ONE IN A SERIES OF REPORTS FROM THE WHARTON GLOBAL FAMILY ALLIANCE

Wharton Global Family Alliance

Report Highlights for "Benchmarking the Single Family Office: Identifying the Performance Drivers"

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November 2009

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A Note about this Report

Benchmarking the Single Family Office: Identifying the Performance Drivers is one in a series of reports from the Wharton Global Family Alliance. The detailed report of the 2009 survey, conducted in partnership with the Family Business Chair at IESE, is distributed exclusively to family offices that completed the survey. This summary of Report Highlights is presented to share more widely some of the insights gained on current practices and performance drivers for SFOs around the world.

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Acknowledgments

We thank the team at the Wharton Global Family Alliance, particularly Xu Han, Sylvie Beauvais and Greg Pitter, for their outstanding support. As well, we are grateful to the team at IESE's Center for Family-Owned Business and Entrepreneurship (CEFIE), especially to Lorenzo Martini, Riccardo Marcello Bruni and Renata Semmel. We are indebted to Laird Pendleton, our partner at the CCC Alliance, for his insights and support throughout this project.

The Wharton Global Family Alliance is also grateful for the general financial support previously provided by Morgan Stanley Smith Barney and the Penn Lauder CIBER Grant #P220A60017.

Introduction: 2009 Survey Background and SFO Sample

A Single Family Office (SFO) is a professional organization, owned and controlled by a single wealthy family,* dedicated to managing the personal and financial affairs of family members. In addition to investment management services, SFOs' activities often include a range of financial, accounting, legal, educational and personal services which are dedicated and tailored to the exclusive needs of family members. SFOs vary substantially in the scope of activities, in the Assets Under Management (AUM), in the activities that are carried out in house versus those that are outsourced and in other aspects.

Given the highly confidential and private nature of SFOs, there has not been a reliable and robust source of information that relates SFO performance to a broad range of SFO practices including governance, documentation, investment management processes, communication, human resources issues, education, succession planning and technology.

In this survey, we have responded to the request of families to build upon our 2007 study (reported in *Single Family Offices: Private Wealth Management in the Family Context)* in order to benchmark the operations of SFOs around the world. While plans for this follow-up study were already under way in the summer of 2008, the global economic crisis of late 2008 and early 2009 added another valuable dimension in exploring how SFOs were affected by the widespread and dramatic downturn.

By examining at a high level of granularity the governance and management processes of family offices, we wish to illuminate the relationship between the financial performance of SFOs and a broad range of operational aspects, thereby allowing families to learn from each other while maintaining total anonymity and confidentiality.

* We define a family as all the people related by blood, marriage or adoption who have a legitimate claim to be a stakeholder of the family through its ownership. This definition includes members from multiple generations and multiple branches of the owning family—whether or not they work in the family business.

The Partners

The Wharton Global Family Alliance (GFA) and IESE Business School partnered in the development and execution of this study.

Wharton Global Family Alliance

The Wharton GFA, a unit of the Wharton School *(www.wharton.upenn.edu)*, is a unique academic-family business partnership established to enhance the marketplace advantage and the wealth creation contributions of global families that control substantial enterprises and resources. The Wharton GFA focuses its research on key issues affecting global families and their businesses, including Family Business Management and Governance, Wealth Management and Philanthropy. The Wharton GFA's mission is to create and disseminate groundbreaking knowledge about family-controlled businesses and about the families that are behind these firms, with a high standard of scholarship that has positive real-world impact.

IESE Business School

Established in 1987, the Family Business Chair at IESE (www.iese.edu) pioneered this field in Europe. Following the IESE mission and values, the Family Business Chair aims at educating entrepreneurial families to successfully develop business activities along different generations. The IESE Family Business Chair is structured around three pillars: (1) Research—the Family Business Chair counts on a broad scientific production, including books, articles and academic papers. (2) Education—IESE offers new programs each year targeting requests from all the family business stakeholders: owners, founders, management. (3) Networking—since the very beginning, the Chair has kept a strong and close network with the most important European family businesses.

The SFO Benchmarking Survey

The development of the survey instrument took place in the summer and fall of 2008 and included over 40 in-person interviews with family offices around the world. The survey instrument, finalized in December 2008, was distributed, in both hard and soft copies, in the first six months of 2009 in four languages: Chinese, English, Italian and Spanish. We received 167 questionnaires from 23 countries around the world. To maintain complete confidentiality, we performed the analyses of the data on a regional basis: the **Americas,** which includes Canada, Central America, South America and the USA; **Europe;** and the **Rest of the World (RoW),** which includes Asia, Australia and the Middle East.

The survey included 10 sections:

A. Family background and the SFO
B. SFO costs
C. SFO financial performance measurements
D. SFO governance
E. SFO documentation
F. SFO processes
G. SFO communication
H. SFO human resources issues
I. SFO education and succession planning
J. SFO technology

Each section contained a set of detailed questions on issues that are of concern to principals and managers of family offices. Survey participants were asked, for example, what activities the SFO performed, the relative importance and expense of different activities, what services were performed in-house by SFO staff vs. outsourced. To help benchmark best practices by performance, SFOs were also asked to report on their past and expected net actual returns.

SFO Survey Sample: Families and their Businesses (by Region and Wealth Levels)

Our sample represents SFOs from around the world. Nearly half of the 167 SFOs in our sample locate their headquarters in Europe. Another 44% are in the Americas and 5% are located in the rest of the world (RoW), as depicted in Figure 1.

Figure 2 illustrates the wealth level of the families served by our respondents: 40% of our respondents have Assets Under Management (AUM) greater than $1 billion. In the survey, we refer to these SFOs as "billionaires," distinguishing them from SFOs with AUM less than $1 billion, which we call "millionaires," who represent approximately 54% of respondents. As the survey revealed, the size of AUM is one determinant of how SFOs operate.

As can be seen in Figure 3, there are strong regional differences in the level of family involvement in operating businesses. Just under half of SFO families in the Americas are involved in operating a business, compared with 58% of European families and 88% of RoW families. One explanation for the significantly higher level of involvement in RoW families is that most RoW wealth is relatively new. In many cases the families are in their first generation and the initial wealth creator is still active. The relatively higher business involvement of European families compared with American families is somewhat surprising, as family offices in Europe are older on average than their counterparts in the Americas. One explanation might be that the more liquid capital market in the Americas increases both the temptation and the opportunities for families to sell their business.

