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White Paper

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Solutions for Entrepreneur Families: How to transfer wealth without killing ambition

White Paper
How to transfer wealth without killing ambition

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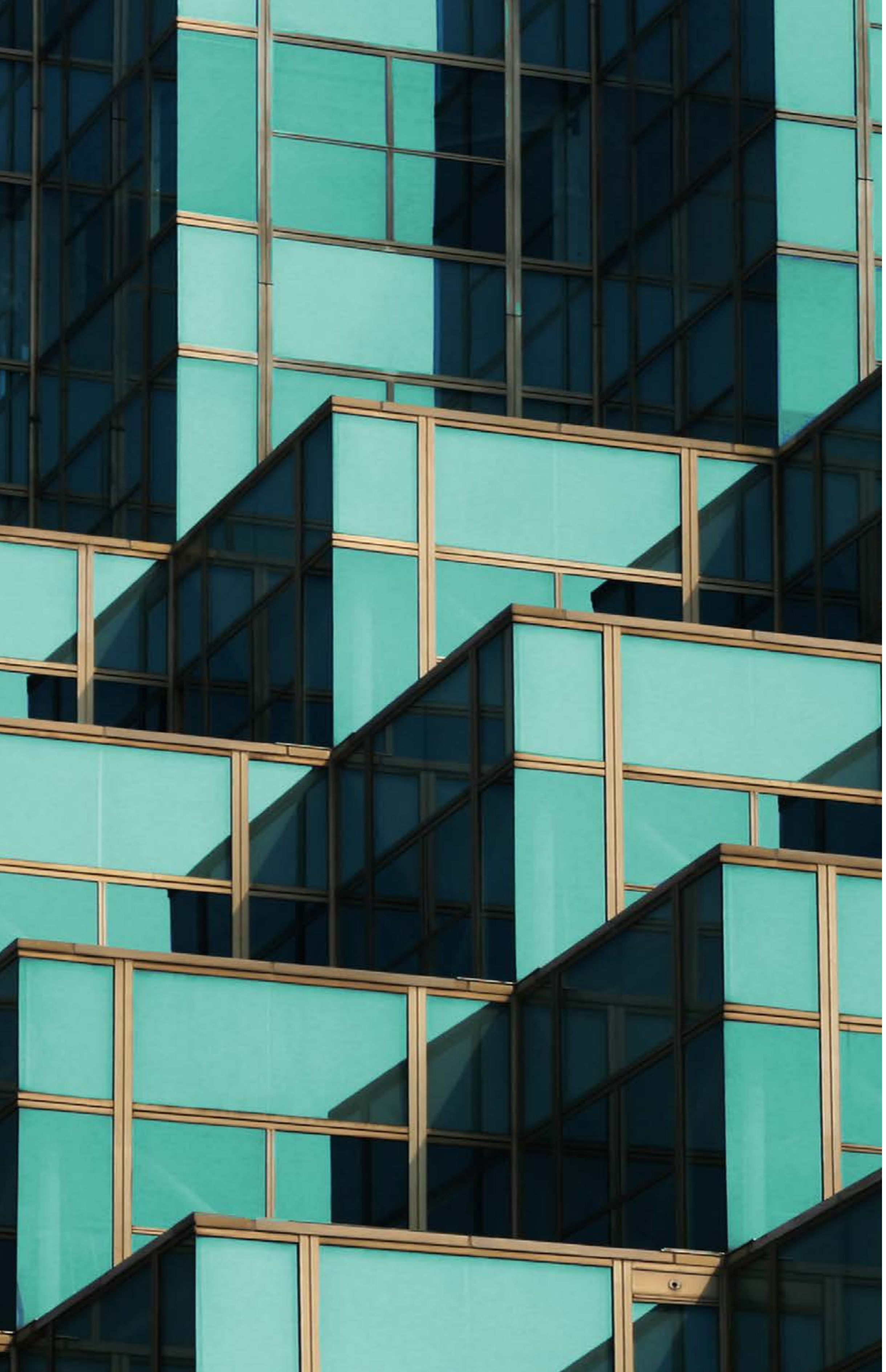
Through surveys and interviews with over 200 members of Business Families, the first part of this White Paper analyzes the challenges faced by Business Families when it comes to the generational transition process. From the research carried out, we can conclude that the greatest challenge is "How to transfer wealth without killing ambition" or in other words, how to pass on not only wealth, but also the family legacy and the ability to continue creating value over the generations.

The second part of the White Paper proposes solutions for Business Families so that they can achieve this objective. Transferring wealth without destroying ambition involves:

a) Establishing the ground rules for managing shared wealth, for which development of Family Governance, a Family Protocol and Shareholder Agreements are suggested;
b) Consolidating family assets for more effective management thereof through trusts and holding companies;
c) Transferring family assets from a Family Foundation;
d) Creating a transgenerational vision by drawing up a roadmap for family wealth, and
e) Establishing integrated wealth management through the creation of a Family Office.

Throughout the White Paper, not only will we describe how each of these mechanisms works in detail, but we also explain to what extent each of them can help Business Families overcome the challenges of generational transition.

Content



Introduction

"I would like to leave my children enough money so that they would feel they could do anything, but not so much that they could do nothing."
— Warren Buffet, *Fortune Magazine*, 1986

For many families, business success means what started out as a small family business grows over time and starts to make an abundance of money beyond the main business interest, creating family wealth that becomes ever more complex. This means that in addition to the complexity of managing relations between the family and the business, Business Families have to deal with a new dimension, wealth management.

The problem is that the skills needed to manage wealth differ enormously from the skills needed to manage a business, and very often, members of Business Families are not able to recognize this difference. Only when they face the process of generational transition do they become aware of the great challenges of managing shared wealth, which should unite the family at the same time helping maintain certain independence for its members. Sometimes though, it is already too late, resulting in a loss of numerous opportunities to create wealth. Despite the significance of the problem, most current research focuses on analyzing family-business relations, disregarding the implications of the triple family-business-wealth relationship. Through this new White Paper, we want to bridge this gap by carrying out a comprehensive analysis of the challenges faced by Business Families during the generational transition process and the mechanisms on offer to successfully navigate this transition.

To better understand these challenges, we first carried out a survey and a series of in-depth interviews with a group of 200 members of the future generations of Business Families in all four corners of the world. We will call these the "NEXT GENs"[1].

As we will see throughout this study, some of these young people currently hold a senior position in one of the companies within the family group, while others intend to do so in the near future. Although many do not expect to take an active role in managing family wealth, all identified themselves as part of a business family, which is something that they cannot easily relinquish. This means that in the future, regardless of the role that they have within the family, all will inherit the family legacy in one way or another. The challenge is, therefore, how to successfully pass on this legacy to new generations, in other words "**transfer wealth without killing ambition.**"

The initial analysis of data demonstrates the importance of the question we have raised. As shown in Chart 1 (next page), only 13% of the Business Families in our survey have completed the generational transition process. The rest of the families will face the process in the near future, albeit with different perspectives. 45% of families are in fact in a transition process where two generations are involved, although it is striking that in this group, those families who are following a planned process are in the minority. Therefore, in the next few years, these families are going to face a transfer of wealth from one generation to another and, in many cases, their members are not properly prepared for it.

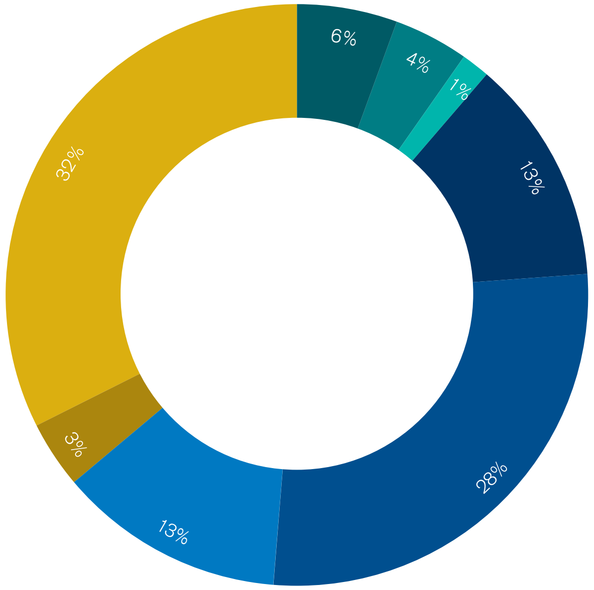
In the rest of our cases, families face an uncertain future in that the next generation does not wish to be actively involved in the management of the business or else has decided to sell the company. However, even in these cases,

[1] To find out more about the characteristics of the NEXT GENs, please see ANNEX I: Research methodology and descriptions.

the question we raise in this White Paper is still relevant as, regardless of whether the family ends up passing on control and/or leadership of the companies that it currently controls to the next generation, **all family owners face the challenge of passing on the wealth that they have created to the next generation in an effective way**.

The first part of the study focuses on an analysis of data taken from the surveys and interviews with the NEXT GENs with the purpose of understanding what exactly the challenges of the generational transition process are for a business family. Once these challenges have been identified, the second part of the study focuses on proposing mechanisms for Business Families.

Chart 1. Stages of the generational transition process



- Only one generation is involved. The members of the next generation are not yet of working age
- Only one generation is involved. The members of the next generation are not interested in working for the family business
- Only one generation is involved and there are no plans to include descendants in the management of the family business
- Both the incoming and outgoing generations are involved in the business and they are preparing for generational transfer
- Generational transfer has taken place and the outgoing generation still has ties with the business
- Generational transfer has taken place and the outgoing generation has cut all ties with the family business
- Both the incoming and outgoing generations are involved in the business
- Only one generation is involved and it is considering selling the business

Key challenges in the generational transition process
What makes the wealth of Business Families different?

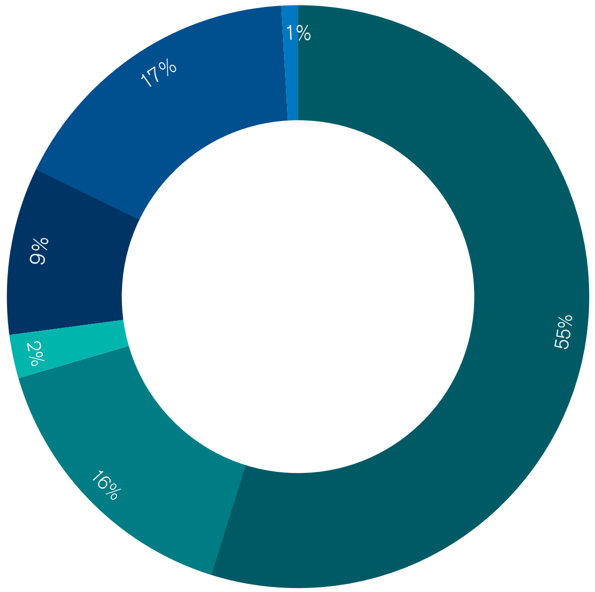
1.1 Economic-financial aspects

The first step in helping Business Families to carry out the transition process effectively is to understand what elements actually make up family wealth and which of these elements it is important to pass on.

To do this, we used the data from the survey to first make a snapshot of how family wealth is distributed. This snapshot (Chart 2) shows little diversification in wealth as, on average, 71% of it is invested in businesses where the family holds over 50% of the shares. In fact, 10% of the families in our survey have all their wealth concentrated in companies under family control, as shown in Chart 3 (next page).

