NEWSLETTER N°2

8th July 2016

"I need a hero": who's the best director for a Single Family Office!?

The term Family Office, or (single) FO (SFO), is used to define in almost all languages an entity – and a group of people working in/for it – which takes care of the interests of a single individual or family, managing their everyday life and wealth, irrespective of the fact whether the latter stems from ancient times, just a previous generation or a recent sale of a family business or shares in multiple companies.

Given the fact that people working in an SFO take care of a wide variety of aspects of the private and business life of one or more families, they remain - in a way - in "the shade" and are not very well-known to the outside world and general public, nor do they want to be. When mass media publishes interviews with CEOs or chairmen of the board of commercial companies, the CEOs and top managers of Single Family Offices, which are quite often behind these companies, remain practically unknown to the public.

A Family Office takes care predominantly of private matters of the UBOs (ultimate beneficiary owners) and partially for this reason has limited reporting liabilities or obligations other than vis-a-vis the UBO or other family members, and eventually their trustees. More often than not these entities are constituted as "anonymous companies", or their equivalents, as they want to be as discrete and go as much unnoticed in their operations as possible. However, the consequences of such "opacity" and lack of direct control by authorities quite often can be negative, directly or indirectly, for the families themselves. This can lead to situations that can be amusing, comic, ridiculous, absurd, even tragic or absolutely incredible (the French word "rocambolesque" would best describe it) – just like several recent example of billionaires building their art collections have shown.

Without pretending to be able to list all the potentially negative aspects which could be the result of such opaqueness of the "Family Office World", we have chosen some "Best of" (="worst of") examples to give, which have particularly impressed us (and which sometimes were almost shocking), and which we have observed both from close and far. Then we would give our advice to wealthy families how such situations can be avoided – which are often harmful financially or (which is even worse) damaging the image and reputation of the families – by taking the liberty of exposing what should be the ideal profile of a CEO of a Family Office, according to our own experience.

1- A real estate agent offering commissions to executives of an FO: the most widespread and classical case. A CEO of the FO (or a member of his team) receives part of the commission of the real estate agent due to the fact that he managed to position himself as the "gatekeeper" without whose agreement a visit of a family member to the property, which would be subsequently bought or rented, is impossible. The consequence is a non-negotiation of the price (or a softer one, often starting from an overstated value). The member of the FO team responsible for such transactions often even briefs the real estate agent on the psychological traits and habits of the future owner, such as how hard he likes to negotiate, what is the maximum price he is willing to pay, and more often than not he himself (the CEO) is negotiating the price on which he knows he will get a kickback!

2- The commissions on lifestyle expenses in general: the CEO cashes in commissions or kickbacks on all lifestyle expenses as - again - he positions himself as gatekeeper or even “selector” – purchase or charter of private jets or yachts, organization of events, purchase of luxury goods and items – the range is wide, from Zegna to Hermes, from Brioni to Dior, and the motto is simple “I send him/her to you only if you pay me back something”.
3- Kickbacks ‘in kind”: the family builds or restructures a property and engages an architect, a designer, a construction company, a landscape designer or anybody else for their expensive and exclusive property. The CEO, or quite often the person who heads his construction department or team, negotiates with the above suppliers and contractors a kickback “in kind” – to do some works for himself free of charge or at much lower rates than the market. Quite often, in order to do this, the subcontractors do not make any discounts for the principals (which they would normally have done), or even inflate the prices.

At the end of the day, one should really try to understand how such crazy things could be possible? How can beneficiaries and their family members be so blind and so naïve, if they are so capable and successful in businesses?

Our answer is very simple: these people get relaxed! They worked very hard to earn their tens and hundreds of millions, they spent years and years controlling everything in their companies which they have created or inherited, they have avoided the pitfalls set by the competitors, they have overcome the obstacles posed by the regulators, and they continued to work hard, never despairing or surrendering in front of problems or bad news. We think that the world of business is so difficult that the entrepreneurs must develop behavioural patterns close to paranoiac in order to survive and succeed, and thus once they have cashed in on all the previous hardships and efforts – they relax – and rely on the people whom they [think they] trust.