A note about our regional analysis: Our goal is to present the most comprehensive but confidential picture possible of SFOs around the world. Wherever possible, we include all three regions. However, in order to preserve the anonymity of our SFO respondents, most of the regional breakdown charts in this report will focus on Europe and the Americas.

Figure 1 - **Location of SFO Headquarters**

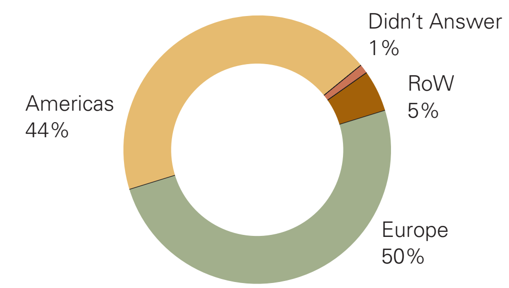


Figure 2 - **Wealth Level of Families**

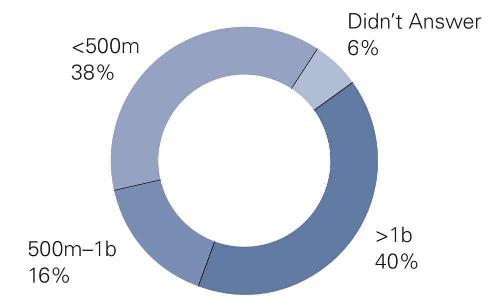
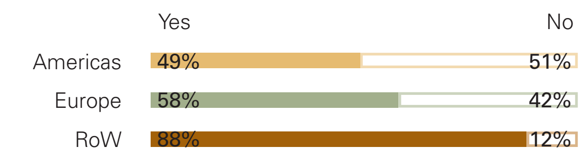


Figure 3 - **Family Involved in Operating Businesses** ***(Regional Breakdown)***



Scope of the Family Office

The survey looked at the broad scope of SFO activities (investment-, family- and administration-related), by region and by wealth. As Figures 4 and 5 indicate, SFOs in the Americas and RoW perform more family-related and administration-related activities than the SFOs in Europe. This difference holds for both millionaire and billionaire SFOs. In other words, the SFOs in the Americas and RoW are engaged in more "soft" responsibilities than their counterparts in Europe.

Figure 4 - **Number of Activities: Millionaires** ***(Regional Breakdown)***

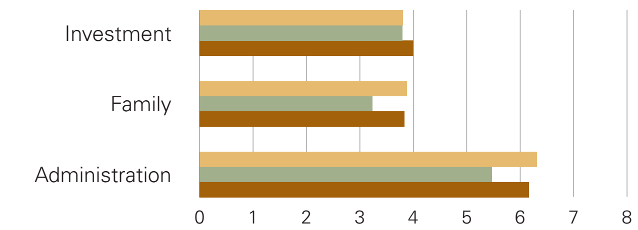
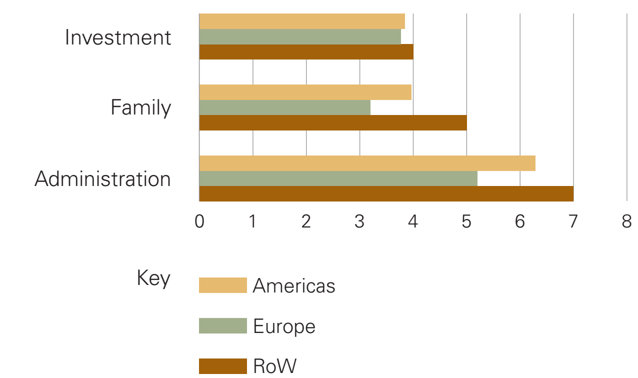