According to previous research, this high concentration of family wealth in specific assets implies a high risk for the owners and largely explains the aversion to risk that they sometimes show when it comes to making strategic decisions[2].

Chart 2. Distribution of family wealth



- Main business (largest business under family control)
- Other businesses controlled by the family
- Investment in businesses not controlled by the family
- Financial instruments
- Real estate assets
- Others

[2] Anderson, Ronald C., Sattar A. Mansi, and David M. Reeb. "Founding family ownership and the agency cost of debt.", Journal of Financial economics 68.2 (2003): 263-285

An effective transition process should help business families to achieve greater separation between personal wealth and business wealth.

The objective of the process should also be the diversification of wealth, which translates into less risk for owners and therefore a greater willingness to take additional risks in other investments.

Despite this high concentration, a more detailed analysis revealed that within this group, there are also families with a more sophisticated wealth portfolio (25%), mostly invested in real estate assets, financial instruments, or other businesses where they participate as minority shareholders (Chart 3). This demands the creation of wealth management solutions that are flexible and highly customized and can cover current and future requirements of very different families. With regard to assets controlled by the family, the data analyzed supports the need to go beyond the family business, as 77% of the families in our survey own more than one company, with five being the average number of companies under the control of the same family.

In this respect, the families are in fact diversified at sector level; 79% of the groups are made up of companies that belong to different sectors. However, this is not true internationally, as only 7,8% have companies in countries other than the country where the main business is based.

All this data indicates that we are dealing with families whose wealth goes beyond the family business and so the unit of analysis for the transition process should be the business family and not the family business.

This means:

- The need to approach wealth management from a broad perspective, which considers all the wealth managed by a family and not just the assets that it controls
- The need to design structures that consolidate the family's assets to protect the wealth created and to facilitate the transfer of ownership to the next generation

Chart 3. Diversification of family wealth – from business family to investor family

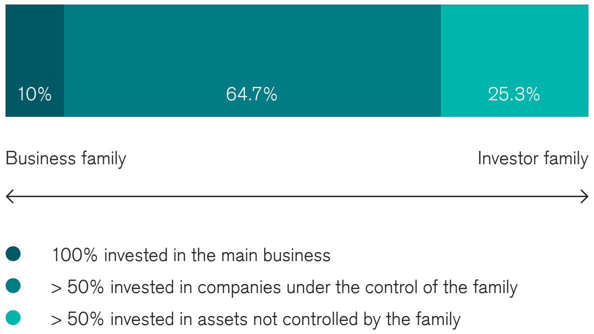


Figure 1. Business activity of Business Families

Each family has an average of five companies under its control. 77% of those questioned have more than one company

Within the same family group, in 79% of cases, the companies belong to different sectors

Within the same family group, in 7.8% of cases, the companies are diversified internationally

In 12% of cases, the main business (largest business in terms of volume of assets) was founded after the other companies in the family group

The transition process should adopt a broad vision of family wealth, analyzing all the assets in which each business family has part of its wealth invested, understanding that the elements to pass on go beyond the company/companies under family control. The transition process should be customized as much as possible, designing solutions adapted to the level of sophistication of the wealth portfolio managed by each family.

1.2 Non-financial aspects: the importance of Socioemotional Wealth

Secondly, based on evidence from several previous research studies, we analyzed whether there are other non-monetary aspects that make up the wealth of Business Families. Academic literature uses the term **Socioemotional Wealth**[3] (SEW) to refer to assets of a sentimental value which a family acquires from its position as the reference shareholder in a company. So Business Families not only have to concentrate on maximizing their financial wealth, but their socioemotional wealth as well. The challenge is how to achieve the perfect balance between the two (Figure 2). SEW includes all those aspects that add value for their owners, but which are not necessarily related to the creation of financial value. Figure 3 summarizes the main elements that make up this Socioemotional Wealth[4]:

Figure 2. Objectives of business families

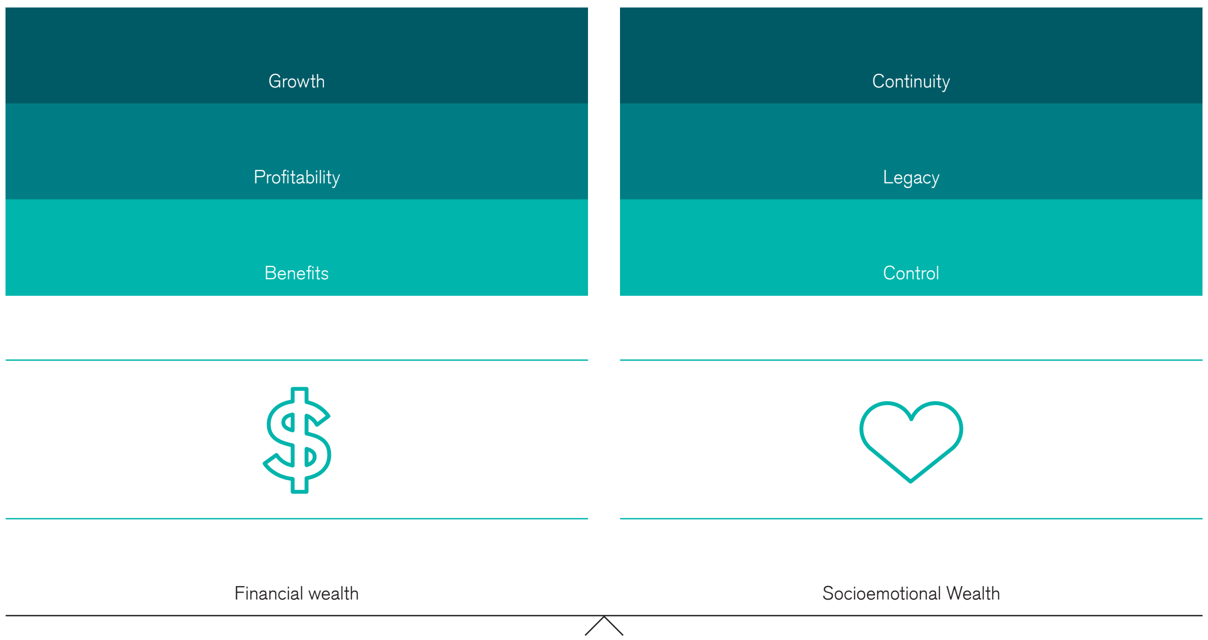


Figure 3. Elements of Socioemotional Wealth

F	Family control and influence Desire to maintain family control and influence	**4,07**
I	Identification of family members with the firm Identification of the family with the assets that it controls	**3,93**
B	Binding Social Ties Implications for society/community. Long-term relations with clients, employees, etc.	**3,65**
E	Emotional attachment of family members Presence of emotional bonds between members of the family	**3,75**
R	Renewal of family bonds to the firm through dynastic succession Passing on the legacy: preserving family bonds in the next generation	**3,88**

Figure 4. Average Socioemotional Wealth

Average Socioemocional Wealth: 3,86

Scale of 1-5: 1 meaning not important and 5 meaning very important

Identifying this stock of Socioemotional Wealth is key in the transition process, as several studies show that when it comes to making strategic decisions, the fundamental objective of business families is to protect this stock, even when this means neglecting the creation of financial value[5].

Figure 4 shows that the Socioemotional Wealth of the families in our survey is high. On a scale of 1 to 5, the average for each element is greater than 3,5 and the total average is 3,86. The most significant elements are those relating to "Maintaining family control and influence" and "Passing on the legacy," with average of 4,07 and 3,88, respectively.

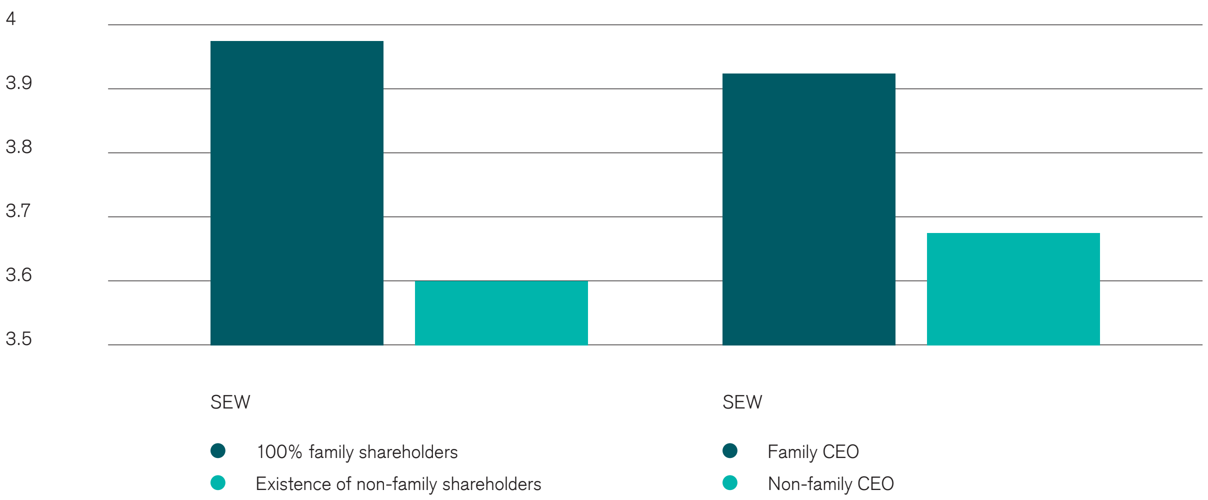
The transition process should go beyond the purely financial aspects of family wealth, identifying all those socioemotional aspects that are important for owner families and form part of their legacy.

