The New Family Office: Innovative Strategies for Consulting to the Affluent

Introduction

This book is a guide to building and maintaining exceptional businesses that will generate exceptional revenues for astute practitioners in the midst of ongoing challenges in the market-place. The book is not a simple, how-to manual, nor does it attempt to provide a turnkey solution to financial services advisors' ailing practices. Rather, it is designed as an educational tool that will prove its value through the successful implementation of its guidelines.

The challenges financial advisors and investment management consultants face in the financial services industry today are significant and unprecedented. Top-level investment management consultants are coping with them more effectively than the bulk of the financial services advisory. What makes these consultants better able to make the challenges work in their favor? *By basing everything they do on each client's unique vision for successful wealth management rather than their own, they command higher fees and enjoy exposure to high-quality business opportunities*. These consultants have also realized that there is a price for attaining and maintaining this level of success: they must operate with the paradoxical mind-set that monetary reward is a natural by-product of doing the right thing for the client. In other words, by switching their focus from increasing revenues to providing clients with the service they demand, not only do they attract the profits the entire industry craves, but they also achieve more personal satisfaction in the process.

Problems for the financial services industry

Despite its efforts to convince the investing public otherwise, the financial services industry is still primarily profit-driven, often at the expense of investors. Its profit-driven culture is deeply embedded in its history. It has attempted to shift to a family office style service focus in a furious effort to replace the cash cow of commission-generating business that carried it through the early 1990s only to quickly abandon that focus because it did not generate the immediate profit panacea demanded by shareholders. That cash cow is on the way out, but it still dominates the financial services industry.

The vast majority of advisors at large financial services firms continue to receive their compensation from transaction-based business. They are milking the cash cow for everything it is worth, which is diametrically opposed to the way solid, long-lasting profits are generated in today's world. Granted, the firms employing today's advisors are verbally encouraging them to make the switch to fee-based compensation, but the firms' actions to date in supporting that encouragement have been less than spectacular. This lack of deep-seated support may be rooted in the industry's general failure to fully appreciate or understand how people feel about their money, suggests Charlotte B. Beyer, founder and CEO of the Institute for Private Investors (IPI),[1] as well as industry firms' overall feeling that they cannot make money by providing open architecture, individually customized, client-focused service. As a result, the proportion of revenues generated at financial services firms today from family wealth is under 15%, according to Family Office Exchange (FOX) founder and CEO Sara Hamilton.[2]

These factors cause firms to focus on the goals of increasing margins and satisfying shareholder demands and, paradoxically, to miss the mark for sustained achievement of those goals. This sets up a difficult hurdle for financial services firms and the advisors and consultants who work for them. By definition, the interests of shareholders and clients conflict. Shareholders tend not to be patient and this adds significant pressure on financial institutions to 'perform'.

Although some firms have done a much better job of accomplishing the shift in focus than their less committed counterparts, the overriding pull of shareholder demands and expectations still dominates. The answer to these problems lies in educating shareholders that a long-term, high-quality approach to profit generation is actually more lucrative than the current short-term approach. The responsibility for providing this education lies with the financial services firms themselves, who, so far, have made little attempt to come to grips with the issue. As a result, at most financial services firms, attempts to boost margins continue to address the symptoms rather than the root causes of the problem. Thus, astute investment consultants are placed in the frustrating position of having a clear understanding of what they need in order to move their businesses forward while not having the appropriate tools to accomplish that goal.

Problems for the family office industry

The family office industry has had the right focus, but feasible business models and retention of the level of professional talent required to implement that focus in recent decades have been elusive. The family office traditionally has been viewed as an entity designed to provide the ultimate level of service to the family rather than as a business designed to make a profit. But as families and their wealth grow in size and complexity, the costs of managing the family and the wealth also grow. This increase in costs eats into investment returns from all sources of capital – financial, human, intellectual, and social. Families have attempted to achieve more cost-effective and profitable ways of managing their portfolio of assets by adopting the multi-family office structure and/or specializing in niche offerings such as hedge funds or private equity funds. However, these efforts can only be rewarding if the family views the office as a separate, formal business entity, not simply as a way to get the service they demand with the bonus of a little profit thrown in.

So an overlap in the focuses of the two industries is occurring: the financial services industry is attempting to emulate the family office industry's level of service in order to boost profits, whereas the family office industry is attempting to add greater cost-effectiveness and even profitability to its unsurpassed service mix. This overlap is limited and it is the author's view that, unless fundamental changes occur in the financial services industry, it will remain so. However, the family office industry's inclusion of profits within its focus offers it much greater reciprocal benefit than the financial industry's frustrated attempts to lay claim to the profits from the larger assets indigenous to the family office industry.

The financial services industry's view that capturing the larger assets of families would automatically generate larger profits has proven to be erroneous. The industry miscalculated the costs required to offer the broad range of services required by wealthy families; therefore, they are now trying to reinvent the wheel. In times past the financial services industry created the service models offered to clients; now, client demand is dictating the service models that the industry adopts.

The family office industry has the optimal service model. Its challenge is to contain costs and increase profits without unduly compromising the quality of that service model. The financial services industry had the optimal profit model, but that entire model is being undermined by market forces stemming from the desire of a more sophisticated investing public to have stable, more responsible, and more knowledgeable management of its assets. The growing momentum of these forces has been accelerated by corporate scandal in the midst of one of the worst bear markets in capital market history.