Figure 5 - **Number of Activities: Billionaires** ***(Regional Breakdown)***



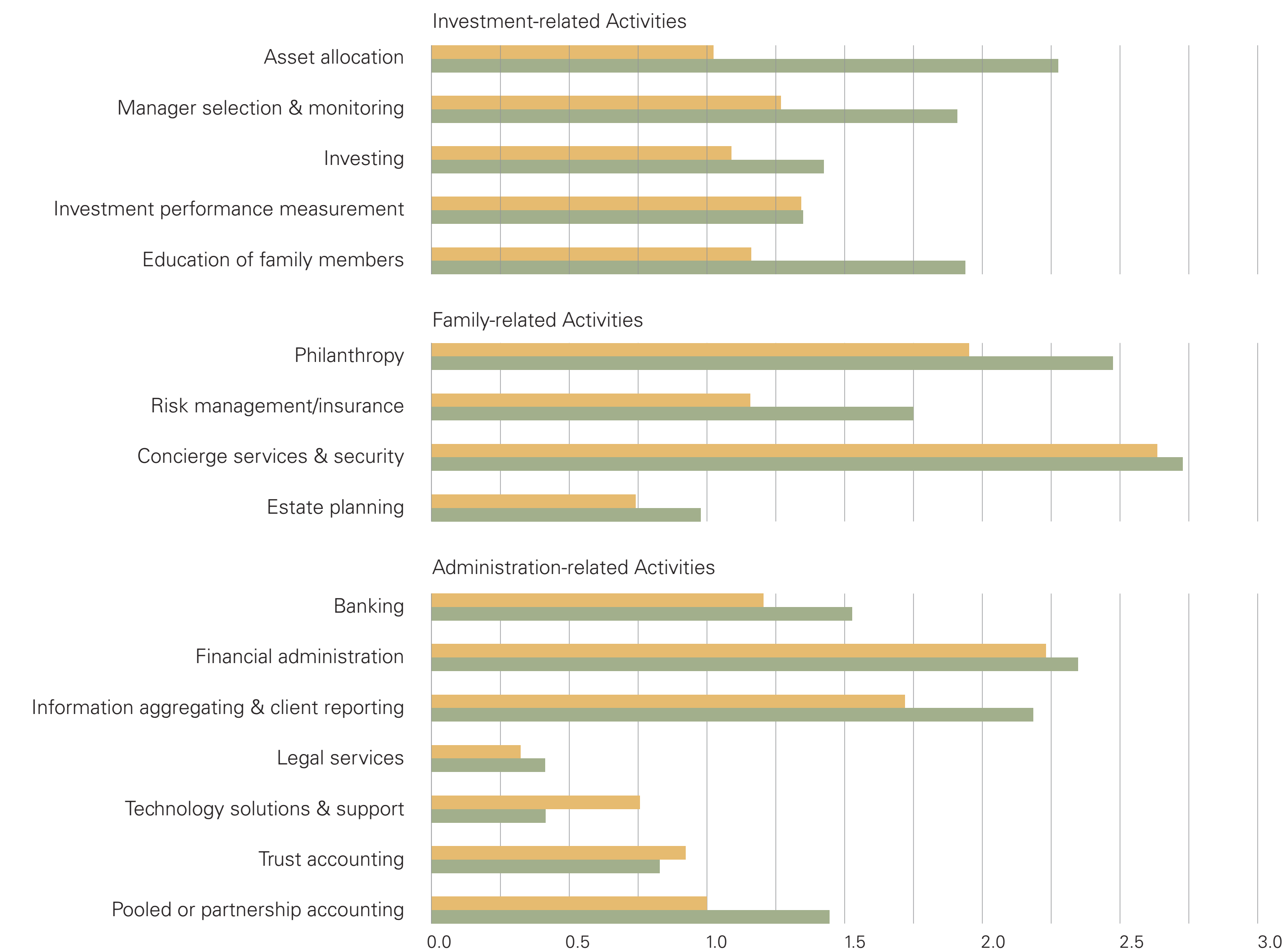
In-house vs. Outsourcing

SFOs differ in the degree to which activities are conducted in-house by SFO staff or outsourced to other professionals. Figure 6 depicts how the activities are performed by SFOs in different regions. Of note is the fact that European SFOs have a higher in-house to outsource ratio in 13 out of 16 activities.

SFOs in the Americas use in-house staff more than SFOs in Europe only for technology support and trust accounting. As will be seen in our Key Findings, higher use of in-house sources also correlated with higher performance.

Key Americas Europe

Figure 6 - **Source of Services: In-house to Outsource Ratio *(Regional Breakdown)***



High Performers vs. Low Performers

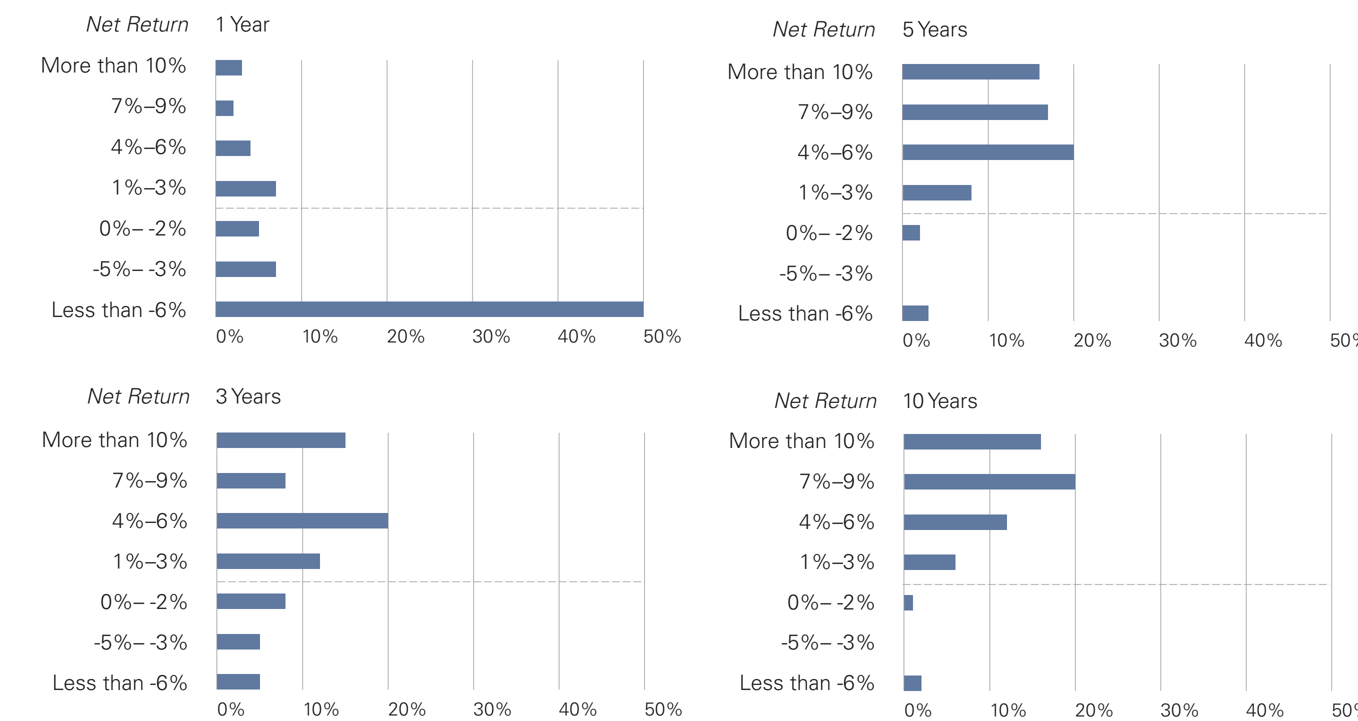
In order to establish best practices of SFOs worldwide, throughout this report we use the 5-year actual net return (after fees, taxes and expenses) of the SFO as the criteria for dividing the firms in our sample into two equal-sized groups: "High Performers" are those SFOs with a net return greater than 6%, while "Low Performers" are those with a 5-year actual net return below 6%.

We selected the 5-year return as a relevant criterion for two reasons. First, SFOs manage the wealth of families with a long-term investment horizon. Second, some asset categories such as private equity and principal investment have investment cycles of about 5 years. Since some SFOs are quite young, they do not have data on 10-year performance and hence we could not use the 10-year actual net return measure. The net return of 6% is elected as the performance threshold mainly to assure that the two groups of sample firms are of equal size.