[3] Gomez-Mejia, Luis R., Cruz, Cristina; De Castro, J.2011. "The bind that ties: Socioemotional Wealth preservation in family firms." The academy of management annals 5.1 (2011): 653-707

[4] Pascual Berrone, Cristina Cruz, and Luis R. Gomez-Mejia. "Socioemotional Wealth in family firms theoretical dimensions, assessment approaches, and agenda for future research." Family Business Review 25.3 (2012): 258-27

[5] Gómez-Mejía, Luis R., et al. "Socioemotional Wealth and business risks in family-controlled firms: Evidence from Spanish olive oil mills." Administrative science quarterly 52.1 (2007): 106-137

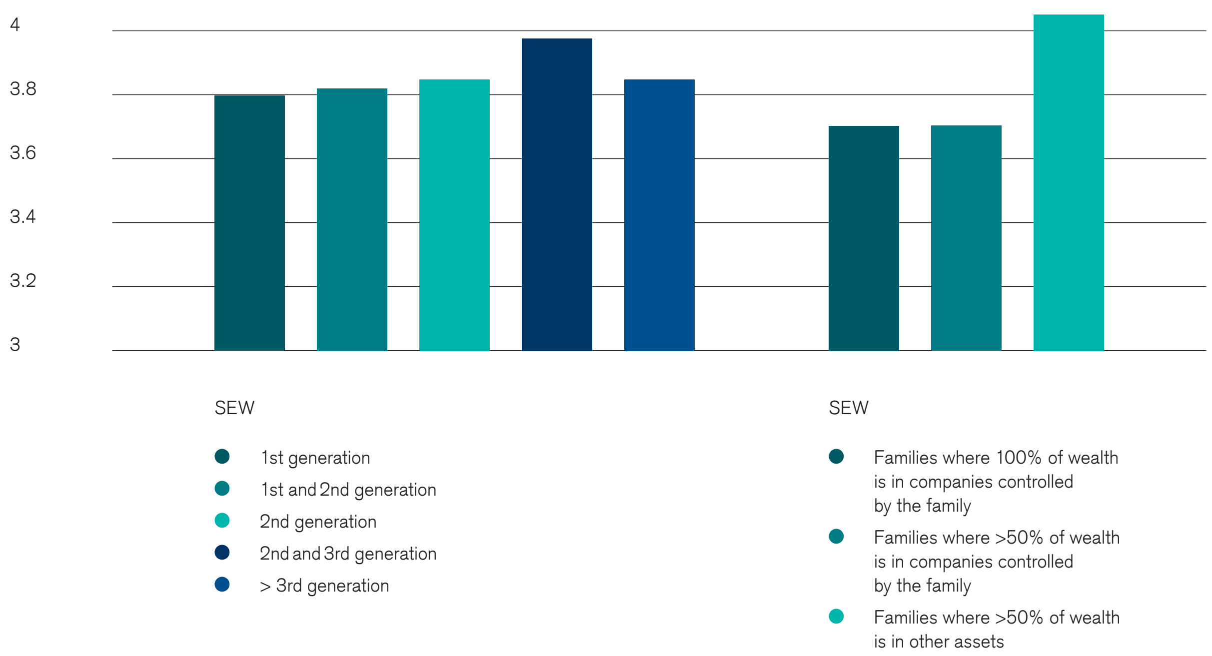
Chart 4. Importance of Socioemotional Wealth for business families



Analysis of survey results shows that identifying this stock is not easy as it is not the same for all business families, and the factors that determine its importance in each family are not immediately obvious. In particular, as seen in Chart 4, according to the families in our survey, the importance of socioemotional aspects decreases when the business has partners and/or directors who do not belong to the family. However, strangely enough, this does not depend on the generation that has the wealth or on how the families have distributed their wealth (Chart 5).

Once again, this highlights the need to have highly customized transition processes in place, which recognize the diversity of objectives within business families, and whose mechanisms are flexible enough to accommodate this diversity.

Chart 5. Factors that do not affect Socioemotional Wealth



In an attempt to better understand the importance of this Socioemotional Wealth, we asked some of the NEXT GENs to give us their definition of success as a business family. As shown in Table 1 (next page), in all cases, success as a business family is defined as a mix of financial and socioemotional aspects: aspects such as preservation of family unity and harmony are deemed to be as important as the creation of financial and social value.
The challenge, therefore, is how to maintain this balance in the next generation.

The transition process should help families to achieve a perfect balance between the creation of financial wealth and the preservation of Socioemotional Wealth.

Table 1.

Definition of success according to business families

“My family defines success as having been able to preserve our heritage through thick and thin, without ever losing anything that has been earned and while keeping the family united.”

“Success for my family means preserving and improving family harmony and unity, with the objective of creating financial and social value. We’re like a fist; the sum of each of us makes us stronger.”

“Success for us is that each generation achieves more than the one before, and not only in terms of money.”

“For us, success is being able to ensure a good standard of living for members of the next generations, while also contributing to the economic development of our region and our country.”

1.3 Shared wealth

Finally, the results analyzed show that another distinctive feature of the wealth to be passed on is that it is shared and managed between several members of the same family. So, for example, as we see in Figure 5, on average, each family-controlled company has nine members of the same family as shareholders, and 63% of those on the Board of Directors are also family members.

Figure 5. Family influences over the businesses it controls

Average number of family shareholders

9 shareholders

Family shares

91.60% of shares are held by the family

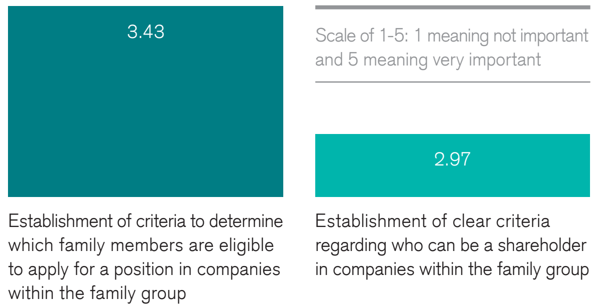
Board of Directors

63% of those on the Board of Directors are family members

We are therefore looking at wealth shared between several members of the same business family. In many cases, it is a question of accidental partnerships, in the sense that members of business families share the wealth with partners who they have not necessarily chosen, but who come about through family ties. They also have to share the management of a number of common assets with these partners. Therefore, one of the fundamental challenges of any transition process is helping families to establish the ground rules for managing this shared wealth effectively.

In this sense, the result shown in Chart 6 speaks volumes; it reveals the importance attached by those questioned in the transition process to establishing criteria for determining who can be a shareholder compared with establishing criteria for who is eligible to apply for a management position. Greater importance is given to the last point and this indicates that, for most families, the position of shareholder is an acquired right. What has to be regulated, therefore, is who is best able to manage this shared wealth, thereby avoiding future family conflicts.

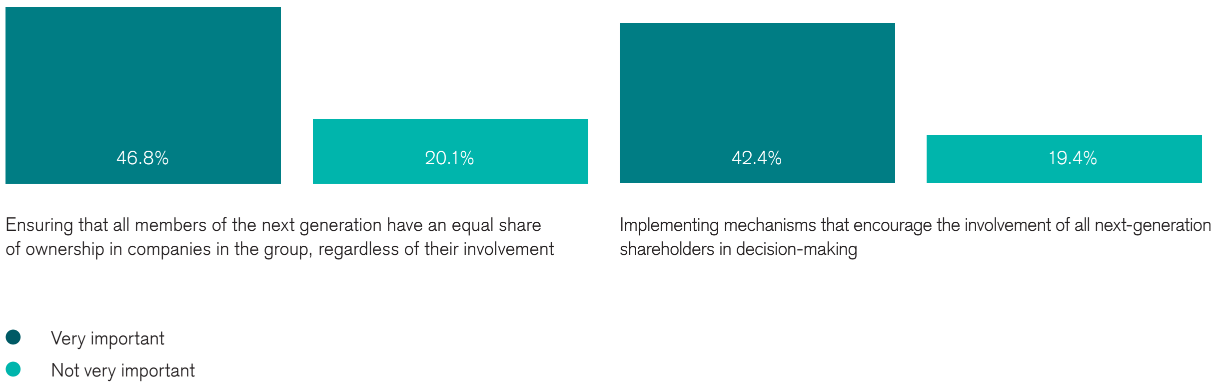
Chart 6. Choice of shareholders vs. managers



The transition process should help families to establish the ground rules for managing shared wealth in the most effective way.

Also revealing is the fact, as shown in Chart 7 (next page), that a high percentage (46%) consider it very important that the transition process ensures an equal share of ownership for members of the next generation. Similarly, there is a high percentage of families who attach great importance to the provision of mechanisms to ensure involvement of all members of the next generation once the transition is complete. So, the objective of families when embarking on the transfer of wealth is that it continues to be shared between the members of the next generation. The challenge, therefore, is to educate these new generations about the rights and responsibilities that come with this shared wealth, regardless of the position that they hold within the business family.

Chart 7. View on the importance of shared wealth



The transition process should teach all members of the next generations to be responsible owners, regardless of the position that they hold within the business family.
Similarly, it should educate the next generation about the rights and responsibilities of shared wealth.

What are the key elements to pass on in the generational transition process?

Once we have identified the various aspects of the wealth of business families and what implications these have for the transition process, the next stage is to identify the key elements to pass on from one generation to another.

To do this, we first asked the NEXT GENs in our survey to put the importance of passing on the following factors in order of priority:
1) An entrepreneurial mindset,
2) Family values,
3) Family control, and
4) Management skills.

As we can see in Figure 6, 34.8% believe that passing on an entrepreneurial mindset is a priority objective, while a slightly lower percentage, 30.4%, prioritize the transfer of family values over other objectives.

And what do the NEXT GENs understand by "transferring an entrepreneurial mindset"? Based on the interviews, in Table 2 (next page), we summarize what the NEXT GENs believe are the fundamental elements to preserve to keep the entrepreneurial spirit in the family. Some of these elements involve bringing about a change of mindset in the family, managing the approach to change in a more proactive way, while others refer to the implementation of tools to manage investment with more entrepreneurial methods, ensuring that the best resources are channeled to the best opportunities.

Figure 6. Order of importance of factors to pass on in the generational transition process

Table 2.

What does it mean to pass on an entrepreneurial mindset?

More effective management of family resources and investment	A proactive approach to change
— **Institutionalizing a filtering process which selects business opportunities related or not to the current business**	— **Proactively looking for new alternatives for investment**
— **Establishing a decision-making process which develops, puts into practice, and evaluates wealth-creating opportunities**	— **Adopting objectives focused on the creation of wealth (as opposed to survival) as part of a mindset focused on results**
— "Treat every business as if it was unique, analyzing its strategic potential"	— "Being able to anticipate the future, solving problems even before they arise"
— "Professional business management without losing the characteristics of family values"	— "Break out of our *status quo* and look for new sectors with potential for growth"
— "Being able to manage the wealth-creation cycle, making disinvestments when necessary and making investments that bring us value as a family"	— "Shape future generations as entrepreneurs, not just as successors"

The transition process should pass on an entrepreneurial mindset to the next generation, which means:

- Adopting objectives focused on the creation of wealth for generations and not just on survival as a family group
- Implementing tools that help to evaluate and analyze new investment opportunities in a more systematic way.

The process should also ensure the transfer of family values as an inextricable part of the family legacy.

Having discovered the key factors for the next generations and the challenges that they pose, our research then focused on understanding the gap that exists between what the new generations hope for and the factors that their families are working on with regard to generational transition. So, when we asked the NEXT GENs for the factors that are most important for their families when it comes to implementing the generational transition process, they unanimously agreed on giving greater consideration to the creation of mechanisms to keep control in the hands of the family, as well as helping in the financial planning behind the transfer of ownership (Chart 8).

Table 3 summarizes key elements that were not included in the survey, but which the NEXT GENs brought up time and again as key concerns for their families when it comes to implementing the generational transition process.

A number of concerns stand out, such as those relating to the provision of liquidity for family members, strengthening family unity in the face of an increasingly dispersed group, and the need of many of these families to keep a low profile, which makes confidentiality one of the main challenges in the process of transition to the next generation.

