Helping Families Transition from a Single-Family Office to a Multi-Family Office

Reasons, Risks, and Recommendations

By James Grubman, PhD, and Jill Shipley

When Ralph Wyman succeeded his father in 1960 as head of Eagle Capital, their family's fifth-generation single-family office (SFO), he realized there was no easy answer for what would happen after his own passing. He struggled with the question of what direction the SFO should pursue next. Ralph's nephew-in-law Juan Meyer, a next-generation leader in the SFO, later explained that the first step toward change was providing services for a small number of other families.

"Our single-family office took on a few nonfamily clients in the mid-1980s and experienced firsthand the advantages of a larger client base," Meyer said, as described in Soldano and McCarthy (2005). "Over time, though, we realized that Eagle Capital alone as a small multi-family office (MFO) was vulnerable …"

"Attracting smart, younger professionals and being able to compete in the global investment community were important hurdles. Another big concern was keeping costs acceptable to the next generation while still offering a full range of services—in other words: ensuring that our family office would be successful well into the 21st century."

Through outside consultation and extensive family discussion, merging with a much larger MFO eventually was chosen as the best solution for the new millennium, even though it brought an end to the original single-family focus. "Our [current] venture offers new depth and services to our family as a whole, and I'm surrounded by younger smart and fun people," Meyer said. "We've found a model that is working for us—and others."

Like the Wymans, many multigenerational families of wealth find themselves re-evaluating the future of their single-family offices. Family offices are faced over time with the same stresses and potential transitions that the wealth-creating business originally underwent in its own growth, development, and maturation. Just as the founding family business had to mature and develop organizational structure as it grew, the SFO faces changing pressures as it struggles to handle the myriad complexities of a growing multi-household, multi-branch, multigenerational family.

SFOs typically are created following liquidity events in order to manage and oversee wealth for a group of family members. They often are run by one or more key executives who make the majority of decisions informally alongside the elder family leadership. As families grow, complexity increases exponentially. New generations have different needs and make different demands. Eventually, connections to the wealth and to the legacy diminish, communication and decision-making become more challenging, and additional family-office matters such as leadership development, education, and governance become more pressing. These can be difficult to fund and scale in an SFO model. Meanwhile, the outside world evolves into a complex new environment with its own demands and pressures. At some point, the family must step back and plan for the family as well as the family office.

Reasons for Transitioning from an SFO to an MFO

In the past decade a convergence of trends has made many families question the benefits and financial efficacy of the SFO model as they move toward hybrid models or entirely different service delivery options, especially the MFO model. Here are some reasons why this trend toward MFOs is accelerating:

Demographic pressures. With the World War II generation now well into their 80s, baby boomers and their adult children are ascending to leadership in significant numbers. Elders have benefited from medical advances in longevity to preserve their influence, but aging still is inevitable for even the hardiest of patriarchs and matriarchs. Succession is coming to more and more families, whether planned or not. Just as high-net-worth families often switch advisors upon generational transfer, ultra-high-net-worth (UHNW) families commonly re-examine their wealth management as succession occurs and new leadership steps forward. Dovetailing with this are two other factors. First, the 2007–2008 bear market uncovered weaknesses in family-office procedures, risk management, investment models, advisors, and perhaps even competence that previously were hidden or tolerated. Second is the dramatic transformation of the wealth management industry itself in the past 20 years. New investment models, options, and structures have greater transparency, financial options, and risk management. The result is that, for many families, the rise of the next generation is expressed as criticism of the elder generation's family-office management, with modern wealth management waiting at the door to capitalize on the push for change.

Family dynamics and governance. In combination with the demographic and wealth management trends, many families are finding the next generation has its own imperatives for change which, if not handled well, can lead to significant stress. Those families with effective governance structures and communication may be able to work through addressing family-office needs, but for many families governance may be awkward, pressured, and rife with conflict. As new leadership emerges with its own ideas and a desire to re-evaluate and restructure what the wealth-creating generation built, families with established SFOs are being challenged to consider new options. The result is that legacy family-office services and professionals may find themselves perceived as aligned with the elder generation while the next generation pushes for more modern, responsive, and next-generation-friendly services. In some scenarios the pressure to change comes from expanding family branches, not the next generation. As new branches undergo their own stresses and governance fails to maintain cohesion, a branch previously served by the SFO may choose to go its own way. They then have to gravitate to an MFO because the branch wealth is typically smaller than the total family wealth. Over time, other branches may follow. The family may therefore undergo an SFO-MFO transition from secession, not succession.