Impact of the 2008 Global Economic Crisis

The economic and financial crisis of 2008 and early 2009 had a significant impact on SFO performance. During the most recent 12-month reporting period which included the crisis, more than 45% of SFOs interviewed reported a net return on investment below negative 6% (see Figure 7, while only 15% of SFOs interviewed were able to achieve positive returns, which is actually quite remarkable.

Figure 7 - **Actual Net Return In Last 1 Year, 3 Years, 5 Years and 10 Years**



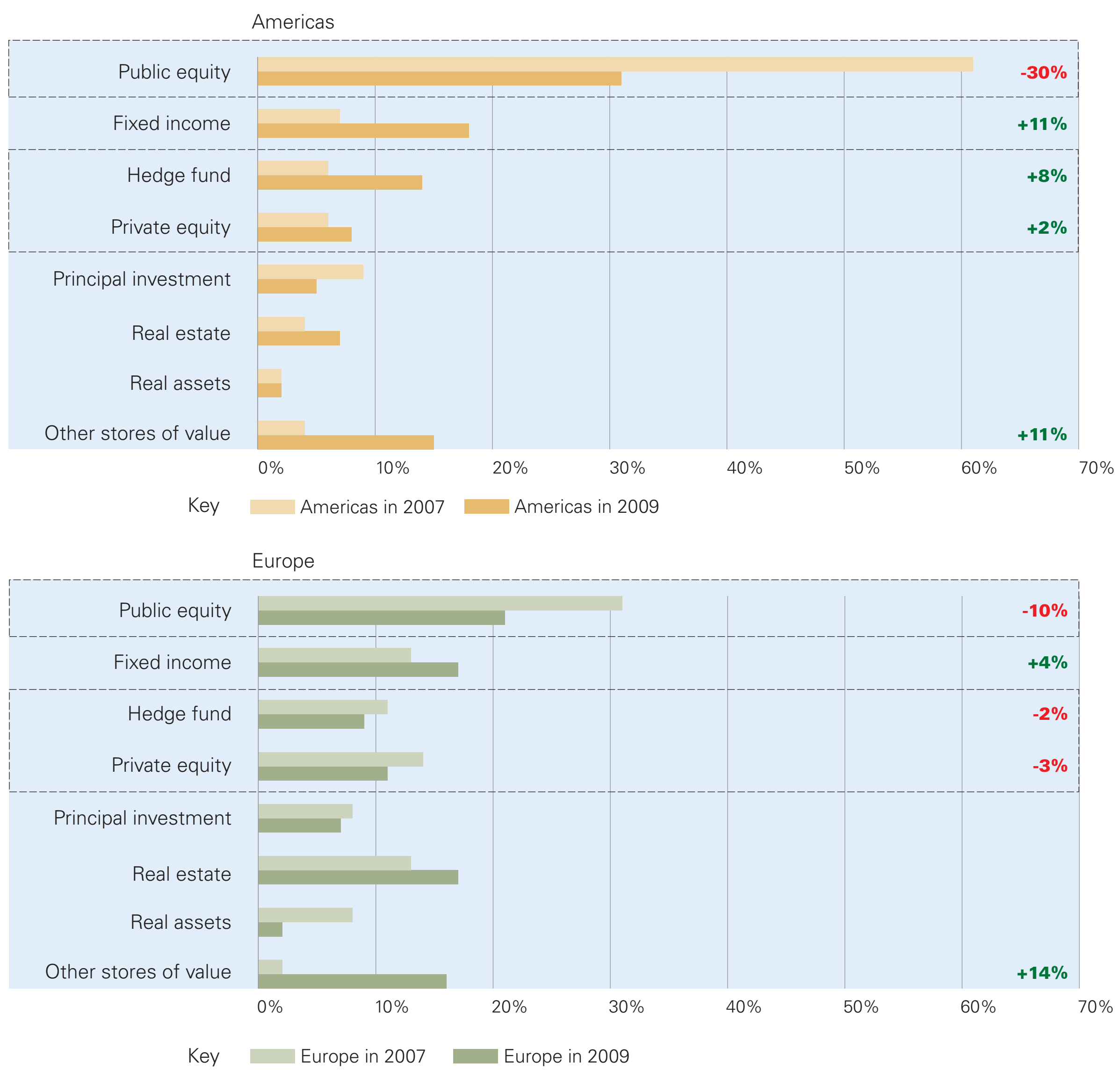
Asset Allocation

By contrasting our most recent results with those of our 2007 SFO survey, it is also possible to examine changes in asset allocation due to the economic crisis. Differences in the asset allocation between SFOs in Europe and the Americas have always been quite substantial and therefore the crisis had quite different impacts, as shown in Figure 8.

In the Americas, the drop in public equity allocation was far greater than in Europe (-30 points vs. -10 points)—partly due to the Americas' historically higher exposure to this asset class. Hedge funds and private equity show opposite trends: holdings in the Americas increased while those in Europe decreased.

Overall, it appears that one impact of the economic crisis has been increased similarities in strategic asset allocation between SFOs in Europe and in the Americas. The big difference in terms of funds allocated to public equity has diminished (in 2007 the Americas topped 61% vs. Europe 31%; in 2009 Americas dropped to 31%, Europe to 21%) and there seems to have been a general evening across asset categories, albeit with some exceptions.

