

CONFERENCE:

GOVERNANCE FOR FAMILY BUSINESSES

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THE FAMILY CAPITAL AND

THE ROLE OF THE FAMILY OFFICE

IN THE GOVERNANCE OF THE FAMILY BUSINESS

Introduction

The aim of this intervention is to analyse the various assets of a family of entrepreneurs. We will also take into consideration the role of the family office in the interaction among these assets (paying particular attention to the governance of the family business).

Let us assume that a family decides to keep the control of the family business over different generations; therefore the family business is entirely controlled by the founder's heirs (or descendants). Let us also assume that this family is composed by different branches and has accrued over the years a significant share of its own capital even beyond the family business.

The components of a family capital

The capital of a family who wants to keep the control of its own business throughout generations can be divided into 3 components (see *Table 1*):

- 1) family business: it is a tangible asset but it is not disposable for sale (if the family wants to transfer the business to the next generation);
- 2) the rest of the family tangible assets (financial, real estate, artistic investments...): it is a tangible component available for sale as these assets are usually bought and sold;

- 3) the third component consists of the network of relations and image built over the years by the family: this is an intangible component, even though it is sometimes fostered by tangible goods (for example, philanthropic activities sponsored by the family business or the family itself).

In order for a company to grow and flourish over the years, all the 3 components of the entire capital must be managed in a balanced, effective and efficient way. I do not want to talk about the criteria of a good family business management, I will only touch upon some of the basic elements of a good governance of a family business: clear distinction between company and family capital, presence of independent board members, autonomy and responsibility of the management in line with the general policies and strategies set out by the shareholders, high level and quality of the management with the presence of external managers, formal and well defined succession process of the top management, clear cut dividend policy. It is obvious therefore that the above governance criteria might limit the decision-making autonomy and tend to reduce the personal economic benefits for the single member of the family.

In this context, a sound and good management of the family assets (both tangible and intangible components) should help avoiding controversies, tensions and family clashes over the management of the family business. In other words the second and the third components of the family assets might serve as a clearing house in order to satisfy the economic and image needs of the members of the family not directly involved in the management of the family business (i.e. the first component). Interactions between the first and the second components are evident. The rest of the family property (beyond strictly personal belongings, first of all the main and the secondary residences of each member) must be managed in an optimum way in order to create a constant income and to guarantee its preservation. Constant income has to balance a possible lack of dividends during periods of crisis or when major investments are necessary if the company has to grow or (worst) to survive. Furthermore a constant income avoids that some family members, in case of lack of dividends, press to get managerial jobs even without any skill nor propension. The conservation of the capital invested in the family business contributes to strengthen the idea that the family business is not a disposable asset which is necessary to keep the control throughout generations.

Dividends allocated by the family business are another example of interaction. These dividends not only offer an advantage to family members, but they could also increase the rest of the tangible family capital which could be used as bank collateral in case of loans or it could be reinvested in the purchase of the shares of those family members who do not want to remain anymore shareholder in the family business.

Finally, if assets non invested in the family business are large enough to assure both a constant income and the capital conservation, there could be some resources to finance entrepreneurial activities for those family members who do not play an active role in the family business or those who are not interested in it. Supporting such activities is very useful to develop an entrepreneurial mind among the family members belonging to the third or fourth generation (those who didn't assist to the birth of the family business) and in some cases it can also turn out to be a very good investment.

Interactions between first and third components are less obvious, but they can be very important. In fact, the position and image of the family built over the years play an important role in the family business. In a way, the reputation of the family and the good personal relationship of the family members, a strong trade mark, the links among family members, family business and trade mark, are an asset that contributes to the promotion of the image of the family business and to the satisfaction of the social needs of the individual members of the family not directly involved in the family business. Sponsoring philanthropic, cultural and artistic activities contributes to the development of the intangible assets. Furthermore, the involvement of those family members who are not active in the business can contribute to their personal development with the feeling of pride of belonging to the family. On the other hand, moral and image assets can contribute to create interesting opportunities for the family business, opportunities not always easily available to multinational companies or companies controlled by private equity funds. The following sentence: *"We have been here for generations and we want to stay here"* has a certain importance, especially in a period of globalization and delocalization.

Generally speaking, the relation between the capital made up by the family business and the intangible capital should be strengthened by a good communication of the long term company strategies to the family members who actively operate in the company. This way they should consider the company not only as a source of dividends, but also as a constant contribution to the development of their intangible, relational and image capital.

The role of the family office

It is clear that a good management of the second component of the family capital requires a specific structure. In fact involving company structures to manage the rest of the family wealth would compromise the clear and net division between private and company dimensions, which is one of the main elements of a good governance of a family business. Even a *"do-it-yourself management"* adopted by all the family members can't assure the above mentioned objectives of profitability and capital conservation.

The specific structure usually takes the form of a family office. It can be defined as the structure made up of human, physical and relational resources (personnel, office, expertise, contacts...) which has the role of managing economical activities of the family outside the business. The family office has to deal with activities linked to the third component (the intangible one), if it is not entrusted to a dedicated foundation.

Clearly, a family office manages financial investments of the family, normally performing asset allocation and giving specific mandates to specialized asset managers. The family office is often in charge of the real estate property management and sometimes it is also engaged in artistic investments. Finally, as we previously mentioned, the family office can also expand its areas of expertise to philanthropy and to the promotion of cultural initiatives. Such activities can be carried out either by single a family office or by a multifamily office (which works for different families). It is clear that the choice between a single family and a multifamily office depends on the size and the diversity of the assets, as well as the number of family members. There is a deep difference between managing some financial activities of a single family and supplying services linked to financial, real estate and artistic investments to a variety of family branches around the world. Obviously, below a certain asset size it is not advisable to create a single family office, but it makes more sense to use the services of a multifamily office.

Although a multifamily office can easily manage in an effective, efficient and even customized way the assets of a large family, it can hardly guarantee a harmonious coordination amongst the three components of the family assets, coordination vital for the prosperity and longevity of a family business.

In fact, a multifamily office has a certain number of restrictions concerning the involvement of those family members who do not play an active role in the family business. It is obvious that a single family office can offer great opportunities of involvement and professional growth to the family members. However their involvement has to depend on criteria of competence and engagement (as well as honesty, which is a basic feature in order to avoid any misunderstanding within the family).

Single family offices and multifamily offices deal in a very different way also with the third component (moral and image assets). The link between the company, the strength of its brand, the family reputation and relations is much more effective if the philanthropic and cultural initiatives are managed by a private structure (ideally a foundation carrying the family name) and not by an external structure – a multifamily office.

To conclude, the continuity of the relationship between the family and its business throughout generations needs a careful evaluation of the governance, not only of the family

business, but also of the other two components of the family assets (both tangible and intangible).

Table 1: INTERACTIONS AMONGST THE 3 FACTORS OF THE FAMILY CAPITAL

