



i3 Insights - Thought Leadership
for Family Office
and Family Business Oversight



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i3, LLC

i3 Insights is a monthly thought leadership document from i3, LLC addressing key issues faced by family offices and family businesses today.

To ask a question or to inquire about Family CFO consulting services, email us at info@i3resources.com

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After the Documents are Executed

The Hows and Whys of Creating a Family Office

I am often asked "How do we set up our family office; where do we start?" The foundation of a single family office is a family's desire to have access to information through multiple channels, they want an infrastructure that enables them to manage their assets, philanthropic endeavors and administer the family's lifestyle and they want investment counsel and opportunities for both private assets (private equity, commercial real estate, etc.) and financial assets (stocks, bonds, etc.).

If you're reading this, you are either exploring or are in the process of setting up a family office. You may have come to this place after being a member of a successful family business that has operated over the past two or three (or more) generations. The business itself may be enjoying great success or be experiencing a time of crisis.

You may be the child of or direct relation to a founding member. You may have siblings. You and your siblings may be involved directly in the day-to-day, continued management and growth of the business. You may be an only child. You may have an expanding family that while not directly involved in the continued operation of the family business, has an interest in being involved in the continued growth of family interests such as venture philanthropy, future generational wealth education, and private asset growth. You may be the second or third family by marriage of a founding member.

Just as there is no one profile that fits all family businesses, there is no one profile that fits a family involved in a family business.

Through the family business however, the tools and counsel available to grow and sustain profitability have traditionally, been abundant; there are strategies and succession planning tools and other business education and support resources readily available. An advisory or other board may exist that assists in guidance and oversight in the management and operation of the family business.

There are business continuity plans, crisis plans, disaster plans and associated communication in place and, if best practices dictate, these are tested regularly.

Any business built on a sound foundation has specific processes and procedures in place to assure the smooth operation and continuity of the organization.

There are clearly defined chains of command, and there is a clearly articulated mission and vision statement that acts as the Rosetta Stone to refocus purpose if the business philosophically wanders.

It is only in the past few years that we have seen this same purpose-driven approach applied to the critical framework of the family business, the family themselves.

The family office may function as a formal entity guided by employees, consultants, or some combination thereof, but it is foremost the entity that unifies and articulates the mission and vision of the family.

It is a confidential, safe entity that fosters objective, healthy communication between family members, leading to an organized, documented structure for future generations. It is wise and mature, and above all else, it evolves in a wise and mature manner based upon its people and charter, or as we at i3 approach it, its Family Constitution.

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"An estimated \$8.8 trillion will be passed down to Gen X and millennials by 2027¹. But research shows that 70% of families lose their wealth by the second generation and 90% lose it by the third²."

1. Joslyn, Heather, "\$9 Trillion Will Transfer From American Estates, New Analysis Says," The Chronicle of Philanthropy, Apr. 17, 2018; LOCUS Impact Investing in partnership with the Center for Rural Entrepreneurship. 2. Williams, Roy O. and Amy A. Castoro, Bridging Generations: Transitioning Family Wealth and Values for a Sustainable Legacy, HigherLife Publishing, Dec. 2017.

After the Documents are Drafted

Initially, attorneys and CPAs may be the first point of contact in the family office creation process, however, once the legal paperwork is drafted, what happens next?

The startup of a family office can be initiated through either consultants that are brought in to help or by hiring the person who is essentially the first employee. In either scenario, the first mission is to define the "Why" of the family office.

For some, the family office may address sustainability, education, venture philanthropy and investment goals. At i3, we break this out into Investment Dynamics and Behavioral Dynamics.

We work with the family to first define the type of office they need, and the team needed to support it. We then create the cornerstone document for generations to come -- the Family Constitution which includes the information, investment philosophy, and infrastructure including policy and the resources needed to support it.

These are essentially the three 'i's' of i3: information which includes market intelligence and information, asset specific research, and access to subject matter experts; infrastructure -- managing third-party vendors and property managers and supporting relationships with third-party vendors and investment: performance tracking, performance vs. benchmarks, risk mitigation and insurance, capital stack, and deal flow.

We support this structure with an underlying, proprietary software, five years in development and groundbreaking in the industry.

Logistics

Depending upon the size and management of the family business, the family office may operate inside of the family business as specific expertise and resources related to financial leadership, legal matters, technology, human resources and training and education may be leveraged internally.

However, as the family business grows and diversifies, this internal approach may become problematic. Confidentiality may be compromised, and the financial obligations of the business may come into conflict with the financial obligations of the family.

It is at this point that a family business may separate the family office; oftentimes moving the business CFO to become the family CFO. A consulting firm may complement and assist with the family office creation, based upon the specific needs of the family.

For example, one family office may have an investment analyst because they invest primarily in financial assets in the public markets and require entity relationship management. The role may have the additional support of a bookkeeper acting as the accounts payable point-person for the day-to-day expenses of the family.