Chart 8. Important factors for families of the NEXT GEN during generational transition

Scale of 1-5: 1 meaning not important and 5 meaning very important

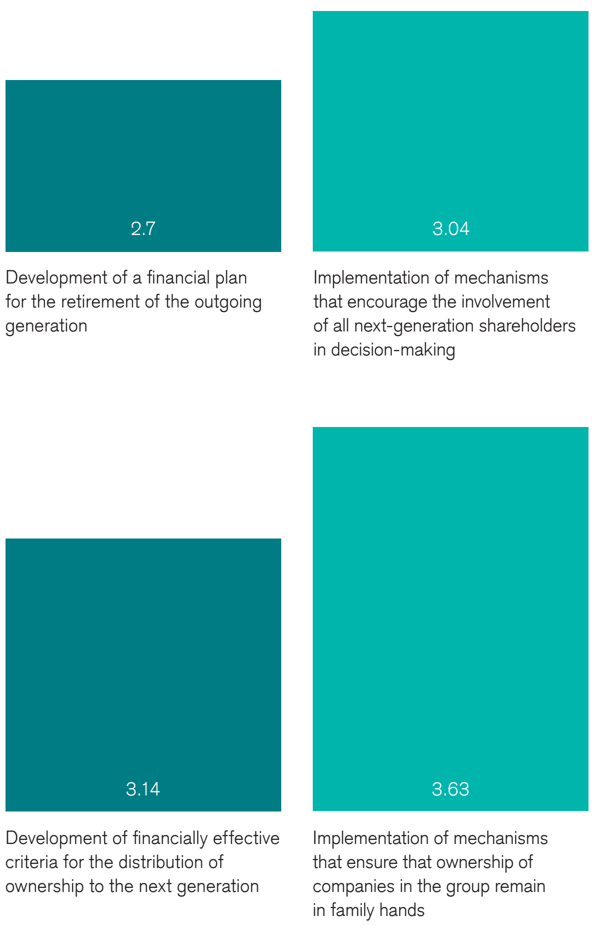


Table 3.

What are your family's key concerns when it comes to implementing the generational transition process?

- "How to maintain the same standard of living if there are increasingly more of us? That is our greatest challenge."
- "Security is a big issue. We want to continue to keep a low profile."
- "My father is concerned about keeping control within the family, but at the same time being able to meet the particular needs of each of his children. We are all very different…"
- "Years ago, we had a family drama which ended in a break-up because of a lack of common goals. Our concern now is how to achieve something that unites us, but at the same time allows each of us to go our own way."
- "For us, everything related to privacy is important… we are a family that is very well-known for what we do, but not for how we do it."

The generational transition process should help business families to solve the growth-liquidity-control dilemma. In other words, it should help them to create structures that are flexible enough to allow families to manage shared wealth effectively:

- **Generating enough wealth to meet the needs of the family in the long term**
- **Helping families to consolidate ownership in a way that facilitates transition to the next generation**
- **Allowing a certain level of independence between different members of the group.**

In addition, this has to be carried out ensuring a level of privacy for the assets managed by the family.

The challenge is even greater as the analyses carried out also indicate that lurking behind these average values are important differences that once again reflect the diverse nature of business families. So, for example, Chart 9 shows how the view of the NEXT GENs in relation to key aspects of the generational transition process vary from one business family to another, depending on the position held by members of the business family within the family business. Similarly, Chart 10 shows how the importance of these factors also varies depending on the generation to which owners of the family wealth belong. This poses a new challenge for the generational transition process, as it implies the need to achieve a vision embraced by all members of the business family as to what the objective of the wealth shared by the family group actually is.

Chart 9. Views on the key aspects of the generational transition process according to the role performed within the company

Scale of 1-5:
1 meaning not important
and 5 meaning very important

- Non-management shareholders
- Management shareholders
- Management Team + Board of Directors

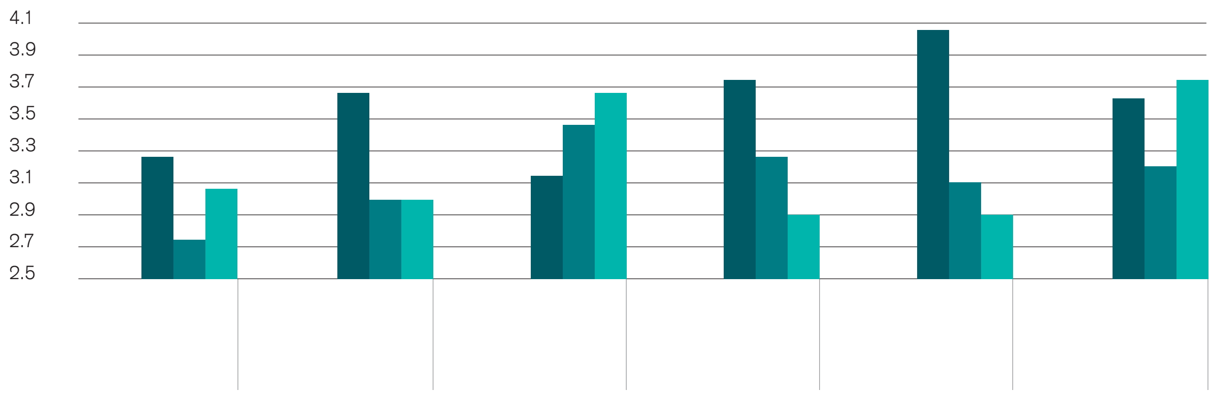
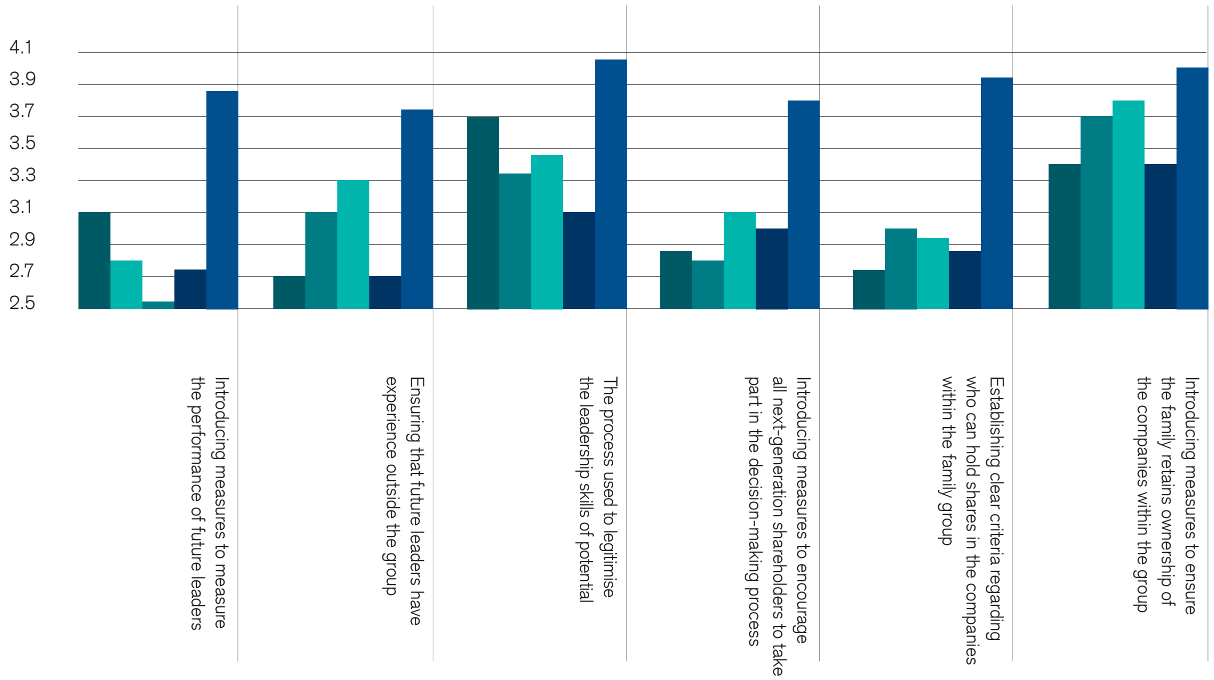


Chart 10. Views on the key aspects of the generational transition process according to the generation to which family owners belong

- 1st generation
- 1st and 2nd
- 2nd generation
- 2nd and 3rd
- > 3rd generation



An effective transition process should unite the family around common objectives in relation to its shared wealth.

A major challenge for business families: Transferring wealth without killing ambition

Through this research we found out that business families want to transfer much more than a set of assets to future generations. We also discovered that, according to the NEXT GENs, the transition process should not simply seek to maintain control of the family assets, but also to preserve the entrepreneurial spirit within the family, so as to be able to continue creating value over many generations. This is why we summed up the challenge faced by business families in terms of generational transition as "**Transferring wealth while keeping ambition alive**."

On the basis of this challenge, we identified two distinct areas for action. The first focuses on the actions to be carried out in order to change the mindset of members of the next generation (mindset). In this sense, the transition process should seek to achieve the following:

Mindset

— Create a transgenerational vision among members of the next generation, in which the success of the business family is defined not only as preserving its wealth from one generation to the next but also as creating value through the generations. This means:
  - Developing an entrepreneurial mindset where members of the younger generations proactively seek out new ways of creating wealth for the family
  - Switching from an operational mindset that is focused on family business, to an investment mindset that is focused on overall management of the family wealth

— Pass on the true meaning of the family legacy to the next generation, with the recognition that the wealth to be transferred is composed not only of financial elements, but also of social and emotional factors that give the family group its identity. The younger generations should strike an optimal balance between these two objectives, understanding that it is precisely this balance that gives the family group its competitive advantage

— Educate the next generations about the rights and responsibilities of shared wealth.
This means nurturing a more "proprietorial" mindset in the next generations rather than a managerial one, in order to produce "responsible shareholders" who understand their obligations as guardians of the family wealth. It also means educating them to understand the challenges of shared wealth and to reach agreement on common objectives regarding their joint property

The second area for action highlighted by the study relates to the tools (toolset) that should be used to achieve the following:

Toolset

— Families with more diversified wealth and more equally balanced risks, in which there is a clear distinction between the wealth of the company and the rest of the assets the family owns

— Families that are less personal and more professional, in which decision-making processes do not depend upon one group of individuals and family resources, are managed more professionally

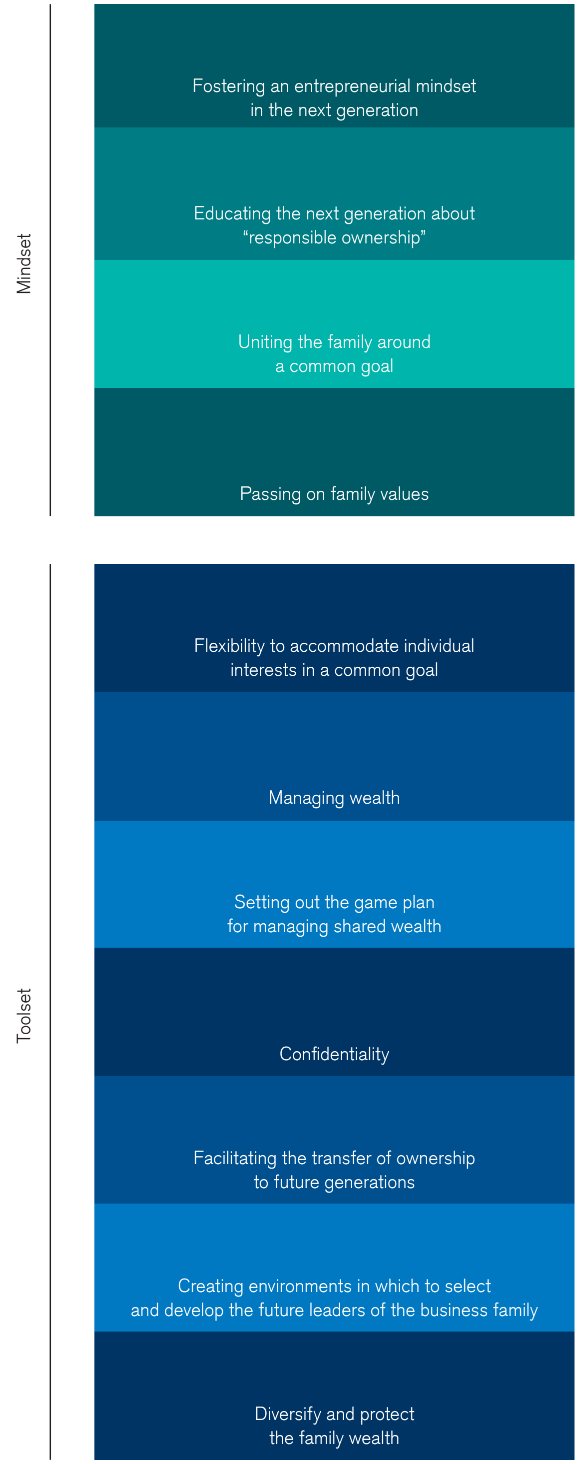
— Families that accommodate the individual interests of each of its members around a common goal

— Create environments in which families can select and develop their future leaders

— Facilitate the transfer of ownership to future generations and ensure that this is kept under family control

Based upon these actions, Figure 7 summarizes the KEY CHALLENGES faced by families in attempting to overcome the challenge of "Transferring wealth without destroying ambition."