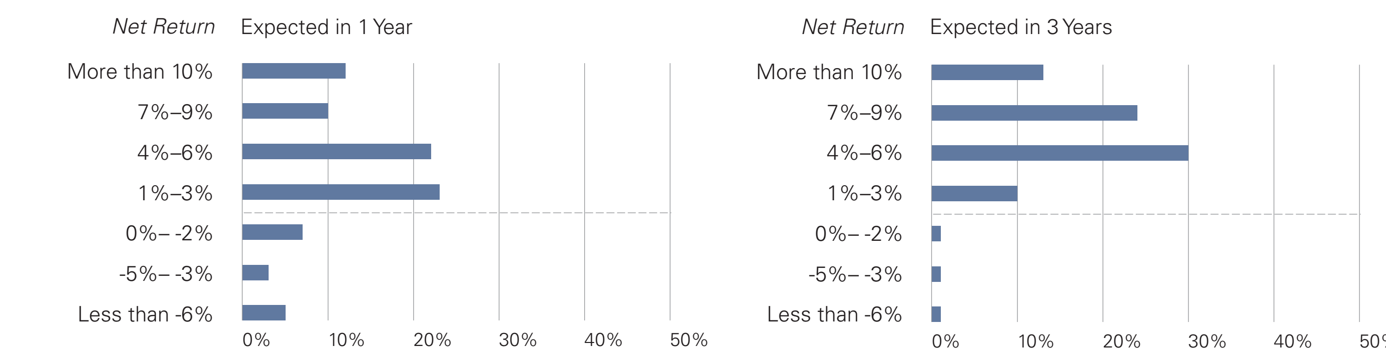
Figure 8 - **Comparison of Asset Allocation (2007 vs. 2009), *Regional Breakdown***



Future Expectations

What does the future after the crisis look like? According to the survey, the majority of SFOs expected a positive return in their next 12-month reporting period, and only 3% of them expected a negative net return in the next three years (see Figure 9).

Figure 9 - **Expectations of Actual Net Return**



Selected Key Findings: Observations on Performance Drivers for SFOs

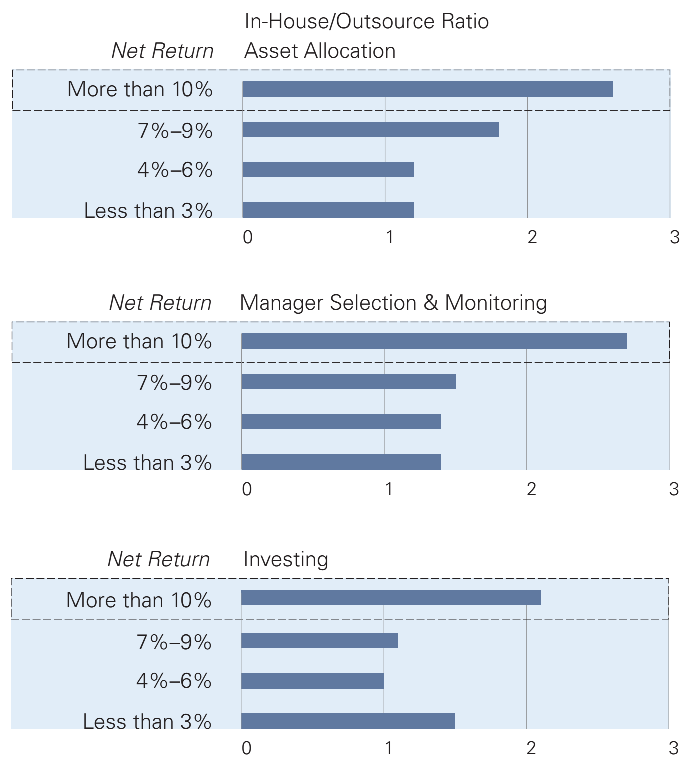
This is the second major survey conducted by the **Wharton Global Family Alliance** and **IESE Family Business Chair** to develop knowledge and produce insights on Single Family Offices around the world. While we started with some assumptions and a thesis, we were, in several areas, caught by surprise. In this Report Highlights summary, we share some of the observations and recommendations that emerged from analysis of the data.

In-house vs. Outsourcing

A reasonable assumption of many investors is that the more you outsource to the best experts and the fewer employees you have, the higher your performance will be. We were quite surprised to learn that the more an SFO controlled directly and the more its members were involved, the better the performance.

When we measured this by an in-house/outsource ratio for the activities of asset allocation, manager selection and monitoring, and investing, we discovered clear trends in all of them: high-performing SFOs are always the ones who have the highest in-house ratio. See Figure 10 for the In-house/Outsource ratio compared with 5-year actual net return performance. It seems that the more knowledge you develop in-house and the more you are able to control the activities, combined with high quality standards, the better are the results.

Figure 10 - **In-House/Outsource Ratio vs. Actual Net Return *(Last 5 Years)***

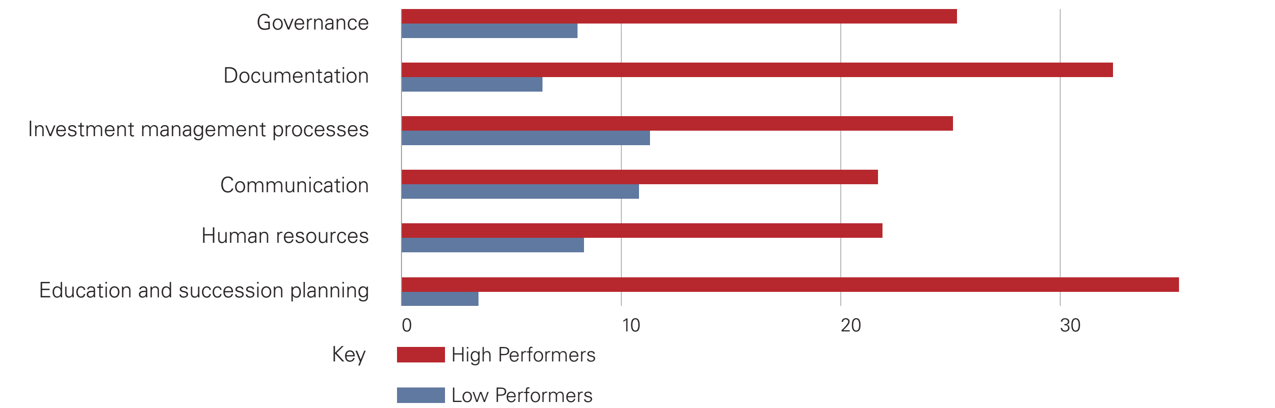


Quality

We have also learned in this endeavor that the better your quality (adjusted for expenses) in the SFO, the higher your performance. This concept of quality was structured around six pillars (governance, documentation, investment management processes, communication, human resources, and education and succession planning).

Figure 11 shows that high performers have higher quality across the board when adjusted for expenses associated with delivering the quality. Each dimension of quality that we measure is greater among the high-performer firms. The results further suggest that quality in non-investment activities such as education and succession planning is also strongly associated with SFOs' investment performance.