Conversely, there are family offices that are more private asset driven -- those with investment analysts, a director of asset management, and perhaps property management. These are more active in the management of the private assets that are family-owned, with portions allocated for investment in stock market and real estate, or real estate and operating companies and various venture capital relationships.

Financial Dynamics

Sustainability

Sustainability oversight assures that the way the family is investing is consistent with the financial needs of the family, supporting the ability of the family's wealth to meet the constitutional directive while sustaining the operating expenses of the family.

Private versus Public Assets

It is important to understand that private assets take longer to deploy; money that's invested in commercial real estate or private operating companies may have time-frames that are largely driven by opportunity or availability and access; The availability of an opportunity to invest in financial assets such as stock market assets; stocks, bonds, and cash may be deployed immediately.

With private assets, there may be waiting periods for properties to come on to the market, or for properties to be built, or any number of other dynamics. A strong family office CFO or leader understands that the family's reputation for accountability and reliability make these types of opportunities more readily available for exploration and action.

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"Wealth, regardless of its form, is a gift from one generation to the next, not an entitlement."

Kevin Heaton, Founder and Family CFO, i3



Education

Education is in large part, what is most critical to any family office -- to educate the next generation in the Family Constitution. Each generation is responsible for the wealth transferred to them, and the Constitution dictates how that gift is received: is the family allowed to create new wealth from the gift or is it earmarked for giving only? An estimated \$8.8 trillion will be passed down to Gen X and millennials by 2027. But research shows that 70% of families lose their wealth by the second generation and 90% lose it by the third.

For families of high-wealth, defining goals and educating all involved now is imperative. This is much more than estate planning, although that is a component; educating on the Family Constitution assures understanding of the rights, values, responsibilities and rules applying to stakeholders in the family wealth .

Behavioral Dynamics

The very act of creating the Family Constitution with a firm such as i3, may surface the underlying behavioral dynamics that influence the family, both in healthy and unhealthy ways, and allows concerns to be addressed through the expertise of the objective, third-party consultant.

This is an especially important exercise in times of crises.

In a particularly disastrous example, behind the bankruptcy of Takata Corp., the Japanese auto-parts maker derailed by vast air-bag recalls and wrongful death litigation, is yet another downfall -- that of the company's founding Takada family, one of the country's most prominent business dynasties.

The company was founded in 1933 by Takezo Takada as a textile producer, and eventually began to manufacture seat belts in the 1950s. Shigehisa Takada joined Takata right after graduating from Keio University in 1988, and succeeded his father, Juichiro, as CEO in 2007 at the age of 41. The grandson of the company's founder, Shigehisa Takada was listed on Forbes Worst CEOs of 2015 list.

In a subsequent Forbes report in 2017, the scandal reportedly resulted in a \$2.7 billion hit to the Takada family itself, which controlled about 60 percent of the company's shares. Shigehisa Takada resigned in 2018, after acquisition by U.S. mobility safety company Key Safety Systems had been finalized.

The takeover resulted in the extinction of the 85-year-old Takata brand, and a filing for bankruptcy protection with liabilities reportedly exceeding \$9 billion US.

Simply put, could your family afford to take a \$2.7 billion dollar hit?

Relationships: Consensus, Conflict and Leadership

One of the goals of a family is to learn how to manage conflict inside the family. This helps to foster healthy conflict resolution and mature decision-making while encouraging relationships to achieve their full potential.

Over the past three or four generations, many family businesses and the families that make them up have moved from purely patriarchal leadership paradigms to evolved versions of partnership leadership, although traditional constructs still exist and flourish.

Today's family construct has shifted as well, from traditional nuclear to a blend of types: Single Parent, Extended, Childless, Step, Grandparent and a variety of other combinations. Relationship conflict however, is documented clearly in the earliest written history of humankind with the first biblical siblings of Cain and Abel and continues to today.

Complexity in relationships, disparate motivation, deeply-rooted rivalries, established communication patterns, legacy vision disagreement, undefined, poorly defined or overlapping roles and responsibilities and trust issues all contribute to the challenges of Behavioral Dynamics within the family office environment. Adding in aspects of perceived greed versus benevolence can create a powder-keg of emotional missteps putting the family wealth legacy at risk.

The Future of the Family

At i3, we recognize the more complex dynamics at play when multiple generations of a family are involved with the growth, management and disbursement of wealth. Our expertise in the mediation of complex challenges facing high-wealth families comes from first-hand experience and deep private asset management insight and expertise.

Next month we'll discuss "Family Business and Family Office: Combined and Separate Philosophies and Methodologies." In September, we'll discuss "Crisis Management and the Family Office." Until then, feel free to contact me personally at kevin.heaton@i3resources.com.

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“A family office can be instrumental in both wealth preservation as well as helping avoid the formation of culture of entitlement.”

Kevin Heaton, Founder and Family CFO, i3

