NARVA & COMPANY

ADVISORS TO FAMILY ENTERPRISE

The Family Dimension of Family Offices

Richard Narva, Founder and Principal Advisor

Introduction

The most obvious flaw in most analyses of family offices is the tacit, but overwhelming primacy of the assumption that all family offices share common procedures and structures, and that these "Best Practices" are the holy grail which all family office executives should seek. The flaw in this assumption is that commonality among family offices is always a corollary. In reality, "Best Practices" in family office management are not uncommon in well run family offices. But such procedures and structures do not address the core realities in the families that found such institutions. Consider the axiom about families posited by Tolstoy at the beginning of Anna Karenina: "All happy families resemble each other. Each unhappy family is unhappy in its own way." Based on this axiom it is possible to state the corollary that efficiency and investment success in a family office are for the families who control them like the tide: predictable as forecast. But like the tide, in unhappy families [and all families are unhappy some of the time] whether calm waters or storm surges occur is a function of the family. The power of family relationships suggests that the very term, **family OFFICE** is a misnomer, as it assumes that the real power lies in the office, when in fact the entity might better be described as The **FAMILY's office**: Since in the end it is the culture of the family and the behaviors of family members that determine the success, longevity and utility of the enterprise.

Redefining the Family Office

In my view, a family office, a family business or a family foundation have vastly more in common than The Bessemer Trust Company, General Motors, and The Red Cross. While the latter three enterprises—a trust company, a listed global corporation, and an international charity seem to have little in common with respect to values, goals or mission, family offices, family businesses and family foundations have a primary common bond: They are each essentially pools of capital controlled by a family via ownership, governance, or management. All three are **Family Controlled Enterprises**, i.e. pools of capital controlled by families irrespective of how that capital is deployed: in operating companies, investment or philanthropy. Capital does not care how it is deployed or by whom—it simply seeks a return. Family controlled capital is often [not always] driven by a controlling family's culture, core values, and objectives specific to it as a family. Family Offices, in my view, are simply just one of several kinds of family controlled enterprises. Where the family office is not ultimately underpinned by a family's culture and guided by a multigenerational family, they are essentially private trust companies with a class of owners or beneficiaries defined by consanguinity. That is not a bad outcome. It is just not truly a FAMILY's office.

While family drivers of family capital are more often implicit than articulated fully, in many and perhaps in a growing number of cases, family capital is deployed in consciously decided ways that may differ greatly from other enterprises appearing to be substantially similar. Such differences may exist among family enterprises as well as between family controlled enterprises and other apparently similar institutions. Family businesses are perhaps the easiest arena in which to draw these distinctions. Why did S.C. Johnson, a multi-billion dollar consumer products company introduce to all its advertising and marketing the tag line: **S. C. Johnson, A Family Company**"? The answer is that its research showed that consumers trusted family firms dramatically more than public companies. By definition, Procter & Gamble cannot lay claim to the same status. I would argue that trustworthy corporate values, i.e. values which drive corporate conduct in ways that sustain continuing customer satisfaction, are the same reason eight of the top ten American supermarket companies ranked by customer satisfaction are either family controlled or family and employee owned enterprises.

Ample research exists that shows that family controlled companies both demonstrate much greater focus on long term outcomes and embody their core values in their operations. Does the same reality hold true for family offices? What, if any, impact does articulating and defining the culture and core values of the controlling family have on a family office? By this question I do not mean, "How does it affect investment performance?" Rather the question is intended as an inquiry into whether any particular family office, like the supermarkets described above, rank high across the spectrum of "customer satisfaction" metrics for the entire range of family members. Should family control matter to the performance of the FAMILY's office—and if so, does the management team running the family office know how to deliver on such a set of customer demands? Generally speaking, I believe the unsatisfactory connection between management of many family offices and the families who founded them is suboptimal for clearly discernable reasons. Set forth below are several of those causes.

