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Winning Mandates from Family Offices

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Winning Mandates from Family Offices

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Marketing to family offices is a lot like trying to break into a fortress. Both require skill and strategy just to get through the door. Once inside, you need to win what could be a long battle. And after achieving that, you must constantly hold on to your position. Holding onto family office business means providing strong performance and excellent client service, because competitors constantly are trying to capture a share of the pie.

Prospective family office clients often confront potential advisers with these kinds of challenging statements:

- "Our operating philosophy is to select the best-in-class for each service."
- "What are the one, two, or three things your firm does best?"
- "Our providers need to either be the best in their class compared with others, or they need to be able to offer the same products and services at a lower price."
- "What distinguishes your firm from all the others who are competing for our business?"

These are not easy questions to answer. As the investment business gets more refined, disciplined, and commoditized, it's becoming harder to distinguish yourself. How, then, do you best position your firm to win mandates from family offices and wealthy family clients?

We suggest the following three steps as essential to landing business in this market segment:

1. Understand the prospective client in the context of the family office marketplace.
2. Know the issues facing today's wealthy families and family offices.
3. Position your firm along the competitive landscape.

Understanding the Client and the Family Office Marketplace

Family offices have several structural facets, and where your prospective clients fit within each facet determines your marketing approach. Each facet provides not only targets of opportunity but real challenges and constraints.

1. Family Office Structures

Family offices can have one of the following four structures:

1. ***Stand Alone.*** This structure serves one family or an extended family of siblings and their families. It provides confidentiality and control, but it can be expensive and needs succession plans for the director and key staff. Many engage an external investment consultant to help oversee a stable of individual investment managers. Some larger family offices engage more than one consultant, so you need to be prepared to operate in that context. It is not always "winner take all" in this segment.
2. ***Multifamily.*** Some families lack the critical asset amount or do not want to expend the resources to establish their own family office. At the same time, other family offices seek nonfamily members to defray overhead or build a new revenue stream. These families come together under the banner of a multifamily office, which gives them the ability to consolidate assets and attract top advisers at attractive prices. The caveats are that families need to have a common outlook and be willing to have less control than in a stand-alone family office. Some of these offices invest in their own staff of investment consultants, but many rely on consultants.
3. ***Multiclient Family.*** This structure is independently owned and serves multiple, unrelated families. It offers investment consulting, reporting, and some tax advisory services to clients. Investment consultants have little opportunity to win significant mandates from this sector unless they can offer the firm access to an otherwise inaccessible manager or investment product.
4. ***Institutional.*** The family looks to a large institution to provide a *de facto* family office, employing a wide range of services covering investments, tax reporting, banking and credit, charitable management, and fiduciary services. Multifaceted banking and brokerage institutions have an advantage in these situations due to their broad array of integrated services. However, sometimes a family employs an independent

consultant to help them select investments from the bank or brokerage platform.

2. Governing Investments

Family offices govern their investment processes in one or a combination of the following five ways. Each has important implications for the role of an investment consultant.

1. ***Self-Managed.*** Some family offices manage the investment process itself, with either the director or a family member calling the shots. For a consultant, this model sometimes is difficult to sell to, because the family office tends to manage investments on an idea-by-idea basis. The portfolios are built from the bottom up.
2. ***Chief Investment Officer.*** Under this structure, the family office employs a CIO, who then hires investment firms to manage segments of the portfolio. The CIO plays the role of an investment consultant, although in some cases the CIO may hire consultants as assistants, particularly if a consultant can provide access to difficult-to-reach managers. Nevertheless, this model usually offers few opportunities for independent consultants.
3. ***Investment Consulting Firm.*** Family offices that want an independent firm that sells no products opt for this model, and independent firms have the advantage in landing business from these clients. On the other hand, winning the mandate requires overcoming some emerging concerns. First, some clients believe certain firms have favorite money managers whom they never fire, due to reciprocal business referrals or friendships. Second, some smaller firms do not have access to enough top managers due to their limited distribution or client network. At the same time, some family offices hire an independent consulting firm to complement one of the other structures and gain an independent opinion.
4. ***Brokerage/Bank Consulting Platform.*** Some family offices like the idea of a complete program that features investment consulting, custody, trading, and reporting. Larger commercial banks and brokerage firms have the advantage here because they have the resources to build large money manager universes and the staffs to perform required due diligence. This market, however, is competitive. Successfully winning mandates from family offices requires platforms that include hedge funds, private equity, and real estate.
5. ***Advisory Committee.*** More family offices are establishing formal governance structures to oversee their investments. This group consists of family members, professional advisers (e.g., attorney, CPA), and trusted investment colleagues. It can supplement any of the other structural alternatives and supports hiring external investment consultants to suggest and implement strategies.