Figure 11 - **Expense-Adjusted Quality Index *(Mean Comparison)***



Europe Outperforms the Americas

Another surprising result emerges from the comparisons between the performances of European and American SFOs. Among our respondents, 94% of European SFOs who reported their performance in the last 5 years earned more than 4%, compared to only 66% of SFOs in the Americas who reported reaching this mark. This trend is constant both in the long term (for performance over the last 10 years, approximately 10% of American SFOs reported having negative net actual return compared to none of the European SFOs) and in the short term (for the last year, only 54% of European SFOs registered a performance less than negative 6%, compared to 76% of SFOs in the Americas).

Governance and Communication

We found a clear connection between SFO governance and performance. One explanation for the stronger performance of European SFOs might be their more developed SFO governance: European SFOs have on average a higher presence of committees, a more advanced use of documentation and a more frequent communication policy than SFOs in the Americas. Similarly, these are features of high performers, as shown in Figures 12 (Governance), Figure 13 (Documentation), and Figure 14 (Communication Frequency).

Regarding the frequency with which SFOs informed family members about the investments, most high-performing and low-performing SFOs report to the families on either a monthly or quarterly basis. We find a significant difference, however, between high and low performers in the proportion of SFOs who communicate investment results weekly, which suggests that higher performers work much more closely with the families they serve.

AUM Size: Millionaires vs. Billionaires

In many cases, key differences between millionaire and billionaire SFOs were also characterized by regional differences. Among the general comparisons that emerged, billionaire SFOs have more investment managers and custodians on average, as well as better governance than millionaire SFOs. Interestingly, millionaire SFOs are significantly more diversified across asset classes than billionaires.

Figure 12 - **Governance *(High Performers vs. Low Performers)***

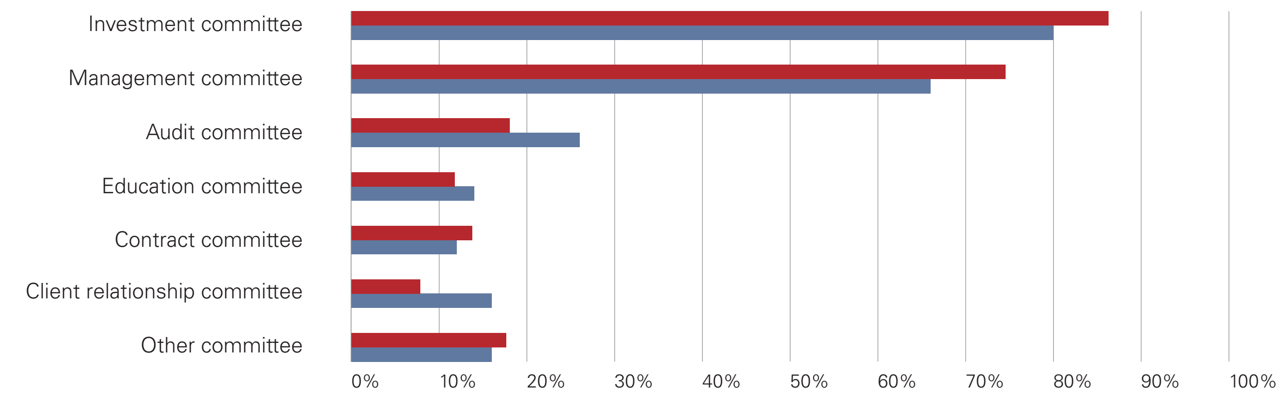
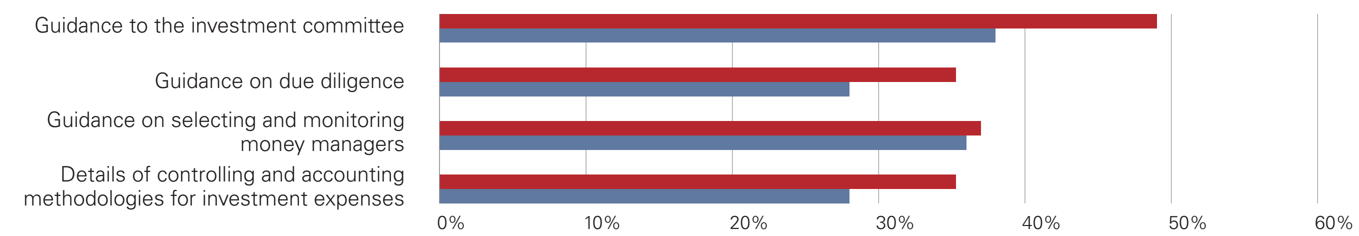


Figure 13 - **Content of IPS *(High Performers vs. Low Performers)***



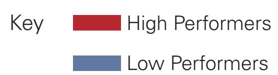
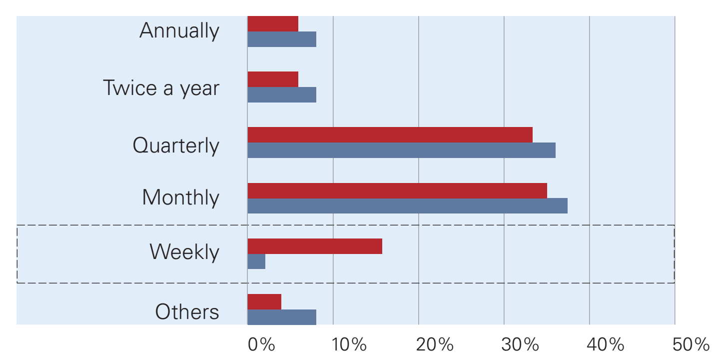


Figure 14 - **SFO Communication: Frequency of Informing Family Members About the Investments *(High Performers vs. Low Performers)***



Succession Planning and Education of the Next Generation

SFOs often engage in a range of educational programs and are involved in the succession planning of the families they serve. Figure 15 compares high and low performers in the number of eligible family members who take part in SFO-organized educational programs. As illustrated, the family participation rate among high performers is significantly higher than that of low-performing SFOs. Twice as many high-performing SFOs (nearly 30%) reported that more than 67% of eligible family members took advantage of the educational programs offered.