Figure 7. Challenges faced by business families in the generational transition process



Solutions for transferring wealth without killing ambition

The challenges illustrated in Figure 7 (previous page) are complex, suggesting that the aim of "**Transferring wealth without killing ambition**" requires various solutions capable of changing the mindset of the business family members while at the same time providing them with the tools to successfully transfer ownership and leadership to the generations to come.

The second part of this White Paper focuses on identifying the solutions best suited to overcoming these challenges. As described in Figure 8, we have grouped these solutions into five main categories, each of which addresses one of the main challenges identified, highlighting the role of the Family Office as an effective tool for comprehensively managing the family wealth.

The purpose of this section is not only to explain what each solution involves, but also how each one fulfils the challenge of transferring wealth without destroying ambition.

Figure 8. Solutions for successfully transferring wealth without killing ambition

Game plan for shared wealth

The change in mindset from family business to business family requires the development of structures to enable social and emotional issues to be handled in appropriate forums, keeping them separate from purely financial issues. A decision-making framework is also required to help the family to align individual interests around a common goal, setting out the "game plan for shared wealth." To achieve these aims, we propose developing Family Governance, a Family Protocol, and a Shareholder Agreement.

1.1 Family Governance

Family Governance is a decision-making system, which helps the owner family govern its relationship with its wealth and its companies, and which manages its shared wealth more efficiently. The ultimate goal is to ensure that the family is capable of making rational economic and family-welfare decisions and to involve all members of the business family in the decision-making process, in accordance with the role they each play, while familiarizing them with the concept of "responsible ownership."

The following Family Governance structures are most often used[6]:

— **Family Assembly**
This collective Family Governance body has several purposes, depending on the size of the family and the level to which the family members are involved in management. The Family Assembly is usually a governing body that is instrumental to family communication and to maintaining the family legacy. The Family Assembly usually meets infrequently, with one or two meetings per year being the norm.

— **Family Council**
This is a more executive collegiate body that ensures compliance with the agreements reached by the family and incorporated in the Family Protocol or Constitution. It is usually the point of contact between Family Governance and the Governance of the company and/or the family wealth. This collegiate body typically meets more regularly than the Family Assembly, usually holding bimonthly meetings.

— In addition, a **Family Protocol or Constitution** should be drawn up, as this is an essential aspect of setting up Family Governance and of it operating properly. Given the importance of a Family Protocol or Constitution in transferring wealth from one generation to another, in the following section we provide further details of what this document is and what information it contains.

In any event, the nature of good Family Governance is not measured by the number of committees or representative bodies it has, but by how it helps the members of the business family to maintain the optimal balance between their financial wealth and their social and emotional wealth.
The aims of proper Family Governance include:

— Passing on the legacy of the family by setting out the family's vision, mission, and values

— Providing forums in which issues relevant to family members can be discussed, such as dividends, employment opportunities, benefits, and specific, important decisions. Even more important is the provision of separate environments in which to deal with the subjects of the company, the family and wealth

— Keeping family members, particularly those not involved in management, informed about business performance

— Establishing channels of communication covering all the family's intangible assets, whether these are ideas, networks, or business opportunities

— Identifying and training the leaders of the next generation

— Educating future generations about the concept of "responsible ownership." Teaching them to distinguish between the challenges presented by each facet of the business family: company, family, and wealth.

[6] For further information on Family Governance, the different mechanisms involved and Family Protocols, see: Credit Suisse White Paper "Family Governance: How Leading Families Manage the Challenges of Wealth."

1.2 Family Protocol and Shareholder Agreements

The Family Protocol — or Family Constitution — is a Family Governance document that governs the relationship between the family members, management team, and shareholders of a family company or group. The purpose of this document is to maintain harmony and preserve the family

The aim, content, and structure of the Family Protocol

The process of drawing up a Family Protocol should involve all generations of the business family and should consider their respective interests and concerns. This may be facilitated with the help of external advisors and mediators.

The business family should bear in mind that the most important aspect of a Family Protocol is not so much the final document itself as the agreements reached in drafting it. This is why it should be implemented at a time when family harmony is not affected by power struggles, lack of leadership, or financial strain in the business. Similarly, it is highly recommended that the Family Council, or a member of the family appointed specifically for his or her leadership qualities, assumes responsibility for disseminating and reinforcing the agreements included in the Protocol.

It is important to emphasise that the Protocol is a "living" document, meaning that the agreements reached will need to be reviewed and refined on a regular basis. In terms of content, there is no one single template for a Family Protocol, since it should be agreed by the members involved in the management of the company group and those who are not involved. However, when drafting a Family Protocol, families usually include the subjects set out in Table 4.

We should not make the mistake of thinking of the Protocol as simply a Shareholder Agreement, as its content is an essential component of the legacy that is handed down through the generations. However, although the Protocol usually has no legal standing, it does have a bearing on the legal documents, including articles of incorporation, buy–sell agreements, wills, and pre-nuptial agreements.
As the number of family shareholders increases and different generations become involved with ownership and management, it becomes increasingly important that all these documents are coordinated to ensure the legacy is preserved. In fact, what is set out in the Family Protocol is usually formalized into Shareholder Agreements.

Shareholder Agreements

A Shareholder Agreement is a contract in which the shareholders in a company set out their rights and obligations with regard to share ownership. The legal force of Shareholder Agreements varies from jurisdiction to jurisdiction, and even within the same jurisdiction the private or open nature of the company may confer upon it a different legal status. Having said that, Shareholder Agreements have proved to be highly effective tools for minimizing sources of conflict, especially those related to family wealth. On the other hand, the private nature of these contracts means that families prefer them over the option of including their agreements in the companies' articles of incorporation, which may be made public.

Among the information a Shareholder Agreement contains, the Share Transfer Agreement is essential for enabling ownership to be kept within the family. In this Agreement, families set out the rules governing the buying and selling of shares in the family group, restricting their transfer outside the family group by establishing, for example, rights of first refusal over these shares for branches of the family.

There is no one single template for a Share Transfer Agreement, as this will depend upon the nature of the family and the complexity of the wealth. However, nearly all agreements generally include provisions governing the three issues set out in Figure 9.

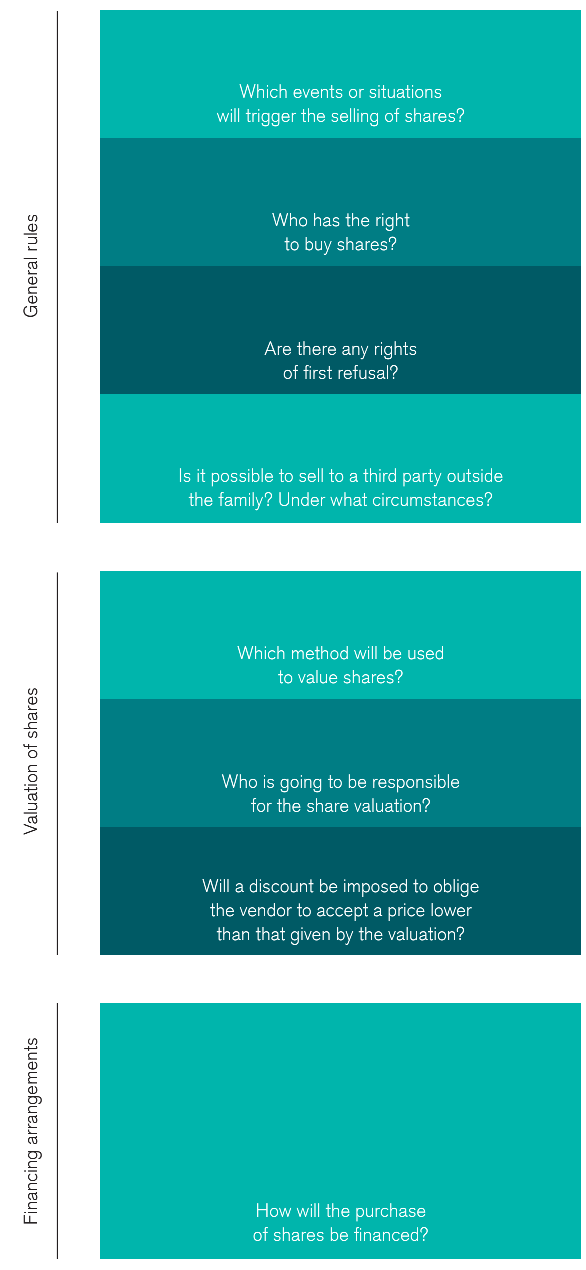
Table 4.

Contents of a Family Protocol[1]

01	**Mission and vision** — The family's vision, the nature of its commitment to the firm. Continuity
02	**Values** — The family's values in its relations with customers, employees, partners, etc.
03	**Family brand** — The family's behavior towards the company and its management
04	**Employment policy** — The requirements that family members need to meet in order to be employed
05	**Next generation development** — The procedures guiding the education and professional development of the next generation.
06	**Ownership policy** — Share ownership, share classes, and ownership transfer policies are defined
07	**Capital funds** — Funds allocated to sponsor the development of new ventures are discussed
08	**Dividends and benefits policies** — A guide to the expected returns on invested capital
09	**Liquidity policy** — Discussion of business valuation, buy-sell agreements and redemption funds
10	**The board of directors** — Its characteristics, functions and operating procedures are described
11	**Family council meetings** — Description of their purpose and primary functions

[1] White Paper Credit Suisse. "Family Governance: How Leading Families Manage the Challenges of Wealth."

Figure 9. Contents of a Share Transfer Agreement



Challenges addressed by Family Governance, Family Protocol, and Shareholder Agreement

Table 5.