3. Family Office Types

Family offices aren't easily categorized. One could slice and dice the universe a number of ways, but we suggest the seven formats shown in figure 1. The role of an investment consultant varies among them and so do the sales opportunities. We consider each below.

1. ***Compliance-Focused Office.*** This structure offers the consultant the best opportunity because the staff is focused on tax compliance, insurance and risk management, and reporting. These family offices outsource their investment function and frequently hire an external consultant to select and oversee managers.
2. ***Business Oversight Office.*** This type is the most challenging for traditional investment consultants because the focus is on managing business interests, including real estate, private equity, and operating businesses. Unless there is a meaningful securities portfolio, there may be no role for a traditional consultant. Some families use this model to manage large hedge fund portfolios or to start a hedge fund to which they solicit outside investors, providing opportunities for consultants with hedge fund expertise and access to top funds.

FIGURE 1 Family Office Types

COMPLIANCE	BUSINESS OVERSIGHT	INVESTMENTS	PHILANTHROPY	FINANCIAL	PRIVATE TRUST COMPANY	MULTICLIENT OFFICE
• Tax reporting • Insurance • Record keeping	• Real estate • Private equity • Operating businesses	• Direct investing • Investment manager • Investment consultant • Managing concentrations	• Large foundation • Pooling of gifts • Targeted giving	• Investment advisory and execution • Integrated wealth planning • Financial reporting • Financial education	• Control • Perpetuate family • Consolidate assets	• Need for revenue • Cost sharing • Business venture

3. ***Investments Office.*** Many family offices organize around managing their investment portfolios and trusts. In some cases, they employ their CIOs for these duties, posing challenges for investment consultants. In other cases, the director may be willing to employ one or more consultants to advise on the portfolios. Families with significant equity concentrations adopt this model, because the director focuses considerable time on this issue. This is an opportunity for consultants, and we discuss it in depth below.
4. ***Philanthropy Office.*** When a foundation dominates the family landscape, it likely dominates the family office activities, particularly when family members run it. We have found that families take this responsibility very seriously and try to install strong fiduciary policies on both the investment and grantmaking sides. Accordingly, this is fertile ground for investment consultants who can demonstrate expertise with foundations and endowments. Foundations recently have embraced alternative investments, so consultants with this expertise have an advantage.
5. ***Integrated Financial Office.*** Some family offices get into everything—traditional asset classes, alternatives, private operating businesses, and commercial real estate. They also may get involved in tax- and estate-planning strategies. The opportunities for investment consultants here depend upon the expertise of the hired staff, so it is difficult to generalize about business opportunities when confronted with a truly integrated family office.
6. ***Private Trust Company Office.*** The extreme in family wealth governance is the private trust company. Families have different reasons for going this route; some no longer want the personal liability of serving as a trustee, others have concentrations or business partnerships that lead to difficulties in getting corporate trustees to serve, still others find it a useful way to pool family investments into collective trust funds. When establishing private trust companies, families may not necessarily hire a lot of staff, so consultants could find business opportunities with the trust company in aggregate or within some of the pooled investment vehicles.
7. ***Multiclient Office.*** As mentioned above, this type of family office takes various forms, which dictate opportunities for an investment consultant.

4. The Family-Office Life Cycle

Of all the characteristics, perhaps the most critical is where a family office is in its life cycle. In figure 2, we highlight the various stages in the life cycle of a family office.[1]

First Generation. The family is still in business and its focus is on running the business. At this stage, many family offices use company personnel to handle the family investment affairs, investment portfolios tend to be scattered among brokerage accounts, and there is no formal investment policy.

Second to Third Generations. This is where the real action takes place, particularly if the company is sold. The family transitions from an operating business to an investment company and establishes a formal family office. The family becomes receptive to establishing formal investment policies and is willing to adopt a more disciplined approach toward investing. Accordingly, the greatest opportunity to land a significant consulting engagement is at this stage.

Fourth to Fifth Generations. Things are set up by this stage, although some charitable foundations experience substantial funding at the death of the patriarch or matriarch. This can present new opportunities for an investment consultant, particularly if a family has not engaged one yet.

FIGURE 2 Family Office Life Cycle

FIRST GENERATION
- Integrated with family operating business
- Use of company personnel

SECOND TO THIRD GENERATIONS
- Independent entity
- Philanthropic structures
- Wealth transfer to children/grandchildren
- Beginning investment structure

FOURTH TO FIFTH GENERATIONS
- Active philanthropy
- Extended generational planning
- Formalized investment program

FIFTH TO SEVENTH GENERATIONS
- Income stress
- Business investments
- Solicit additional families
- Private trust companies

Fifth to Seventh Generations. Nothing guarantees that a family office continues in perpetuity. Families can face a demographic squeeze, where they grow faster than their portfolios. A recession can present further setbacks. The family needs to regenerate its wealth accordingly, either by building new businesses or successfully investing in additional alpha-generating strategies. Consultants with significant expertise in alternative investments, particularly real estate and private equity, have a decided advantage with family offices at this stage.