The educational programs offered by an SFO can also be viewed as an approach that SFOs use to transfer the knowledge, culture and legacy of the family to future generations, as well as to align the values of family members and improve communication so as to increase harmony and happiness within the family and reduce potential conflict. Our analysis of the relationship between educational programs and the financial performance of family offices, depicted by Figure 16, suggests a strong positive correlation between educational programs and SFO performance.

Figure 15 - **Percent of Eligible Family Members Who Participate in Educational Programs *(High Performers vs. Low Performers)***

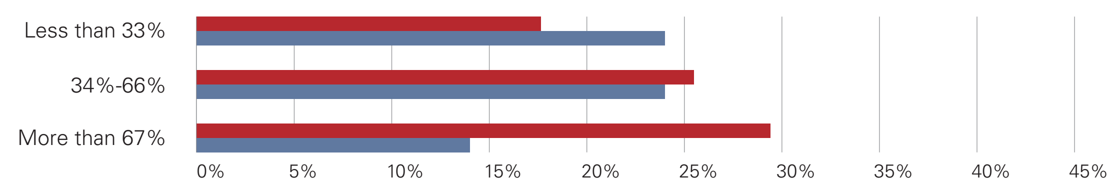
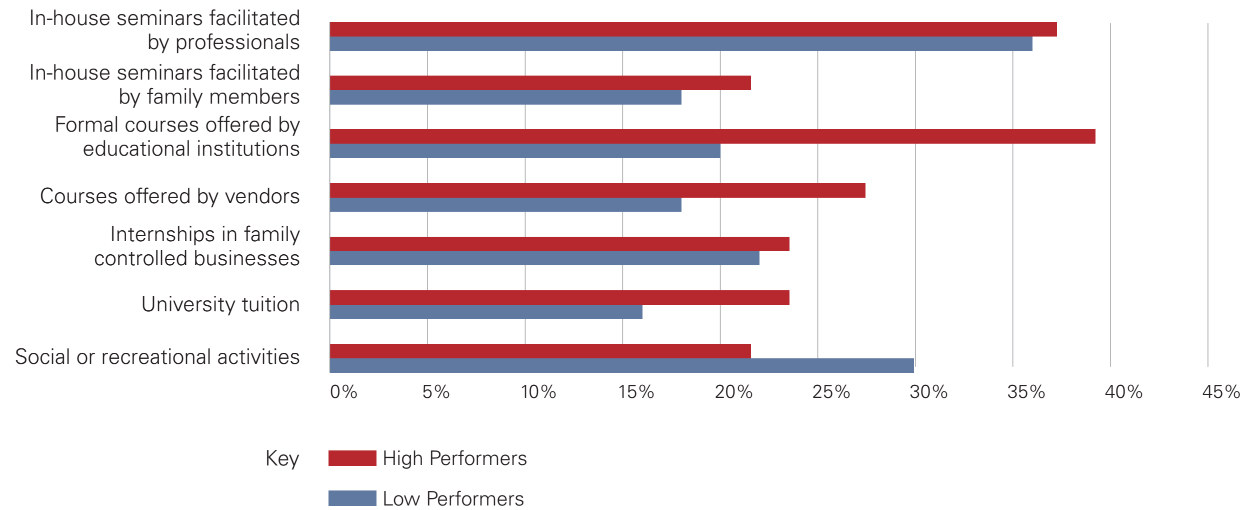


Figure 16 - **Educational Programs *(High Performers vs. Low Performers)***



Entrepreneurial Edge

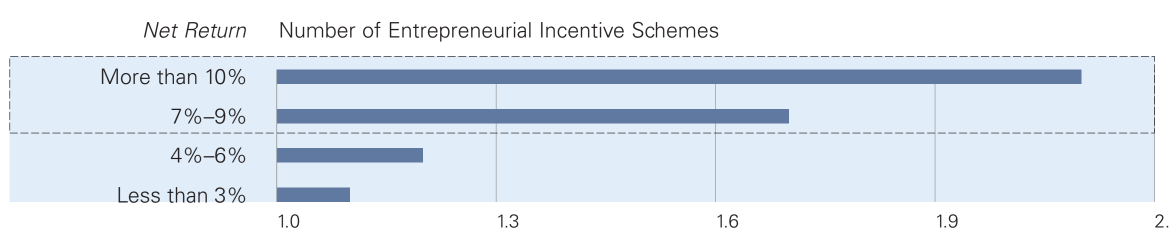
We were interested in examining the impact of an entrepreneurial mindset within an SFO. One assumption we made was that if you have a more entrepreneurially incentivized team in your SFO, you might act differently and therefore your performance might produce different results than an SFO that is run more bureaucratically. A second approach to revealing an entrepreneurial mindset was to look at asset allocation, which might have more or fewer entrepreneurial parts. We therefore defined an "entrepreneurial incentive scheme" and an "entrepreneurial asset allocation" and looked at the impact on performances.

Incentive Schemes. Different incentive schemes underline different commitments by the SFO team to participate in the up and downside. We differentiated all the incentive schemes mapped out in the survey as either "entrepreneurial" or "non-entrepreneurial" based on the aim they have to transform the profile of the manager from a pure administrator to an actively involved and interested entrepreneur. Using this criterion, incentive schemes considered as "entrepreneurial" included cash bonuses based on portfolio performance; carried interest (profit sharing) in principal investment, and co-investment opportunities.

As seen in Figure 17, our analysis showed that high-performing SFOs have applied more entrepreneurial incentive schemes. SFOs with a 5-year actual net return higher than 7% used more entrepreneurial incentive schemes (1.7) than the average (1.5), while SFOs with an actual net return greater than 10% used even more entrepreneurial incentives (2.1).

One could argue that these incentives could lead to a clear conflict of interest that bears a higher risk. However, as demonstrated in the case story "The Entrepreneurial SFO," this potential conflict of interest can be diminished by asking the SFO team to co-invest. In addition, we have compared performances over a period that includes one of the biggest financial crises of the past half-century and have still found this relationship—the higher the entrepreneurial incentive schemes, the higher the performance. So these findings already include the risk dimension.