Setting out the game plan for managing shared wealth They establish a series of entry and exit rules and family policies for joint management of the ownership of assets controlled by the family. They set out guidelines on potential conflicts of interest or lack of agreement between family members.	**Educating the next generation about the concept of "responsible ownership"** The distinction between wealth, business, and governance helps each family member to make a better choice in terms of their role and responsibility within the business family.
Achieving a more professional management of assets They establish requirements for those who can manage the family assets and those who cannot. They make financial information more transparent and reliable. They promote the growth and development of family assets in a simpler and more orderly way.	**Facilitating the transfer of ownership to future generations** They facilitate the transfer of ownership to future generations by establishing the rules that govern share transfers and setting out a succession plan. They can also help the family to retain control by creating restrictions on share transfers, if the family members so choose.
Uniting the family around a common project They provide forums for discussion of the family's vision and set it out in a written document. They establish channels of communication between all the owners.	**Fostering an entrepreneurial mindset[2]** They establish clear policies on supporting new projects within the family group.
Passing on family values They act as a vehicle for transferring family values to future generations by adopting the role of guardian of the family wealth and facilitating the generational transition process.	**Creating environments for the selection of future leaders** They set out actions for the education and professional development of members of the next generation.
Flexibility to accommodate individual interests They provide forums for discussion in which "individual aspirations" can be transformed into shared goals. They set out dividend policies and mechanisms for the buying and selling of shares.	

[2] Although this has not traditionally been a function of Family Governance, which focuses more on retaining control and family values, one of the main conclusions of our research was that the NEXT GENs perceive the need for change towards a greater emphasis on transferring the entrepreneurial spirit. It is, therefore, our opinion that one of the challenges is how to redeploy these mechanisms to help business families to develop an entrepreneurial mindset in the generations to come, without losing their more traditional function.

Structures for consolidating family ownership

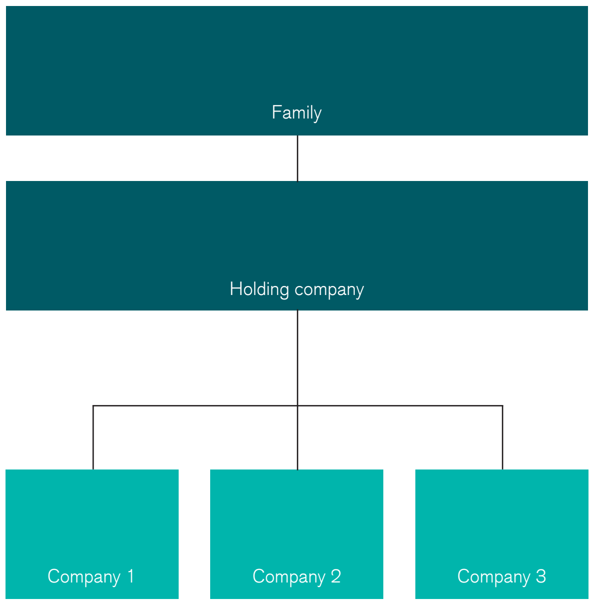
Protecting and managing the family wealth professionally has proved to be the key concern for business families when it comes to generational transition. It is important to develop mechanisms to facilitate transition without undermining the creation of value across the generations.
As described in this section, family holding companies and trusts are an appropriate means of achieving these aims, as they are mechanisms that make it possible to consolidate the family assets within a single structure.

2.1 Holding Companies

Business growth often leads to the creation of family business groups, where the family owns various companies as individuals, often with cross-shareholdings between them. This structure creates various problems for the efficient management of the group, incurs higher costs and tax liabilities, and is an obstacle to the development of new initiatives. Under these circumstances, creating a holding company that holds shares in the capital of subsidiary companies could be one of the most appropriate options for business families.

A holding company is a company whose business consists of holding shares in other companies in order to direct and manage those holdings. The holding company has direct or indirect control over the subsidiaries or may even form a tiered chain of companies.

Figure 10. Structure of a holding company



Structure and formation of a holding company

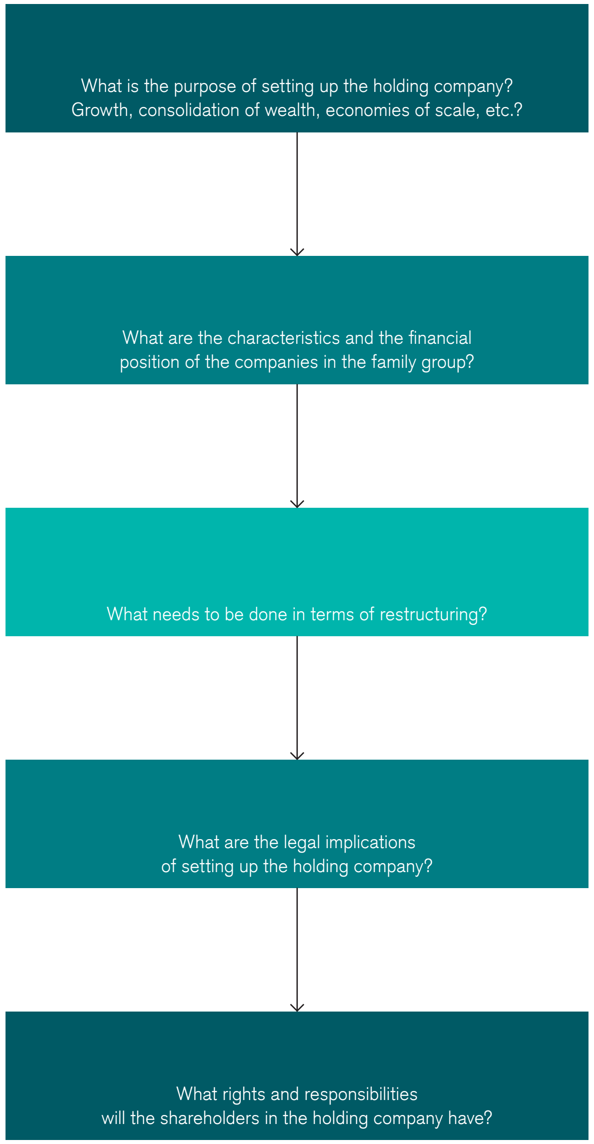
Figures 10 and 11 show the structure and the process for setting up a family holding company. The family holding company is set up by the family members, who contribute to the holding company the shares they hold in the different companies that are to come together under the single management of the holding company. The family members cease to be the owners of the individual family companies, but become shareholders in the holding company, which acts as the lead company in the group.

Figure 11. Process for setting up a holding company

First steps
A business family seeks to reduce the level to which its wealth is exposed to risk and to optimize its structure, since it consists of a network of companies that have emerged as a result of initiatives on the part of different family members.
Formation of a holding company
A new company is formed with contributions of the company shares held by the family members in the various companies that are to be consolidated under the holding company, via an exchange of securities. Through this exchange, the family members receive shares in the holding company.
Characteristics of a holding company
The companies are directed centrally by the holding company, which sets the operating, financial, economic, and even wealth strategies for the owners. The holding company also provides services to the various subsidiaries, to take advantage of economies of scale.

Despite the advantages of forming a holding company, they are costly to set up. More importantly, inefficient management and administration of the holding company can give rise to numerous disadvantages, such as: under utilized resources, over-capitalization of the holding company, under valuation of the holding company for loans granted to the subsidiaries, inefficient information flows, and internal rivalries. For this reason, business families should seek professional advice before setting up a holding company and should think about the following questions:

Figure 12. Questions to ask before setting up a holding company



Challenges addressed by a holding company

Table 6.

Diversifying and protecting the family assets It reduces the family's risk by separating personal wealth from company wealth. It makes it easier to diversify and take in new shareholders by creating new companies or acquiring holdings in existing companies.
Achieving a more professional management of assets It provides organizational synergies. Creating an overview of the group improves access to finance. It enables resources to be focused on where investment is needed and facilitates divestments whenever necessary.
Setting out the game plan for managing shared wealth The family business's own measures (Protocols, Family Councils, etc.) across the company's governing bodies are more easily adopted.
Educating the next generation about the concept of responsible ownership It helps the members of business families to learn to share wealth, by providing centralised and coordinated direction for all the family's companies.
Developing areas for the selection of future leaders It helps to apportion responsibility within the family group. The holding company represents the family as a whole, while some of its members are involved in managing the companies that form it. This also helps the younger generations to gradually take on responsibilities within the group.
Facilitating the transfer of ownership to future generations By consolidating the family assets under a single structure, the holding company makes it much easier to transfer ownership to future generations.

2.2. Trusts

A trust is an agreement under which one person (the settlor) transfers ownership of a range of assets to another person (the trustee) for them to manage for the benefit of a third party or parties (the beneficiaries).

It involves a fiduciary relationship in which the trustee holds title to certain property and assets and is obliged to manage them, together with anything they yield, for the benefit of those persons designated as beneficiaries.

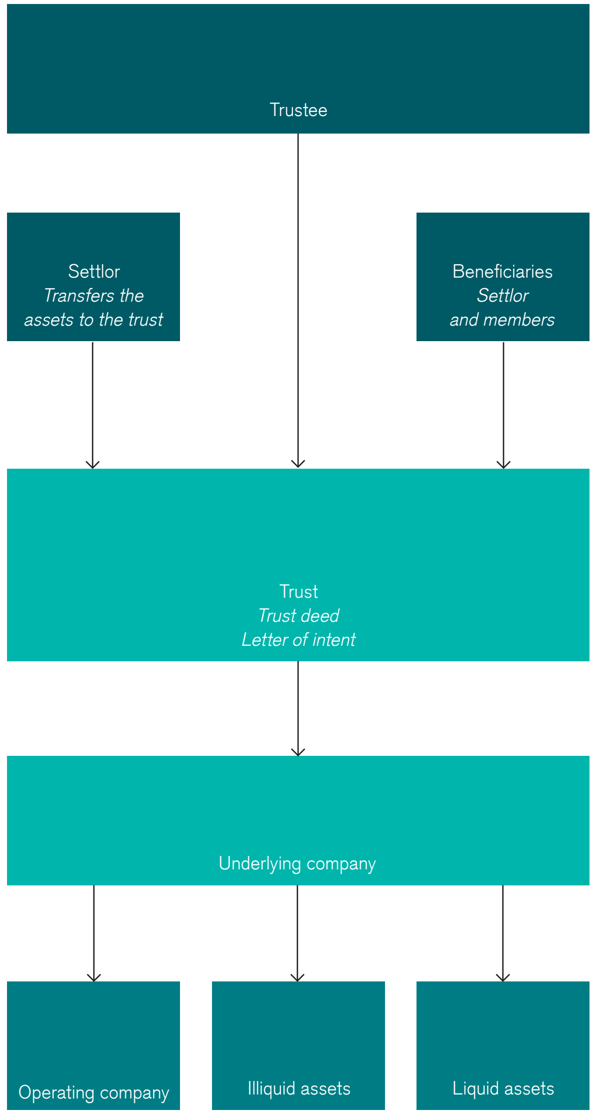
A trust is a legal structure associated with common law and is much more prevalent in most common law countries than in countries with civil law systems where the concept of ownership is different (the majority of countries in Europe and Latin America). Nevertheless, trusts are being used with increasing regularity by business families in these countries[7].

Structure and formation of a trust

Figures 13 and 14 show the structure and the process for setting up a trust. A legal document called a "trust deed" governs the operation and duration of the trust.
The settlor's intentions in respect of the characteristics of the trust, such as the way in which the assets are to be managed and distributed to the beneficiaries, are set out in a "letter of intent."

The responsibilities of the settlor, trustee, and beneficiary are different. The trust's assets are usually held by an underlying company and not directly by the trust.

Figure 13. Structure of a trust



[7] Along with trusts, private foundations are also available in some jurisdictions. These enable families to achieve similar objectives.