5. Family Office Asset Size

The asset size of a family office also shapes a consultant's opportunity. For the sake of discussion, we segment the market as follows:

$50 to 100 million. This size family office presents the consultant with the best opportunity to be the sole adviser and to become effectively the family's chief investment officer.

$100 to 250 million. Here we begin to see family offices adopt a multiple-adviser structure. For example, they may hire two or even three bank/brokerage firms and select what they feel are the best from each platform.

$250 to 500 million. A couple of patterns emerge at this stage. First, family offices hire their own CIOs, who serve as investment consultants. Second, they may hire independent advisers along with bank/brokerage firms, with the independent advisers serving as gatekeepers. As a consultant, you may not be in a position to win the entire mandate and need to figure out what role you can play.

More than $500 million. Here you meet the possibility that the family office does everything with staff, because they have the asset size to gain access to and meet the minimums of prestigious managers. However, in some cases, the family may seek consultants with specialized skills (e.g., hedge fund experts) to watch over a segment of the portfolio. Many of these family offices have extensive hedge fund portfolios, so you need the capacity to evaluate and monitor funds beyond your existing platform.

6. The Competitive Landscape

A last point in understanding the family office market is to visualize the competitive landscape as it impacts this space. In figure 3, we offer one way of looking at this.

As a consultant and provider, you need to determine which box or boxes you want to play in. The boxes, however, are not mutually exclusive, and you can operate in more than one.

As a product provider, you sell and service investments, tax preparation, insurance, or banking. As a tactical adviser, you sell no products but act as an adviser in a specific discipline. Finally, as a strategic adviser you provide clients with broad, integrated advice spanning several disciplines. Some strategic advisers also are tactical advisers or product providers trusted by the family to provide integrated advice beyond their primary disciplines. We speak more on this topic when addressing the concept of positioning.

Key Issues Facing Family Offices

Purposeful Asset Allocation

Over the past decade, asset allocation has evolved into far more than just stocks, bonds, and cash. It also has moved beyond the segmentation of equities into large-, mid-, and small-cap into the multiple manager styles of value, core, and growth. But family offices tend to focus their asset class strategies on some of the following concepts:

Traditional versus Alternative. Investors today frequently are segmenting their portfolios into the traditional financial assets and alternative classes such as real estate, hedge funds, and private equity. The rationale is that the alternatives, if effectively structured, tend to lessen portfolio volatility and provide excess alpha beyond the marketable securities.

Real versus Financial. Some investors find an important distinction between financial securities and the range of real assets, i.e., land, commercial real estate, timber, oil and gas, and commodities.

Global Portfolios. Investors are beginning to structure global portfolios beyond a token allocation to international equities. We are starting to see allocations to international bonds, emerging market debt and equities, international private equity, and even global real estate. Investors are making strategic, long-term commitments in the global marketplace.

Purposeful Allocation/Risk Budgeting. Family offices are starting to look at asset allocation from a much different yet straightforward perspective. First, they are segmenting their assets into three pools: capital preservation, marketable securities, and opportunistic.

1. The capital preservation pool consists of high-grade bonds and some low-volatility hedge funds. Some families also place high-quality, income-producing real estate in this category.
2. The marketable securities pool represents traditional fixed income and equity asset classes where performance likely will track and depend upon the trends of these markets.
3. The opportunistic pool is where family office investors try to achieve their alpha, by investing in directional hedge funds, private equity, and real assets.

Once asset classes are segmented into these pools, examine the ownership structure housing the funds. These structures include simple partnerships and corporations as well as trusts, limited liability companies, family limited partnerships, holding company complexes, and charitable structures such as charitable remainder or lead trusts and foundations. This is where the asset allocation really begins.

Once you allocate each of the three pools to these specific ownership entities you finally can select

FIGURE 3 The Basis of Competition

PRODUCTS AND SERVICES	TACTICAL ADVICE	STRATEGIC ADVICE
• Investment manager • Tax preparer • Custodian/trustee • Insurance agent • Prime broker	• Investment consultant • Technology adviser • Tax adviser • Lawyer • Charitable adviser	• Advice on establishing and operating a family office • Family transition consultants • Decision facilitators • Integrated wealth planners • Big picture/multi-disciplinary advisers

the asset classes within each pool and within each structure. Then the family investor is no longer focused on just expected return but wants a more reliable measurement of the true risk in the portfolio.

