FINANCIAL NAVIGATOR

Family Office Dynamics

Information systems are critical tools of the family office and its staff. In order to use the tool most effectively, it is necessary to understand the key functions the office performs. This document identifies many of the key issues involving the selection, installation, and use of an information system in a family office. This material comes from the experience of various professionals who have managed family offices or provided consulting services to family offices for many years.

This document consists of two parts:

- Family Office Dynamics (this document)
- Family Office Technology

Types of Family Offices

A ***family office*** is an operation where one person or a staff of people maintains financial records and performs other functions for one or more members of a family. Often these family members have accumulated their wealth through the success of a closely held business or businesses. Family offices are normally described by the following characteristics:

- **Generation** — Family offices are most often categorized by reference to the generation that created the wealth. For example, an office established for a person who created the wealth is called a "first-generation" family office. If the wealth was created by the great-grandfather of the generation currently served by the office, this is called a "fourth-generation" office.
- **Investments** — The amount of investments managed and the form of the investments have a large impact on how the family office operates. Often the nature of the investments monitored by the office defines the type of family office it becomes.
- **Size of staff** — Sometimes the clearest distinction among offices is the number of staff people working in the office. This is normally a function of the number of family members or clients the office serves and the amount of assets the office manages.
- **Relationship with outside professionals** — There are several types of financial professionals such as accounting firms and investment managers who offer many of the services required by family members. In creating a family office, someone decides whether to perform those functions within the office or to engage the services of outside professionals. These decisions greatly influence the nature of work done by the office.

- **Nature of services provided** — The people a family office is designed to serve determine the exact nature of the office and the services that the staff is expected to perform. Often the nature of service required by family members may be more significant to the size and operation of the family office than the level of wealth.

Financial Navigator and the Family Office

Many of the functions performed by a family office involve collecting, reporting, and making decisions based on financial information. The success of the office is directly related to its ability to process financial information effectively. In this digital age, an office must use a powerful financial management system if it is to perform these functions effectively. Financial Navigator is such a system, with capabilities specifically designed to perform these functions.

Because no two family situations are the same, no two family offices are going to be alike. For example, an office serving a first generation of wealth-holders can be very different from a fourth- or fifth-generation family office. However, to provide specific information about using a system like Financial Navigator, it is necessary to generalize about family office operations. Anyone applying the material presented here must use considerable professional judgment when deciding how to act on these recommendations.

Understanding the Roles

The family office is a business unit that revolves around the family members, the office staff, and the assets being managed. A family office typically includes:

- **Family office manager** — As with any organization, the most important role is that of the senior manager, usually referred to as the Family Office Manager or Senior Financial Manager. The manager answers directly to the family members, advises the family members in financial matters, and establishes and implements office policies.
- **Staff** — Depending on the size of the office and its philosophy for outsourcing, there can be a number of staff members who perform various financial, technical, and administrative roles. In small offices, each staff member may perform many functions, which would typically be handled by many different people in a larger office.
- **Family members** — Family members are those persons who have direct or indirect ownership of the financial assets being managed. They are often referred to as the "clients" of the office. This terminology reinforces the concept that the office is very similar to a professional financial services firm such as an investment or accounting firm.
- **Client as staff member** — In some offices there is not the clear separation of family members and office staff. Sometimes a family member elects to be part of the office staff

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and perform functions that are normally performed by the employed staff. This can occur in first generation offices, but also in second, third and fourth generation offices. This is not necessarily good or bad for the office, but it will affect the relationships of all parties.

- **Client as manager** — There are also many small, first-generation family offices where the person who owns the wealth also serves as the family office manager and supervises a small staff.

Relationships Among Staff and Family Members

To understand the workings of the family office, it is important to understand the relationships between family members and the office staff. The financial information system must be implemented and used based on the nature of these relationships.

Who is the Client?

When working in a family office setting, the family office manager must have a clear concept of who the client is. Differing family offices are run differently. In some offices a patriarch or matriarch of the family is considered the client. In other offices, the family as a whole is considered the client, or some other part of the family may be the client. The family manager must understand this, and educate the staff to this end. This creates a safety net around the confidential nature of the relationship with the client and the family office. Staff training regarding these issues will reduce potential problems.

The question of who the client is may change due to changing circumstances. For instance, who is the client in the event of family death, disability, or other family crisis? The office manager and staff must be sensitive to these often shifting circumstances and respond to the family's current needs for confidentiality.

Confidentiality

In addition to maintaining confidentiality with the identified client within the family, the office manager will at times function as a holder of information for individual family members. For instance, information revealed by one family member may not be shared with other family members. The family manager must listen to competing confidences of family members while maintaining an objective, fair, and neutral confidentiality.

Family Office Dynamics

In the psychological world, the Family Systems Theory is derived from the General Systems Theory. The Family Systems Theory attempts to define principles found universally in all systems of nature. The Family Systems Theory suggests, for example, that a two-person family dyad experiencing high levels of anxiety will attempt to solicit a third person (inside or outside the family) to stabilize the relationship. This stress-reducing behavior is referred to as triangulation. Through triangulation, stress can be diffused among additional people, and the homeostatic balance of the family is restored.

In family offices, family members may regularly attempt to involve members of the office staff in these triangles. Family office members cannot avoid such interactions. They are a natural part of being human and working within a family. The family office member's challenge is to avoid getting caught up in the family's emotional system while staying intimately involved in the business of the family.