Figure 14. Process for setting up a trust

First steps

An individual or company with assets (settlor) seeks to address the following requirements:

— Estate planning
— Protection of assets
— Consolidation of assets
— Confidentiality
— Succession planning

Formation of the trust

— The beneficiaries of the trust are determined
— A trust is set up in order to preserve the wealth generated and to address the stated requirements
— The trust documentation will set out the rules for distribution
— A company is set up, which owns the trust's assets
— A trustee is appointed to manage the trust

Characteristics of the trust

It is possible to include the role of protector in the structure of the trust, to provide support to the trustee for carrying out his or her duties and to safeguard the interests of the beneficiaries. If a protector has been appointed, the trustee will require the protector's agreement in order to change a number of aspects in connection with the trust, such as, for example:

— Changes to the statutes governing the trust
— Changes to or removal of the trustee
— Distributions made to beneficiaries
— Changes to, addition or removal of beneficiaries

Types of trust

There are different types of trust, including revocable trusts as opposed to irrevocable ones and discretionary trusts as opposed to fixed ones (Figure 15).

Figure 15. Types of trust

Revocable trust

— The settlor reserves the unconditional right to revoke all or part of the trust at any time
— Once the assets are transferred to a revocable trust, they are no longer owned by the settlor
— Although legal title to the assets has been registered in the name and on behalf of the trustee, they are held by the trustee for the benefit of those persons designated as beneficiaries

Irrevocable trust

— The settlor has no power to revoke the trust
— Once the assets are transferred to an irrevocable trust, they are no longer owned by the settlor
— Although legal title to the assets has been registered in the name of the trustee, they are held by the trustee for the benefit of those persons designated as beneficiaries

Discretionary

— The trustee has the right to decide how the trust's assets should be distributed and/or to choose who should be the beneficiary of the assets

Fixed trust

— The trustee has no right to decide on the distribution of the trust's assets. The beneficiaries and their interests are determined in advance.

Despite the advantages of using a trust as a wealth management tool, a trust is a complicated instrument and is costly to set up. It is important to seek professional advice before setting up a trust due to the numerous legal implications involved, and to answer the following questions, among others:

Figure 16. Questions to ask before setting up a trust

What are the family's goals?
↓
Who will be the beneficiaries?
↓
What type of trust will be set up?
↓
Which assets will be transferred to the trust?
↓
Who will be the trustee?
↓
For how long will the trust operate?

Challenges addressed by a trust

Table 7.

Protecting the family wealth
The purpose of a trust is to protect wealth. It seeks to protect the wealth from a temporary or permanent lack of capacity on the part of the owners, for their benefit, but also from potential business-related capital liabilities. Trust property cannot be seized against liabilities that are unrelated to the purpose of the trust and do not form part of the matrimonial property of the beneficiaries or the wealth of the trustee.

Through the trust, the family ensures that its succession plans will be carried out as it intended, reducing the risk of conflicts regarding inheritance.

Achieving a more professional management of assets
Consolidating assets within a trust helps them to be managed more efficiently.
The appointment of an external trustee (corporate trustee) protects the family from the risks of nepotism. Similarly, appointing a protector will help to monitor the duties carried out by the trustee.

Confidentiality
There is no public record of a trust, which helps families to keep private the details of their arrangements for transferring wealth.

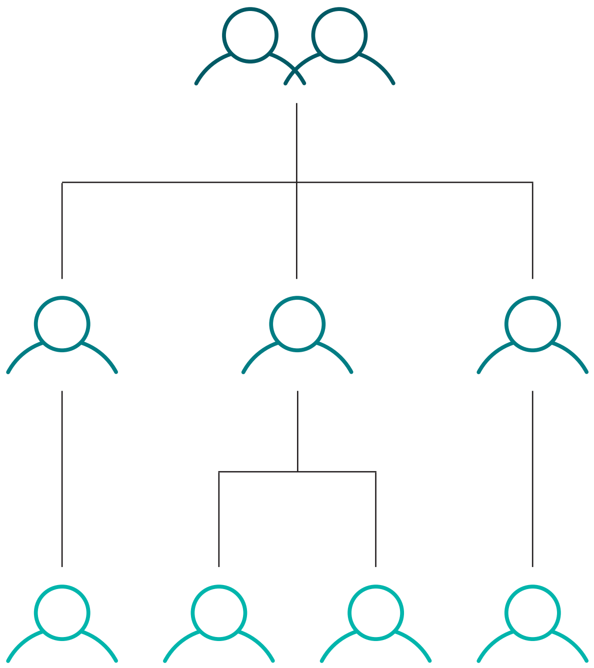
Case study 1

Family History
In 1973, Mario Gutiérrez founded a textile company in Mexico called VESTIMENT SA. The beginnings were complicated by the lack of economic resources, but thanks to Mario's enterprising and persevering spirit, after ten years, VESTIMENT expanded to all Central American countries.
Following the rapid growth and internationalization of the company, Mario decided to open new lines of business in order to spread the risk.

During this time, Mario had three children, who, after completing their university studies, decided to start working in the business. Today, Mario's efforts have paid off and the family business is one of the most successful in the Latin American sector. Mario Gutiérrez currently owns the following portfolio of assets:

— All of the shares of the family business
— Liquid assets in several bank accounts
— Several real estate properties
— An art collection

After a long period of reflection, Mario has decided to retire as it is now time for the next generation take over.
Mario's decision raises many questions in the Gutiérrez family about the best way to perform the generational transition and maintain control of the business.
Therefore, based on the advice of several friends who have gone through similar processes, Mario decided to seek advice with the aim of finding the right mechanisms for preserving and strengthening the family assets.



The Family's Objectives
In order to implement the mechanisms that meet the family's needs, the Gutiérrez family's medium- and long-term objectives have been identified:

— **Consolidation of assets**
"We want to effectively and professionally manage different types of assets – both liquid and illiquid – in a single family structure."

— **Succession planning**
"Our desire is to consolidate the family property and for the second generation to receive equal shareholdings. On the other hand, we want to ensure that future generations receive a quality education and are protected in the event of any disability, whether temporary or permanent."

— **Flexibility**
"We want the distribution of shares and assets to be flexible based on the profile of the various generations."

Solution: Trust-holding Structure
Given the Gutiérrez family's objectives, one of the most efficient mechanisms for serving the business family's interests is the trust-holding structure.

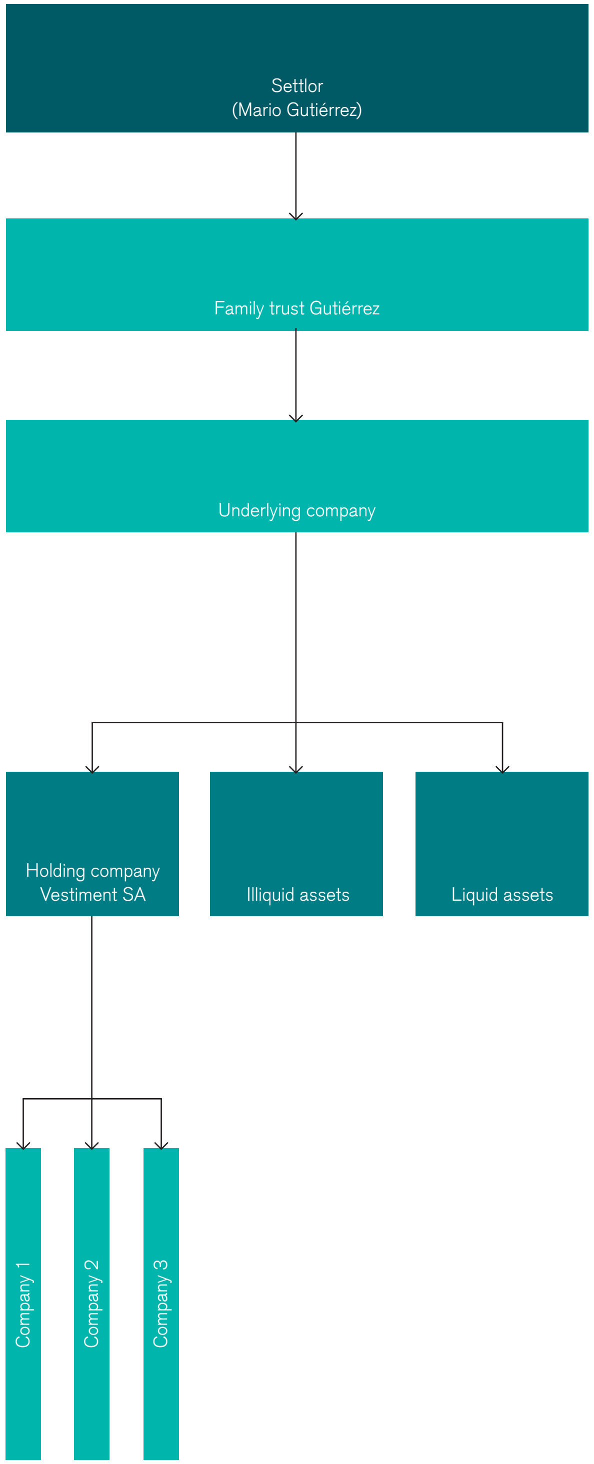
How would the scheme be established?

1
Mario (settlor) transfers legal ownership of his portfolio of assets to a trust administrator (trustee), so that he/she can manage it for the benefit of his children and grandchildren (beneficiaries).

2
In the "letter of intent," Mario will establish how he would like the trustee to manage the trust, including who the beneficiaries will be and how the assets will be distributed according to the family members' needs.

3
The trust will be composed of the following asset portfolio:
— A holding company created to bring together all of the Gutiérrez family's companies. Mario's three children will be part of the Executive Board.
— Illiquid assets
— Liquid assets

Added value: objectives met
— Professional management of the assets in a single family structure
— Consolidation of family assets
— Estate planning
— Legacy protection
— Flexibility in the distribution of assets



Legacy preservation through philanthropy: the Family Foundation[8]

As a family's estate grows, many feel a strong desire to use part of their wealth to benefit others, by giving something back to the community or supporting a social cause that they consider to be important. Family Foundations are a very effective mechanism for achieving this[9].

Philanthropic activities carried out by the foundation are usually related to a cause to which the family has a personal and emotional bond (e.g. support for research into a type of illness suffered by a family member). Many are also focused on helping to develop the geographical area where the family business was set up. In all cases, there is a strong emotional bond between the family and the philanthropic activity being carried out. That is why foundations are an excellent way to pass on values and the family legacy to future generations of family businesses, aspects that have proven essential in the process of generational transition, according to research conducted in the first part of the White Paper. Figure 17 summarizes the process of establishing the philanthropic Family Foundation.

A foundation is a legal entity that is established based on the assets of a person or company for philanthropic purposes, which are set out in its founding charter.

Figure 17. Process of setting up a Family Foundation

First steps

A philanthropic Family Foundation addresses the following challenges of the business family:
- Uniting the philanthropic interests of the various members of the business family
- Passing on values and the family legacy to future generations

Establishing the foundation

The business family donates a number of assets to the foundation, which becomes the owner of them.
The founder decides who the potential beneficiaries of the foundation are and what benefits they are to receive.
The founder's intentions must be written in the foundation's by-laws.