Measure this risk with a value at risk analysis to get the probability of loss beyond a stated amount. This new way of visualizing asset allocation is taking hold among wealthy families and family offices, and investment consultants are being challenged to adapt their practices to this framework.

The Challenge of Portfolio Construction

Over the past decade as investment options have proliferated, family offices have built portfolios of multiple asset classes and manager styles.

With portfolio construction, clients face the following five challenges that can provide opportunities for an investment consultant:

1. Manager styles go in and out of favor. Should investors have a "car in every lane" and cover all of the capitalization and style boxes, or should they make bets, with your guidance?
2. Family offices are beginning to hold consultants accountable for "manager benchmark" risk. If you recommend a stable of managers and more than half underperform their benchmarks over time, you face increased client scrutiny. More and more family offices with large capital pools are asking about indexing parts of their portfolios. Getting clients to agree about time horizons and benchmark evaluations is becoming more important because of the proliferation of ETFs and other index-like products.
3. Still far too many clients continue to chase the "hot dot" or the managers who perform best over short periods.
4. Rebalancing needs to be done in a disciplined way.
5. How should one balance a portfolio among managers who are likely to outperform in up markets versus those likely to hold value during down markets?

Integrated Advice

More and more, family offices are looking for consultants who can help them connect the dots. For example, they want advisers who understand and can navigate the maze of trusts and partnerships. They also favor advisers who may be able to help with performance reporting and after-tax management. They want consultants who can advise across the spectrum of financial, estate planning, and charitable solutions.

Reporting

With some family offices, reporting has emerged as the number-one issue. Reporting issues are present on the following three levels:

1. Family offices want to aggregate their portfolios on one platform and across all custodians and brokers.
2. Most want reports delivered electronically in an easy-to-access, attractive format.
3. They want reporting analytics that communicate their returns and the level of risk they are taking.

Preparing Heirs

Instilling a culture of family education and learning is key to preparing the next generation to be good stewards of the family wealth, and consultants contribute in a couple ways. They design seminars about investment markets and management for family members. They also can help the family organize its family meetings and retreats. Many family offices look to consultants for good retreat agenda topics.

Positioning

We conclude by looking at how investment consultants can position their firms along this competitive landscape. We offer the following observations:

- Look back to figure 3 and determine where you wish to operate along the competitive continuum, keeping in mind that you can play in more than one box. For example, you may be an independent consultant but could decide to develop a hedge fund of funds product for your clients. This may be the only way you can provide them with access to some top managers.
- To supplement your traditional asset class platform, consider specializing in finding some long-only managers with unique investment processes. Examples include managers specializing in distressed companies, spin-offs, etc. The idea is to provide family office clients with access to managers they otherwise could not find.
- To what extent do you want to compete in performance measurement? Some consultants buy or develop attractive reporting platforms and package them with their investment consulting services, then market the unique package.
- Specializing in single stock strategies can be an attractive niche. However, one needs strong competencies across derivatives, exchange funds, wealth transfer structures, charitable techniques, tax-enhanced indexed portfolios, and other solutions. Additionally, consultants need to be able to implement the solutions within their own firms or have arrangements with third-party firms.
- Wealthy families and family offices have an emerging need to engage advisers who oversee and monitor existing portfolios of hedge funds. Most advisers are willing to perform ongoing due diligence on funds that are on their platforms. The real need, however, is for advisers who can evaluate hedge funds not on their platforms. The consultant willing to build out this analytical infrastructure may create new opportunity.
- Many wealthy families have longstanding relationships with commercial or investment banks, and they are unwilling to sever these ties. At the same time, some family offices like the idea

of engaging an independent consultant to oversee all their investments. Consultants who can demonstrate the ability to integrate external platforms with their own create additional opportunities.

- Finally, to what extent are you willing to serve as a strategic investment adviser to your clients? This could entail serving on a family advisory committee or foundation board. It also entails providing input about a family's entire investment complex and working with the family office staff on performance reporting, wealth transfer structures, philanthropy, and other issues.

Family offices are a challenging and complex segment for consultants to navigate. They also can be a rewarding client segment because they tend to be at the forefront of new ideas. The family office market is very private and there is little written about its operating practices. At the same time, most family-office staffs are eager to learn the best practices of other family offices. Consequently, consultants who practice in this space are able to transfer best practices from one client to another.

An investment consultant who enjoys rewarding challenges, diverse business practices, and pushing the envelope should look no further than family-office consulting. M

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Endnotes

1. Sara Hamilton, "Wealth Management: Keeping it in the Family," *Trusts & Estates* (August 1977): 28-34.

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