

Modeling the alternative family office

By **Elise Coroneos**

A family office may come into existence for any number of reasons. Oftentimes, it does so after a family has sold an operating business and is in need of a new focal point from which to manage its wealth. In such instances, the family office can become the new family business, bringing with it issues similar to those faced in the business where the wealth was accumulated.

Treating a nascent family office like a business means making certain tactical decisions. These decisions usually have to do with which family office model to utilize, who should run the office and how to balance the desire for cost efficiency with the need for privacy and confidentiality of the family's financial affairs.

Before any of these issues can be resolved,

however, it is important to develop a mission statement, which will lend support to the developmental process and provide an outline to carry the office forward once activities are underway.

During the developmental process, the mission statement will help to identify the core interest or passion of the family, which will become the core competency of the family office. "There is always something at the core that binds the family together, and it provides the impetus for the family office to start," says Jonathan Carroll, a family office consultant based in Florida. "It can be something like a certain style of investing, the legal profession or philanthropy."

One of the major factors determining which family office model is chosen is how involved the family members want to be in the day-to-day operations of the office. This is important because some families will want to hand everything over to a private bank or a multifamily family office, while others will prefer to maintain some level of autonomy.

The latter will generally be the case when a family business has been sold and a family member who was active in the business wants to take on the running of the office. "A lot really depends on the involvement of the family," says Greg Kushner, founder and president of Lido Consulting, a family office consultancy based in California.

"Sometimes the members of the family are far flung, and there is no family member active in the office. At other times, they are extremely active."

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Families searching for an integrated solution have more options from which to choose.

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A recent study of high-tech donors looks into the "new" philanthropy.

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STRATEGIES UPDATE

Legg Mason acquires PCM

Baltimore-based **Legg Mason Inc.**, one of the largest publicly traded US money managers by assets, has agreed to purchase **Private Capital Management LP** of Naples, Florida, for an initial \$682 million.

The total price for PCM might reach \$1.4 billion in five years if certain unspecified growth targets are reached, and Legg Mason is planning to link PCM with its established



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◀1 Traditional vs virtual

Once the core competency of the family office and the level of involvement by family members have been decided, the additional services required by the family can be added to the office in a variety of ways. In the past few years, the family office arena has seen a number of different models become available, which has changed the way a family can choose to handle its affairs.

"The landscape changes daily with new products and services that are faster, cheaper and more robust," says Carroll. "Every time you turn around, some firm is doing more for less. It is a terrific time to be a family and be searching for an integrated solution."

In a traditional family office model, almost all functions are brought inside the four walls of the family office. This means that professionals will need to be hired to complement the skills of the active family member taking charge of the office.

"The family member or person running the office may not have a certain skill set in dealing with their clientele, and they may not be aware of all the things they will need to be involved with to run a family office," says Carroll.

The skills necessary to manage the wealth of a family include investment management, trust management, legal advice and accountancy. In this model, accounting systems, investment reporting systems and performance reporting systems may need to be brought in-house.

The method by which the necessary services are provided to a family will depend on several considerations, not the least of which is cost. Whether skilled professionals are hired by the family or are sourced through external firms, the on-going cost of running a family office will be at least \$1 million a year, says Carroll.

Because of considerations associated with costs, many wealthy families are streamlining their family office operations. "For families with less than \$100 million in wealth, spending \$1 million a year on a family office may be considered too great an expense," says Carroll.

The traditional alternative to running an in-house family office has been to hand over operations to a multifamily

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family office. In recent years, however, a new method of providing family office services has sprung up.

Known as a "virtual family office," this option is an alternative for families where a family member wants to take the reins, but does not want to go to the expense of setting up a full-blown office.

In a virtual family office, the involved family member can maintain control of the family's affairs, while using technology to keep in contact with advisors and business associates. Thus, the operation has the autonomy and functionality of a full-service family office within a considerably more streamlined structure.

"I think the virtual family office concept is appropriate for a family of any size that is comfortable substituting technology for labor," says Carroll. "As a model, it is entirely scaleable and it doesn't have anything to do with assets in the family because it is a low-cost model."

Revolutionizing

One firm offering families the technology to streamline their offices is Pennsylvania-based Private Family Networks. According to chief marketing officer Scott Budge, the firm was founded on the belief that there was a missing option in the suite of family office models.

This model would allow high-net-worth families to maintain a degree of control over their affairs while keeping expenses to a minimum.

Many complex financial families, says Budge, are not big enough to feel truly nurtured by private banks or multifamily family offices. They are also not big enough to validate the expense of starting a full service in-house family office. "The need for specialized family office services really comes about when a

family outruns their deductions, which we believe is in the \$5 million range," he says.

The dichotomy, says Budge, is that whether a family has \$5 million or \$100 million, they will have similar investment, legal and trust considerations, but managing this wealth using the traditional family office model is generally a viable option only for families with over \$100 million.

"We see ourselves as revolutionizing the way a new family office structure is set up," says Budge. "The virtual family office model caters for those who have the need to create a dedicated family office, but not the inclination to do so."

Private Family Networks has built its virtual family office around the provision of three key services. One is an Internet-based document repository based on a model of the family and its advisors and what documents the various entities typically require.

The second service is a calendar that acts as a workflow and notification system customized for each family. Private Family Networks notifies the various entities when they need to complete activities for a family. Third, the firm provides an account aggregation service that collects and delivers all of a family's public and private investments on a single page.

Furthermore, the family member or advisor in a virtual family office can receive eight hours of help each month. Budge says this time is typically used for training family advisors or for specific requests having to do with immediate family business.

The ability to create a thin, virtual family office environment is measured against the need for privacy and confidentiality—an issue close to the heart of all families of exceptional wealth.

"There are instances where a family has foregone a cost benefit because they want control and complete security," says Carroll. "People will oftentimes bear the cost of a certain solution because they are not convinced about the technology."

He says that although the virtual family office concept is one that people are embracing, there is a tremendous need to ensure privacy and confidentiality. "There are still some types of decisions that are made without regard to cost." ♦