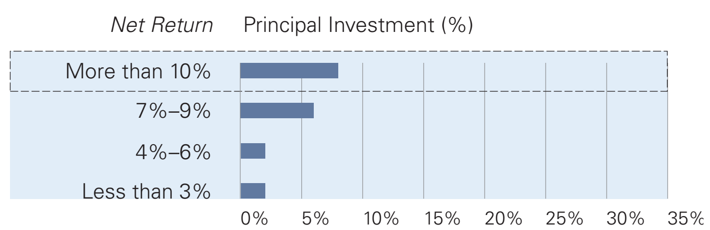
Figure 17 - Number of Entrepreneurial Incentive Schemes Compared to 5-Year Performance



Asset Allocation. Following the same reasoning used above in incentive schemes, we identified and classified asset allocation activities as another useful proxy for the evaluation of the entrepreneurial mindset of an SFO. In this case, the different allocation strategies underline different levels of commitment by an SFO to be involved directly in the investment. A higher percentage of assets allocated to principal investments implies a higher degree of entrepreneurialism from the SFO. On the other hand, investment in fixed income and public equities are de facto not entrepreneurial asset classes, since the involvement and the possibility to make a difference by the investor is far less compared to principal investment.

As shown in Figure 18, the better performing SFOs have a higher percent of assets allocated to principal investment (8%) than low performers (2%). High performers also had a lower proportion of assets allocated to fixed income and public equities than low-performing SFOs.

18 - **Entrepreneurial Asset Allocation Compared to 5-Year Performance**



Strategic Approach to Investment Management

In the past year we have lived through one of the biggest global crises in financial markets since the Great Depression of the 1930s. Many of the decisions made by investors were based on mathematical algorithms or models, since financiers prefer such tools in the belief that a simplified explanation of reality via statistical and mathematical models provides credibility. The events of the past year have revealed many of the flaws of relying on such models.

Successful SFOs did not trust those models and the advice derived from them. Instead, these SFOs followed more strategic principles, such as the indirect approach: avoid combating in asset classes with the strongest competition and focus on those with true opportunity or those with few or weaker players. Strategic approaches to decision making in SFOs, driven by the principals of SFOs, complement the guidance of advisors and allow SFO principals to develop core competencies which in the long run will lead to stronger sustainable performance.

Importance of the Value System and its Implementation

In our interviews and case studies, we have seen many high net worth families serving society by knowing who they are and what their mission is in society. This coincides with the very meaning of humility: self-knowledge without pride or vanity.

These families have made, and are making, a significant effort to strengthen and develop their sense of purpose and moral responsibility, as well as their creative entrepreneurial edge. They achieve this through sound family values that enable them to implement a sophisticated form of family and SFO governance.

Supporting this perspective, the quality index shows that the more you invest in a governance structure for your SFO, the more you communicate and interact with the family members and the more you invest in the education of the next generation, the better the performance will be.

Moreover, we found these families to be happier than others as they were able to balance their personal wealth with entrepreneurial creativity, philanthropy and leadership in society, to serve as positive role models.

The Entrepreneurial SFO*

The Challenge: How can you create and keep an entrepreneurial spirit in an SFO?
One client, one owner, little growth rate of the Assets under Management—looking in general at the main traits of Single Family Offices, they promise everything but entrepreneurialism. Yet this SFO is one of the clearest examples of an entrepreneurial family office we found in our analysis. How was this SFO able to overcome the general challenge of SFOs and be entrepreneurial?

The Family and its SFO
Created in 2005, this Single Family Office is one of the largest in the United States in terms of amount of wealth managed (a "two digit" billion patrimony). The SFO serves the first generation, composed of two family members who are founders of a major IT company in the U.S. They still own a relevant portion of shares of this listed company. The personal satisfaction is visible in the eyes of one of the founders when he tells us about his decision to set up the Single Family Office. "One of the objectives this SFO was founded for," he explained to us, "was to gradually diminish the participation in the IT company and to invest the proceeds broadly and thereby diversify the wealth. Therefore we have been implementing a broad diversification strategy, investing in several asset classes."

The Solution
This SFO creates a very entrepreneurial mindset in its SFO managers through the following strategies:

- The SFO manager owns the management company: the wealth is organized in a fund and there is a contract with the management company to manage this fund and to do the investments. The management company earns a relatively small and competitive 0.8% per year fee, which covers all the costs. Therefore the SFO managers are owners and entrepreneurs.
- Profit participation: the management company earns 10% of the profits made.
- Alignment of interest: in addition to profit sharing, however, as a rule, the managers of the SFO also co-invest a very relevant part of their personal fortune in the asset class they are responsible for (the hedge fund manager in the hedge fund investments, the equity manager in the equities, etc.) and a smaller part in all other asset classes. If they lose money for the principals, it hurts them even more.
- Principal investments: besides the rules described above, all managers are invited to make principal investments in private companies, together with the fund (like a small in-house private equity fund). In this way the managers are all involved in real entrepreneurial endeavors.
- Growth of the assets under management: it is a lucky feature of this SFO that there is a significant yearly cash inflow from the money the SFO gradually gets from the sales of the shares of the IT company. Therefore the assets under management are growing each year, which helps to keep the entrepreneurial spirit high.

This incentive system avoids any form of opportunistic behavior toward high short-term return and high risk exposures. "Managers and principals all participate and co-invest together with the result that their interest is perfectly aligned." The entrepreneurial spirit and risks are therefore shared by all, the principal and the SFO managers.

* The full report includes six anonymous case stories. Each story is based on an SFO and its family and demonstrates different value sets, strategies and levels of SFO success.

Looking Ahead: Future SFO Surveys

Benchmarking the Single Family Office: Identifying the Performance Drivers is one in a series of reports from the Wharton Global Family Alliance. The detailed report of the 2009 survey is distributed exclusively to family offices that completed the survey.

Wharton GFA is committed to continuing its study of family offices with the goal of contributing to the ability of family offices to preserve and enhance all forms of family wealth. Our plan is to conduct a comprehensive survey every other year and to address at a higher frequency specialized topics of interest to family offices, such as family office governance and compensation for professionals.

For information on this and other reports—or should you be interested in participating with us in future surveys—please email *wgfa@wharton.upenn.edu*

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