The solution

The solution for both the financial services and family office industries and their advisors and consultants lies in optimizing all sources of client wealth and consultant wealth. Today's leading investment management consultants are already well on the road to such optimization, but even the top consultants must constantly re-examine their business models to ensure continued success. They must transform their identities from investment management consultants into wealth optimization consultants^{SM}, realizing that the wealth optimization consulting model^{SM} provides the basis for long-term competitive superiority.[3]

The need for investment management consultants to be skilled in wealth management is already apparent to the Investment Management Consultants Association (IMCA), the industry organization that licenses the Certified Investment Management Analyst (CIMA) designation. IMCA has acknowledged this need by creating a wealth management certification course among its other certification courses designed to help consultants remain competitive.

But educating investment management consultants in such wealth management disciplines as compensation plans, retirement plans, alternative investment strategies, fiduciary tax planning, asset protection, estate and gift tax codes, and charitable planning – with little mention of the effects that family dynamics and other aspects indigenous to the wealthy have on the employment of these skills – leaves high-level advisors and investment management consultants only partially equipped to work effectively with owners of significant wealth. In fact, only one organization – the IPI – has structured a formalized program designed to educate its high-level advisory and investment management consultant members in these so-called 'softer' service areas of wealth management.[4] Yet, these are the areas that hold the greatest influence over wealth management results, and they are also the areas most sought after by today's increasingly sophisticated investors.

The author expects that several such programs will be in place by 2005 due to demand from high-level advisors and investment management consultants and an increasingly challenging market-place. An integrated, comprehensive application of traditional wealth management skills and softer service skills optimizes all forms of a family's wealth – financial, human, intellectual, and social. Thus, a practitioner sufficiently educated and experienced in both skill sets becomes a consultant not just for wealth management, but for wealth optimization, and wealth optimization is the key to competitive excellence through any type of challenge or industry climate.

The future of the financial services industry

Unless the industry makes an 'about face' commitment to addressing the needs of the wealthy, it will succumb to the commoditization forces at work in all tactical areas of service, including setting up separately managed accounts (SMAs) and unified managed accounts (UMAs) and the front and back office services so critical to those investment products. Chapters 4 and 6 explore both aspects of this industry metamorphosis.

Without such a commitment, the author sees the market for financial services lying predominantly with investors having net worth of between US$500,000 and US$5 million.[5] The ultra-wealthy will always be the smallest market segment (and the most eagerly sought after), but the ultra-wealthy will continue to demand single family office (SFO) level services regardless of whether they exist in the traditional format. However, there is a middle market that is being virtually ignored. This market is divided into two segments – US$5 million to US$24 million and US$25 million to US$100 million.[6]

Wealth optimization will enjoy the luxury of being able to address this middle market range of needs, signified at the extremes by the US$5 million investor and the ultra-wealthy, plus everything in between. This is not to encourage consultants to be all things to all wealthy people; however, the wealth optimization model is flexible enough to accommodate various market level focuses of individual wealth optimization consultants and wealth optimization consulting teams. There are three basic levels or tiers of service in the new model: services targeting the US$5 million to US$24 million market, the US$25 million to US$100 million market, and the ultra-wealthy. Whichever service level a consultant chooses, the wealth optimization model can be adapted accordingly.

The purpose and structure of this book

This book is designed to offer a new, objective view of the state of the financial services and family office industries from a knowledgeable, experienced third party. The author's objective is to enlighten financial industry advisors and consultants to competitive solutions that will allow them to create thriving businesses.

The transformation to wealth optimization begins in this book with a thorough examination of the histories of both the family office and financial services industries, followed by a full exploration of the factors that make family office models so attractive, the essential ingredients of the new wealth optimization model, and what high-level advisors and consultants must do in order to realize their business objectives despite the contradictory backdrop of the financial services industry.

Part I encompasses the history of both industries from the 19th century onwards. The two histories are laid side by side so that their concurrent development may be examined and the ways in which they are beginning to overlap may be clearly seen. Layered on top is an overview of current family office service models and the elements that will be retained and/or tweaked in creating successful models for the future. Part I closes with a reality check covering the current state of both industries and defining choices and opportunities presented to today's high-level advisors and investment management consultants.

Part II contains an exploration of the new wealth optimization model and the formats through which it can be implemented. It explains the collaborative relationships that must be created between family advisors and the comprehensive integration of services that attract wealthy families. It examines the technology requirement, plus the costs and education needed by the wealth optimization consultant, and also explores traditional wealth management skills in a new light. From this point, the book predicts the development and characteristics of wealth optimization consulting into the future.

Part III of the book encapsulates the considerations necessary for transforming a practice to the wealth optimization model. A fresh look at traditional wealth management skills is followed by the marketing and client education guidelines that will position the advisor/consultant and build his or her identity as a wealth optimization consultant.

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[1] Personal interview with Charlotte B. Beyer, founder and CEO, IPI, November 2003.

[2] Personal interview with Sara Hamilton, founder and CEO, Family Office Exchange (FOX), September 2003.

[3] The terms 'wealth optimization consultant' and 'wealth optimization consulting model' are the marked property of graymatter STRATEGIES LLC.

[4] IPI offers one-day seminars designed to give both private investor attendees and their advisors hands-on opportunities to find solutions to common challenges through its Investor–Advisor Dialogue sessions. FOX offers educational conferences for its family client members and their advisors. However, there are no programs available focused on the education of advisors or consultants wishing to attract wealthy family clients.

[5] IBM Business Consulting Services (in *Technology is Not the Trump Card in Mass Affluent Wealth Management Game*, 2003) places the ideal financial services market at between US$100,000 and US$1 million in investable assets beyond the traditional ultra high net worth and high net worth focuses of the industry.

[6] The founder and CEO of FOX, Sara Hamilton, states that most experienced professionals identify that the complexities of managing wealth start to change dramatically at the US$25 million level. Hence, the author's service tier division at that level. (Personal interview with Sara Hamilton, September 2003.)