to make to ensure the office operates effectively?"

Nearly half of the survey respondents -- 43% -- chose a family member to head its SFO, while 51% chose a professional from outside. Based on a more detailed analysis, the research shows that richer families were more likely to hire outsiders to handle their money. While 55% of the millionaire SFOs had family member at the head of the family office, only 27% of the billionaire SFOs were run by family members.

During interviews, the GFA research team learned that some families chose professionals from the family business to be the head of the SFO since they were familiar with both the family business and the family. At the same time, other families specifically avoided hiring from the family business because they wanted to separate the family money from the business. "Governance is very important," says Amit. "Interestingly enough, when we compared the Americas to Europe and the rest of the world, U.S. offices have the weakest governance."

The study also revealed information about the operation of SFOs. In the Americas, the average size is 8.7 employees compared to 13.2 in Europe and 11.8 elsewhere in the world. The researchers contend that the larger size of European offices is due to the maturity of family wealth in Europe, where there are more generations and family members to handle.

The survey also states that investment professionals are willing to work at SFOs for less pay than they might earn elsewhere in return for a more relaxed and flexible work environment, Amit notes.

Discretion Needed

According to Rabin, discretion is critical for SFO employees managing the fortunes of families whose wealth might put them in the public eye. For example, his company has no web site and does not advertise. "But it really depends on the nature of the business and the family," he notes, adding that some high profile public families don't care as much about discretion, but most do. Dutton agrees that discretion is a major part of the job description at any SFO. "It must always be top of mind when working at a family office. "Normally, this is quite straightforward. It becomes challenging mainly when certain specific assets, such as a privately-held operating business or real estate, are held jointly by disparate family members."

The GFA study concludes with recommendations for families operating SFOs.

First, having a purpose seems to enhance the performance of an SFO. "Well-functioning SFOs tend to be linked to families with a strong sense of purpose where it comes to their fortune. This is particularly true when the family invests, not only its assets, but also its enthusiasm in the pursuit of something beyond mere wealth preservation. This applies to a broad range of objectives, including involvement in entrepreneurial activities and business, worthy causes, philanthropic pursuits, research foundations, patronage of the arts or taking on public responsibilities," the report notes.

Second, the study recommends that families strive for excellence in all aspects of their office. Nepotism has no place in the family office, but the report found that some families compromise the professionalism of their SFOs as a result of family politics or penny-pinching. Separating functions appears to improve performance, the study found. "The highly paid hedge fund expert should not be distracted by dealing with the car fleet, let alone collecting the dry-cleaning," the report states.

A model that appears to work well is to set up separate companies for the different specialized areas of asset management and concierge services, plus a foundation for philanthropic activity.

Finally, the report calls on families to simplify their corporate structures. One SFO in the survey was dealing with 200 non-active holding companies. Few SFOs had less than 80. "This can create problems for family members wanting to supervise, let alone direct, SFO decision-making properly," the report says. "Many simply do not have the time, interest or expertise needed to find the devil in a huge amount of company detail."

Amit says the new research is just a first step in gaining a better understanding of how family wealth is managed. GFA plans to continue its studies and hopes to examine the financial performance of families with SFOs against the investment performance of private banks or other investment professionals. "The vast majority of businesses around the world are indeed family businesses, and there are a number of distinguishing aspects that make family firms unique, raising issues that we as academics must look at, such as succession and governance," says Amit. "The link between the family and the family business deserves more interest."