The Family Office Executive

In my view, the family office executive bears the simultaneous responsibility to the family office as both the captain of an oceangoing ship and the harbor pilot whose local knowledge ensures that an ocean liner docks safely in a fogbound harbor surrounded by treacherous reefs. The former role may be analogized to the managing director of any financial institution. Such skilled executives, while not inexpensive to recruit and retain, are nonetheless in relatively ample supply. Skilled practitioners of the pilot's role, assuming as it does local knowledge that requires years to acquire—whether of the particular harbor or an extended family—are rare treasures not easily found. If one assumes that such executives [and for that matter their primary advisors] ought not earn compensation nor charge fees for services they are unlicensed to perform, then <u>ab initio</u> family office executives who earn an Oxford First in financial management have necessary, but NOT sufficient skills for their role and its responsibilities. Such executives may qualify to run a private trust company, a family OFFICE, if you will. But absent knowledge and skills in advising individuals in a family system who are the owners/beneficiaries/customers of the FAMILY's office, a gaping hole in their required competence remains. As with ocean liners: ship captains may steer the correct course from the UK to the US, but only a pilot can safely guide the same ship out of one port and into another. Family office executive must not only have the ability to "write poetry" in the language of finance or management, but also be able to "read the news" in family systems in order to be qualified fully to lead a FAMILY's office.

Governance and the FAMILY's office

In my experience advising more than 400 family controlled enterprises [mostly family firms, but also family offices and family foundations] over more than 30 years, the next time I encounter a family controlled enterprise with truly effective governance on the day we meet with be the very first time. Governance, like dieting, root canals, colonoscopies and psychotherapy, is a topic of advice often given, but rarely received. And to make the matter of introducing and sustaining effective governance even less likely to occur, family offices need both family governance and corporate governance. [1] What is important for this article is to note that without effective governance, there is no way to hold management accountable in any enterprise for creating and implementing strategies which ownership has sought. Moreover, taking note of Peter Druker's maxim that "Culture eats strategy for breakfast," both articulation of the cultural foundations of a family office and creation and maintenance of strategies premised on that culture, require board members versed not only in the language of business, but also [as noted above] in the dialect of the family that controls each particular enterprise. Although they are only "Guests at the Table" [2] board members can fulfill many concurrent, invaluable roles that enable families who control enterprises and managers who run them to achieve their goals and objectives. [3] If one envisions the table to which advisors/guests are invited as a salon noted for splendid conversation among scintillating guests, rather than the table in the formica decorated kitchen made famous in the classic movie**, Moonstruck**, the metaphor works better.

[1] Highly readable essays on how to create and maintain both kinds of governance are easily found. <u>See</u>, D. Medici, "Family Governance: Questions and Answers," in R. Narva, Ed., <u>Sustaining Family Enterprise: Meeting the Challenges of Continuity, Control and Competitiveness</u> [2016] at 93; and see generally, R. Narva, Ed., <u>Family Enterprises: How to Build Growth, Family Control and Family Harmony</u>, [2015] at 159-204.

[2] D. DeMott, "Guests at the Table?: Independent Directors in Family-Influenced Public Companies," 33 J. Corporation Law 819-863 [2009], available at: http://scholarship.law.duke.edu/faculty_scholarship/1918.

[3] <u>See</u>, R. Narva, "The Role of Independent Directors in Family Controlled Listed Enterprises," in <u>Family Enterprises: How to Build Growth, Family Control and Family Harmony</u>, at 205 [2015].

Family Office Advisors

Even with a family office chief executive who combines the diplomacy of the UN Secretary General, the investment wisdom of Warren Buffett, and the management talents of Jack Welch, and a family council and board of directors/trustees that outperforms the Federal Reserve's Board of Governors, family offices need professional advisors too. Given that the financial and legal complexities of their affairs are usually commensurate with the amounts of wealth they control maintaining all the requisite expertise internally is impossibly expensive for all but the largest family offices, and even then, the independence such advisors offer would be unavailable. Virtually all family offices seek and obtain such advisors and many professional firms across the globe offer highly focused and sophisticated services for such customers. Family OFFICES are usually well advised: Families and FAMILY offices, not so much. Families with counselors or advisors with skills and competence in counseling them on relationship issues, communication shortcomings and conflict resolution that equal the legal and financial advisor's family offices usually retain are as common as unicorns---and I mean the animal, not the Silicon Valley venture by the same name. There are no conferences anywhere in the world where legal and financial advisors who operate at a level of expertise and experience required by family offices meet with their peers who are expert in family systems. And even where families engage highly qualified counselors to families as well as business and legal advisors, family offices which mandate or even request regular discourse between both sets of advisors are beyond rare because there is no real forum for discussion of, nor even any widespread realization that there is an imperative, organic connection between the well-being of the family and the health of the family offices they control.