Cost and compliance issues. The average SFO costs between $500,000 and $1 million annually to operate. Today, families are even more concerned about costs, fees, and transparency due to the asset compression in 2008 and the revelations of corporate and financial scandals. This puts a strain on family-office executives to do more with fewer resources. Service delivery becomes an added challenge in an environment with increased compliance requirements, regulatory issues, complex tax codes, streamlined cash-flow management, and a greater demand for communication and reporting. SFOs are looking at the MFO solution as a way to increase efficiency and decrease costs, all in an increasingly complex regulatory environment. A reality, however, is that the economics of delivering family-office services are challenging for everyone. MFOs themselves are facing strong economic pressures, so they often are not the magic bullet. Nevertheless, MFOs can seem like a better alternative than the difficult economics of running an SFO.

Talent. As business conditions improve in the wealth management world, finding and retaining talent is a growing challenge. A Family Wealth Alliance study (2010) cited human resources as a top concern for family offices. Patricia Soldano, a family-office executive with more than 25 years of experience, expanded to a small-MFO model in 1996. She recently decided to join forces with a larger MFO. "What I was looking for from the partnership was more resources," she said. "As a small firm I could not attract or pay for such talent as [a larger MFO] can attract and pay for in all areas. My families now have more resources and we can do a better job in serving as their family office. I think this is a trend with SFOs and small MFOs as families need and deserve the best and most-sophisticated resources available" (Patricia Soldano 2011, personal communication). SFOs also are finding that filling a retiring family-office professional's position is extremely difficult. The need for replacing top family-office management may precipitate a search for a different family-office model itself.

Benefits an MFO can provide. Aside from the cost efficiencies and investment opportunities, many families see that a variety of intangibles are available by joining forces with other families in family-office services. UHNW families can feel isolated given the lack of an easily accessible peer group and the stigma that surrounds wealth. There is great value in building a community where clients benefit from the power and synergy of hearing about each other's successes and mistakes. An MFO can provide this opportunity for family members and can provide support for family-office executives. Our growing knowledge of multigenerational wealth emphasizes how critical it is for UHNW families to get support from their family-office professionals in managing financial capital as well as the human, intellectual, spiritual, and social capitals of the family. If the family's legacy, communication processes, and values aren't effectively integrated alongside financial aspects of the family office, success is destined to be elusive. These skill sets often go beyond the education of the technically oriented family-office professionals whose expertise is in legal, tax, or investment services. SFOs with limited skills or expertise in family governance, modern financial literacy education, and other formalized family dynamics services may be able to utilize an MFO's understanding of family systems, family dynamics, and governance in the overlap of the financial and family worlds. More MFOs are developing competencies in these areas or building external relationships that provide these services for clients.

Risks during the SFO-MFO Transition

Eagle Capital made a successful transition from SFO to MFO, but not all transitions go as well. The migration toward an MFO can encounter landmines along the way and prove nerve-wracking for everyone. Everyone wants the efficiencies offered by MFOs but not necessarily the compromises.

A decision to move forward without considering all the options and implications can be expensive, time-consuming, and ultimately unsatisfying.

Risks for families. Families may have unrealistic expectations for the transition and may not have thought through their needs or their goals, particularly if they hope to achieve the best of both worlds through a hybrid SFO-MFO structure. Such a structure is sometimes harder to implement than either a full SFO or MFO model. As time goes on, family members may feel like they aren't receiving the attention and tailored solutions they were used to with an SFO, or they may become concerned about privacy and confidentiality. Jamie McLaughlin, an experienced family-office industry consultant, has commented: "The SFO-MFO transition is rarely wholesale. Like a cat putting its paw in the water, most SFOs begin to outsource some non-core duties to an MFO before entertaining a fuller transition" (Jamie McLaughlin 2011, personal communication). Family members also can bring jealousies, hopes, fears, and power issues to the SFO-MFO transition. A reality is that families vary widely in their skills for negotiation and cooperation. They may not have learned much about true collaboration under top-down leadership of the prior generation as they've pushed for change with their elders, siblings, or cousins. Their ability to "play well with others" in this charged atmosphere may be modest, particularly if their own credibility is on the line with the success or failure of the transition.