The key is to focus on the process of serving the needs of the family and the family office while maintaining an emotional distance from family issues and family members. One effective way to do this is to rely heavily on objective reporting of the financial circumstances. That means that all parties are reviewing the same financial data presented the same way. In presenting this information, the financial manager must establish and maintain his or her credibility with all family members involved. This requires the office to have a good financial management system to track and present the data. The goal should be to present the information effectively so that the family members resolve any differences themselves. This enables the family office manager to maintain objectivity with the family members.

Changes

Another aspect of Family Systems Theory compares a family system to a child's mobile hanging above a crib. When one part of the mobile is touched, the entire mobile is set in motion. Similarly, an adjustment involving one family member within a family office will affect other family members in varying degrees. Family office employees must be sensitive to the fact that their individual interactions with each family member may have significant and unanticipated effects on other family members. As a family grows and changes, it is natural that relationships between the family and the family office change.

To manage these changes effectively, it is important to have as much stability in other areas of the family office as possible. One key component of that stability can be the financial reporting that is used.

Family Office Culture

Like any organization shaped by people, each family office will develop its own culture. The family office culture dictates, often more than in many other organizations, how things are to be done. Even though there are many correct ways a situation can be addressed, the office develops a culture that specifies how things will be done in that office. Another family office may be totally different. Family office staff who have also had experience in a corporate environment say the culture in a family office is a stronger influence on which procedures to follow than in a company.

Influences on Culture

The strongest influence on the culture in a family office is often the senior family member. If it is a first generation office and the client created the wealth him or herself, the client will probably have a very entrepreneurial style. The client may have strong feelings of remaining in control and taking strong actions if he or she believes the situation calls for it. If it is a second, third or fourth generation office, the characteristics of an entrepreneurial style may not be present. The office culture will be very different as a result.

Issues that are often addressed through the family office culture include:

- The role of the patriarch vs. other family members.
- What information is shared or not shared with different family members.
- Family meetings or retreats to inform and educate family members.
- Use of outside consultants to address particular problems.
- Use of financial institutions and professionals who may have served the family for years.

Changing Cultures

Just as relationships between family members and staff can change over time, the culture in the office can change. For example, as second and third generation members mature, they may establish their own lives separate from the family. They then begin to go their own way and have different expectations of the family office than the members who reside more closely to the family. Changes such as this can change the culture over time.

Managing Family Office Personnel

Benefits

Having a powerful, well-designed software system like Financial Navigator is only one ingredient in establishing an efficient family office. The other critical component is having staff professionals who operate the system properly. Financial Navigator is only as effective as the individuals who are using it. A qualified and well-trained staff results in:

- **Increased quality of information** — "Clerical-level" employees are able to perform basic reviews of financial reports and correct, or at least point out, more obvious problems. This minimizes the review time of high-level employees.
- **Ability to perform each other's work** — For offices with several bookkeepers, this approach provides improved continuity of work. If one bookkeeper is unavailable or backlogged with work, another person can step in to handle part of the workload since he or she is familiar with the system, if not the actual entity and data maintained by the other person. This keeps the accounting records up to date and balances the workload. This usually results in better office morale and happier family members.
- **Staff reduction** — Hiring and training the right employees results in major increases in office productivity. Effective implementation of Financial Navigator can result in fewer staff members being required to perform the same amount of work.
- **Job satisfaction** — By changing the focus from basic bill paying and bookkeeping to meaningful financial reporting, family office employees find much more personal and

professional satisfaction from their work. This can result in lower staff turnover, higher commitment to quality work, and more motivation for professional development.

Staff Skills

To achieve the maximum benefit of Financial Navigator, all of the staff who perform accounting functions in the office must be skilled in the use of the software. As with any computer software, if an employee is not able to develop proficiency in the program, the person will not be able to function effectively.

Hiring

Selecting the right type of personnel is perhaps the most important single task in establishing any family office. This is especially true if the people handle complex financial matters and the office is highly computerized. Many skills, such as good judgment and effective interpersonal communications (especially with other family members!), are important. Furthermore, office managers realize an effective employee must also have the ability to manage financial information with a computer. When hiring staff, previous experience in this area is helpful, but often not required. The most critical skills to look for are:

- Attention to detail and accuracy with numbers and procedures.
- Ability to work closely with other members of the office team.
- Ability to learn software and practically apply program features to the needs of the office.
- Sensitivity to each family member's confidentiality, as well as the internal politics of the family.

Experienced managers in large family offices say strong consideration should be given to hiring people who have skills other than financial and systems management. This is advisable even if it requires the person be given extensive financial and systems training in order to complete their job. The skills they bring in areas such as human relations can make a major contribution to the performance of the office. For example, one office hired a person who had studied acting because they thought her skills at handling people would be an asset to the office.

Training

Training is an extremely important aspect of developing an effective family office. Staff members will not be able to perform their duties efficiently and effectively without proper training. Training can take many forms but can be divided into two groups:

- Technical training to include financial management and computer systems skills. This topic is discussed in the section below.
- Development of judgement and skills with interpersonal relationships. There are not many opportunities for training on this topic. The Financial Navigator Annual User Conference has some time devoted to this topic. Because of the large number of family offices who use its products, FNI is exploring ways to provide additional training in this area in the future.

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