Let me illustrate the point with a true story modified to protect the identity of the family and its enterprise. The story illuminates the issue of advisors' roles for all manner of family controlled enterprises. The controlling family in this story is comprised of a father, mother and five offspring, three of whom were active in the enterprise, which operated a large, diverse set of related corporations. The father who was founder of the firm had turned over day to day management to one of his children. Another had left the companies by mutual consent with his father based on poor performance arising from lack of interest in a business career, and the third was chief financial officer. The companies were highly successful competitors with little debt despite the fact that the CFO regularly took substantial sums of cash out of the company to finance a gambling addiction, losses which this private company could not sustain any longer. After many years of family-wide denial, how was this problem addressed?

Fortunately, the company's corporate attorney and its family business advisors [a business advisor and family therapist team] had a long working relationship with both the family shareholder control group and with each other. The family business advisors developed a plan and facilitated its acceptance by both the founder/father and the mother/Chief Emotional Officer. The family therapist guided a meeting in which the CFO was confronted with his behavior. The business advisor developed a "death penalty" strategy in which any future recidivism would lead to dire financial consequences for the CFO. And the attorney drafted an amended agreement among shareholders which provided that in the event of a future repetition of misconduct the CFO would be terminated for cause and his shareholdings would be redeemed in their entirety at the lowest end of any supportable range of fair value. The worst case event came to pass, and with full, explicit concurrence, the CFO left the company and was redeemed as a shareholder. While the business events were very difficult, the family was not destroyed and the family controlled business continued to thrive. How the parents dealt with the CFO became a private matter among them as opposed to a drama acted out on the stage of the family firm, with disaster looming for the enterprise.

While the drama of this story may not be replicated in all family enterprises, the reality of family dramas being enacted at the venue of the family controlled enterprise -- whether it be the corporate board room, the family foundation grant making meeting, or the family office investment committee -- occurs every day, and rarely do the executives of these enterprises or the boards to whom they are accountable or the advisors to whom the managers or board members may turn for advice have access to the family expertise needed or that matches the legal or financial advice otherwise available.

Some additional complications

Assets Owned in Trust

One particular constraint on the management of many family offices is the profound cultural discontinuity between the entrepreneurial culture of many founder and family controlled business enterprises and the fiduciary culture of the trusts and other structures into which they deposit the wealth earned by these entrepreneurial firms, whether for investment or philanthropy/social entrepreneurship. While others have more expertise on how to design the legal structures that permit subsidiaries or affiliates of family offices or family foundations to engage in entrepreneurial or start-up endeavors, most institutional trustees are governed by the culture of the fiduciary: a culture that by law in many jurisdictions is required to be prudent, i.e. risk averse—a cultural norm one can assume is the antonym of the risk orientation of the entrepreneur who created the wealth originally.

If Men are from Mars and Women are from Venus, then trustees are from Neptune and founders of startups are from Jupiter. The cultural norms are hard to bridge in both cases. And where wealth preservation is at stake, conflicts are sure to arise between family members keen to preserve and enhance the culture of innovation and even disruption that undergirds the creation of wealth, particularly in technology companies, and their fiduciaries, who by training and perhaps temperament, loathe disruption and tumult. Add to this mix the powerful emotional role wealth plays in families where parenting may have played second fiddle to sustained business and a combustible mixture may exist at the founding of many family offices.