Risks for SFO professionals. The transition can be stressful both emotionally and professionally for SFO executives. Although they may have much to contribute as valued members of the family system, they may feel insecure about what this transition means for them. The SFO-MFO transition threatens SFO professionals' job security as well as their sense of value and purpose. The executive may see the decision to outsource services as a personal rebuke, albeit one to be handled with grace and dignity. Executives may secretly or openly disagree with the decision to outsource or merge services with an MFO, but they are expected to assist with the transition. Worse yet, if it becomes clear the MFO truly does have greater expertise and competence, SFO executives must swallow their pride and manage their embarrassment. For all these reasons and more, family-office professionals must be masters of diplomacy, tact, and self-restraint, a set of rare and difficult skills for any professional.

Risks for MFOs. The MFO is far from a bystander to all this. As the new kid on the block for the family, the MFO wants to prove its worth and skills in comparison to the legacy SFO. The MFO may be used to owning the client relationship, not sharing it in an SFO-MFO hybrid model. The MFO professionals may see the SFO professionals as limited, inefficient, or outdated—not the optimum situation for mutual trust and respect. The MFO professionals must realize the advantages of keeping those SFO professionals who have been important to the family, who know the family history, and who have observed family members in multiple situations over a long period of time. If the MFO's front-line advisors come from traditional wealth management positions with a strong sales-and-marketing culture of competition, real collaboration will be elusive. The atmosphere will not be conducive to the hard work of carving out clear roles, boundaries, areas of decision-making, and ultimate authority.

Recommendations for a Successful Transition

Migration of a family from an SFO to an MFO relationship may be facilitated by the following:

Collaborative communication. Advisors on all sides should resist the temptation to talk about only what they can do and be honest about what they need from each other and the family. Humility goes a long way toward working well together for the long run. When egos can be left at the door in a genuine desire to make the transition work for the family (which, after all, is the center of all the relationships) the chances of success go up.

Aligned culture. The family-office organizations need to have aligned cultures and values, just like any relationship. Similar perspectives help to ensure that a hand-off or integration will benefit the family and retain the cohesion and chemistry developed with the SFO. Due diligence on the front end is crucial in this respect. The family must take the time to investigate the fit between what they have, what they want, and what they will have after the transition, or the components will feel tacked together rather than smoothly integrated.

Clear decision-making. The goal of an SFO-MFO hybrid model is a true partnership in service of the family. That said, it is important that decision-making responsibilities be determined up front. Someone must have the final say on key issues because unanimity or even compromise is not always possible. This is where the family's governance must share in assigning responsibilities, defining goals, and managing accountability. The SFO-MFO transition is a test of the quality of the family's leadership and capacity for healthy decision-making. Strong hands at the helm will help navigate the rough waters inevitable in any journey of this magnitude and complexity.

An SFO-MFO transition needs collaboration from everyone to achieve success. Allison Taff, director of family office partners at Silver Bridge Advisors, has worked with families that retained SFO services or staff while migrating toward an MFO. She finds it has worked best "when the [single] family office professional, the family, and the MFO are all in the room together collaborating and defining roles really clearly" (Allison Taff 2011, personal communication).

Summary

The family-office world is undergoing rapid and major transformation due to demographic, financial, and family-dynamics pressures. UHNW families are demanding cost-efficient ways to get unbiased conflict-free investment advice, fiduciary services, estate and tax planning, cash management, and life-style services. Many also are recognizing that, to sustain wealth successfully across generations, they need assistance with family governance, engaging and educating the next generation, and ensuring the family legacy for the future. Many SFOs may not be able to provide this comprehensive set of services, leading families and SFO executives to look outside for support and expertise.

Despite the benefits, the move toward partnering or outsourcing with an MFO is no guarantee of success from either a financial or a service perspective. When the stars do not align, the best of both worlds becomes a nightmare for everyone. We believe a cohesive integrated relationship has the best chance of working when all parties engage in open honest dialogue, cultures and values are reasonably consistent, egos are left at the door, and good leadership prevails. In the long run the family wins, and the advisors enjoy the benefits of enhanced business development, greater collaboration skills, and a greater sense of job satisfaction and competence.

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