What is then the solution? Quite often entrepreneurs revert to what they consider to be the best solution: they take a top executive from one of their companies, quite often the CEO or CFO or COO, and put him in charge of their Family Office. It seems to be the obvious solution as these people have already gained their trust, have shown their capabilities and are willing to continue working “for the Boss”. One thing the UBOs forget is that running a Family Office is closer to art than to corporate management, even though – obviously – a lot of common issues do exist. The problem is that a FO can never run under strict hierarchical rules of a big, or even mid-size, corporation – there are too many subtleties, too many nuances, too much “human factor” involved.
It is our belief that the best choice is not a top-manager but a mid-level manager who is ambitious and eager to show the owner/UBO/family what he is capable of, rather than a top exec from the biggest entity that UBO has/had. It might be a financial guy working in one of the smaller subsidiaries; it might be a COO working on one of the “private”, smaller projects...

In principle it should be possible to find an external CEO to head the operations but it usually takes much more time than originally expected or planned, due to the simple fact that not only should the person have perfect professional profile, work ethics, honesty etc but there should also be some kind of “chemistry” between him/her and the UBO.

One rule should be observed – and here we are pretty much aware that the next phrase will bring us a lot of new enemies, in addition to the ones we already have – NEVER appoint a lawyer to head your FO and/or never succumb to the pressures and suggestions of a lawyer. While being excellent specialists in their specific fields, or even generally, we have seen that they usually do not have sufficient economic and financial skills and experience in order to properly understand and value complex and sophisticated investment opportunities (which are sometimes ”investment traps”), they lack the flexibility required to run a FO, and their logic of “by the hour” pay makes them prone to creating sub-optimal solutions which are not always in line with the interests of the UBO. They more often than not tend to be “more royal than the King”, tend to miss the big picture because they focus on the potential or existing litigations and are usually not capable to manage internal and external staff, all this resulting in loss of time and money, problems of credibility, image and reputation for the family.

If a CEO "from the inside" cannot be identified or found straight away, then it is wiser to revert to the services of a Multi Family Office company, or at least have them assign an interim director, which would be then controlled and coached while searching for a permanent solution, rather than going through successive rounds of "CEO change" – there is nothing more important in an SFO than team spirit, and nothing more damaging than a constant change of CEOs…

When we talk about a Family Office, which also takes care of all investments of the family, things start getting even more complicated. Our experience shows that quite often it is advisable to split the functions of a global CEO and a CIO in a way that the CIO does not interfere in operations and management but talks directly to the UBO – sometimes on every day basis, if need be! – rigorously about investment issues.

In any case, the most important and touchy issue is the remuneration of Family Office CEO and execs – it should be high enough to motivate them to work well on a daily basis, it should have an incentive plan which would align the interests of the UBO and theirs, it should offer fringe benefits that would be good for the families (such as extra "lodging allowance" or medical insurance, to name just a few), but it should also give proper recognition for the results achieved. Benchmarking is essential but should be fine-tuned to such issues as "UBO satisfaction" (immaterial) or investment performance (a clear IRR, over performance over pre-defined benchmarks, or cash-flow indicator) or also simply achievement of quantitative objectives, which cannot be benchmarked. It is clear that a person working strictly on lifestyle issues brings more "evident" benefits to the UBO and his satisfaction but on a level, which cannot be measured objectively.

There is a balance to be met – not to overpay the employees so that they get lazy and used to a very high standard of living without bringing up too much effort, but also not to underpay them with respect to the commitment expected (or requested) from them as this would inevitably lead to the search for kickbacks, commissions and retrocessions. In a way this is understandable – if an employee is requested to take care of the principal 24 hrs/7 and be "on stand-by" during weekends, holidays etc but is paid the same salary as a good travel agent (who does not have all the confidentiality constraints, very high responsibilities and the knowledge of the intimate life of the UBO), then the person in question inevitably resorts to the ancient motto: " You screw me, I screw you", and then it is the end….

Unfortunately, what we have described above, mostly in the negative part of it, happens way too often… In case anybody would be interested to get more insight into these issues, SERGAN Management is more than willing to assist.

***Sergan Management LLC** is a business strategy consulting company. We work on M&A transactions, search for investment opportunities, advise individuals and their Family Offices in the fields of PE investments, global strategic asset allocation and family governance. We also carry out special business projects such as acquisition of biotech, medtech, and fintech companies. We are fluent in all major European languages and can represent the interests of shareholders and investors in various countries, through specific mandates or board representations.*

 www.sergan.biz www.serganmanagement.com