Culture and Ethnicity

A woman from South Asia who was an early client of my firm asked me in our initial interview two questions which highlighted for me then, and continue to remind me, of the impact of cultural norms when dealing with family controlled enterprises. She inquired first whether the fact that she and her husband had an arranged marriage impacted their relationship as coowners of a family business. Shortly thereafter, she asked whether the fact that her husband was a high-caste Brahmin impacted his issues with building a management team at their rapidly growing company. As to the first issue, I responded that it was unrealistic for her to ask an American born in the USA to offer any expertise on the impact of arranged marriages. As to the second matter, I suggested that norms of team building invoke notions of equality, an issue that might be a matter of some primal difficulty to an executive born into a caste system, even after emigration to America. To anyone who doubts that the same substantive problem can be addressed in the same way independent of the culture or ethnicity of the family s/he advises or the family office s/he manages, I urge a review of the classic work, **Culture and Ethnicity in Family Therapy**. [4] One of the most obdurate challenges to anyone who would manage, govern or advise a family office is to understand in a truly fundamental sense the culture and ethnicity of the family the institution is designed to serve. Failure to do so is tantamount to an American ordering dinner in a restaurant without an English language menu. One might not go hungry, but realizing one's goals or dreams for the evening is a highly unlikely outcome.

Countertransference

Much of the work of my firm involves the non-therapeutic application of therapeutic and diagnostic skills. Since both those members of the firm who are trained and certified as therapists and those who are business or legal specialists are subject to clinical supervision by the senior clinical advisor at the firm, all consultants have an opportunity to address reactions they have that arise during their professional work. One important reaction that affects all professionals working with families and individuals in the family controlled enterprise setting is countertransference. [5] A simple definition of countertransference is the conscious or unconscious reaction of the therapist to the person or material raised by a patient in therapy. What most professionals dealing with family controlled enterprises do not realize because they are not trained to recognize its existence is that as authority figures, managers and advisors in the family enterprise setting they are subject to countertransference precisely because they deal with emotionally powerful subjects as part of their daily work. Few subjects are as emotionally

4. M. McGoldrick et al., Culture and Ethnicity in Family Therapy, 3rd ed., 2005. See also, M. McGoldrick and J. Troast, Jr., Ethnicity, Families and Family Business: Implications for the Practitioner," VI Fam. Bus. Rev. 3 [2004].

5. See, S. Roth, "Consultation for the Consultants: Clinical Supervision of Family Business Consultation," at 118, in Proceedings of the 1992 Family Firm Institute Conference Family Business at the Crossroads, [R. Richards, Ed.] [1993].

powerful as money—for both the family member and the family office manager or advisor. How can this psychodynamic work in a manner that impacts the relationship adversely? Consider thefollowing common, but rarely disclosed countertransference dynamic experienced by the family often than is acknowledged, and even if it is well managed—and the start of managing countertransference is recognizing it exists—it does exist and can impact performance materially and adversely. At the same time, this dynamic, if well recognized and its risks well managed, can form the foundation for powerful empathy and service to the family whose office is being managed or advised.

Conclusion

One of the most respected researchers and teachers of family enterprise anywhere, Ramona Zachary of the City University of New York, once wrote, “Family is the oxygen that feeds the fire of entrepreneurship.”[6] By this she meant that it is the essential ingredient without which entrepreneurship does not exist, much as medieval thinkers thought that a mysterious substance, denominated “phlogiston,” formed the basis of the universe. Those of us who manage, govern or advise family controlled enterprises, whether businesses, foundations or offices, share a fundamental duty to understand and integrate not only a respect for the institution of the family, but also a profound and specific understanding of the particular family whose endeavors, values and success underlie the enterprise we serve. Otherwise, we are merely highly paid and hopefully successful functionaries. Leadership of a family office requires more: It commands that we know a family issue when we see one at work in our enterprise; that we learn to identify how this family issue impacts both the family and the enterprise it controls; and that we know how, or at least where to go and whom to retain, to address the impact of this issue with both sensitivity and success.

[6] E.G. Rogoff and R.K.Z. Heck, “Evolving Research in Entrepreneurship and Family Business: Recognizing Family as the Oxygen that Feeds the Fire of Entrepreneurship,” in 18 J. of Business Venturing 5 at 559-566 [2003].