Particular features of the foundation

The foundation aims to preserve the founder's philanthropic wishes and legacy over time. In most cases, the founding donor or some of the founding donor's descendants are involved in managing or administering the foundation.

[8] To learn more about business families and philanthropy, see: Credit Suisse White Paper: "Funding as a Family: Engaging the Next Generation in Family Philanthropy."

[9] Depending on the jurisdiction, business families may also establish the family's philanthropic wishes and objectives by creating a philanthropic trust.

As in the case of a trust, establishing a foundation can generate high costs and its administration, regulation, and organization can be complex.

For this reason, before establishing a foundation and in order to have a positive impact both on society and on the business family itself, the following questions must be addressed:

Figure 18. Questions to ask before setting up a Family Foundation

Why establish a foundation?
Is the foundation the right means to develop the family's philanthropy?
↓
What are the family values that will guide the philanthropic activity?
↓
What will the social purpose of the foundation be?
↓
What financial resources will the foundation have?
↓
How will the social impact of the foundation be measured?
↓
How will the members of the family be represented in the Board of the foundation?

Challenges addressed by a Family Foundation

Table 8.
Uniting the family around a common project The foundation becomes the mechanism that coordinates all of the family's philanthropic activities, which must agree on several shared objectives. It acts as a link between the various family members.
Passing on family values It makes it easier to hand down the family's philanthropic vision from generation to generation, encouraging the creation of a family legacy.
Educating the next generation on the concept of "responsible ownership" Establishing a foundation to which the family altruistically allocates resources, enhances the education of new generations in social responsibilities, and teaches them to work together.
Developing areas for the selection of future leaders It is an ideal space for new generations to begin to take on responsibilities within the family.

Creating a "transgenerational vision" through the roadmap of family assets

The change from an operational mindset, focused on family businesses, to an investment mindset focused on global wealth management, first requires "the roadmap of assets" to be established, where the foundations are laid that will guide the family's investment strategy, as well as the best investment vehicles for carrying out this strategy.

3.1 Investment strategy

There are many types of investment strategies and types of business families. However, certain elements of this strategy are common to all families wishing to create value through generations.

The aim of the investment strategy is to develop a mindset that is focused more on investments and less on operations among members of the family business by establishing a comprehensive view of family assets and long-term objectives. Over time, the growth of the family and distinct involvement of its members in the management of the group's assets means that the objectives for shared assets are increasingly diverse. Establishing the investment strategy helps families to combine interests around these assets.

When determining the investment strategy, it is important to know your objectives. They must be consistent with market expectations, given that the higher the desired profitability, the more risk there is to be incurred.

It is also important to be familiar with the risk profile of the business family in order to implement a personalized investment strategy. This first requires determining the family's risk capacity, through the "asset map," where the financial situation of the business family members is shown.

Then, the risk tolerance (the risk that the family is willing to assume) and risk awareness (subjective assessment performed by the family of the measurable risk, or objective risk) must be established. All of this is laid down in the investment policies. Choosing an effective investment strategy is useful both for the consultant – as it allows a better understanding of the client – and the clients, since they benefit from greater knowledge when making an investment.

Finding the appropriate risk profile for the investor is probably the most important aspect of investment consulting.
The family's risk profile, along with the values and principles of the investment strategy, will define the strategic asset allocation on which the business family's investment portfolio is built. Lastly, when constructing the investment portfolio, it is important to take into account constraints, such as: the time frame, tax considerations, required liquidity, and any unique circumstances that may arise.[10]

[10] To learn more about the investment strategy, see: Credit Suisse White Paper "Behavioral Finance. The psychology of investment."

Figure 19 summarizes the steps that every business family should review when deciding on their investment strategy.

Figure 19. Steps for establishing an investment strategy

1 Creating the asset map

What assets do we have?
Why do we want them?
Who are the beneficiaries of these assets?

2 Defining the investment philosophy

What values and principles will guide the investment strategy?

3 Establishing investment policies

What is the time frame of the investment?
What is the family's risk-return profile?
What are the investment objectives?

4 Building the investment portfolio

What kind of sectors to invest in?
What kind of assets?
What currency?
For what time frame?

5 Periodically reviewing the performance and objectives of the portfolio

3.2 Investment vehicles

Depending on the objectives set out in the investment strategy, and given the risk profile of the business family and degree of sophistication of their assets, different investment vehicles will be set out. These vehicles can range from creating custom-made funds that satisfy the various interests of the business family members (Funds Family), to in-house programs to support family entrepreneurship (Family Seed Capital).

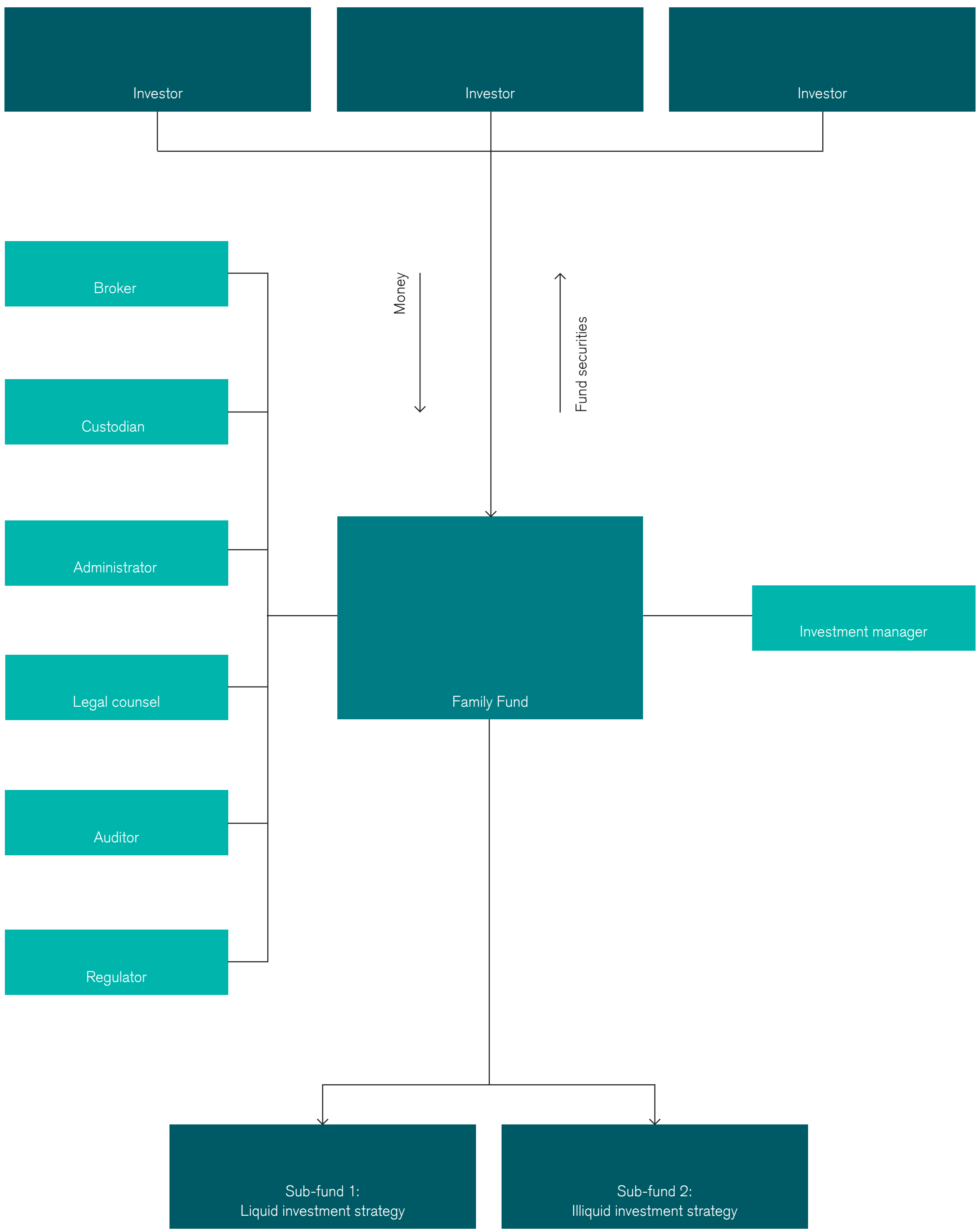
3.2.1 Investment funds tailored to the family: Family Funds

For families with a high net worth, it may make sense to create a "tailored" fund, based on the business family's objectives and needs, called a "Family Fund."

"Family Funds" are customized regulated investment vehicles that allow the assets of several business family members to be jointly invested.

The Family Fund works like any other investment fund (Figure 20), although its structure is determined by the desires of the family. The family decides who the investment manager will be and who will make investment decisions on behalf of the fund's owners. The operation of the fund can be as simple or as complex as the family decides. On many occasions, what begins as a joint venture between several siblings eventually becomes a fund through which different families invest. Joint investment offers numerous advantages in terms of economies of scale and more diversified portfolios. However, it also requires clear rules to be established for combining investment strategies and setting policies for the entry and exit of investors.

Figure 20. Structure of the Family Fund



Challenges addressed by a Family Fund

Table 9.

Diversifying and protecting the family assets The institutional nature of the fund provides access to products that are otherwise not available to these investors. Each owner has a clearly-established share of the fund, but not of its underlying assets, thereby protecting them from any event that may occur to family members (i.e. divorce, death, disability, court trials, etc.).	**Facilitating the transfer of property to subsequent generations** The fund shares are relatively easy to divide and transfer.
Achieving the more professional management of assets The involvement of external professionals (auditors, administrators, etc.) in the fund management ensures a high level of transparency and monitoring of the fund's performance. This presence, together with the existence of a clear investment strategy, reduces the possibility of disputes between family members in relation to the management of the fund's assets. The value of each family member's fund shares is set by an external manager. This reduces the possibility of family conflict over the value of assets corresponding to each member. By objectively and transparently setting investment conditions, the fund simplifies the entry of investors who are external to the family. Joint asset management allows economies of scale and access to lower commissions, given that custodial services, brokerage etc. are carried out at fund level.	**Confidentiality** By investing through a regulated vehicle, rather than individually, the Family Fund allows the family to maintain a more private profile on their investments.
Flexibility to accommodate individual interests in the common project Although the family consolidates its assets in the fund to receive the above-mentioned benefits (economies of scale, etc.), this allows each family member to invest according to their liquidity preferences and/or needs. Under the umbrella of the fund, the family can create different sub-funds for different investment strategies. It allows each family member to decide how he/she will be involved in the fund's management (on the Board, as a manager, etc.). If members do not agree with the decisions, they can sell their shares without affecting the shared assets.	**Uniting the family around a common project** Creating the fund requires the investment strategy to be established, which involves clearly defining the family's objectives and the roles of each of its members.

3.2.2 Programs supporting family entrepreneurship: Family Seed Capital

Business families can encourage entrepreneurship among the members of subsequent generations by supporting the development of the entrepreneurial initiatives of some of the family members with their own financial resources. On many occasions, this Family Seed Capital comes about informally, but as the family grows, it is advisable to "institutionalize" the process, establishing clear rules on what projects will be funded, through which instruments, and how the development of the new business will be monitored. That is why many families choose to establish a formal program to support family entrepreneurship.

Through a program to support family entrepreneurship, the business family finances the development of entrepreneurial projects, usually promoted by members of the younger generations following a mutually agreed process.

The objectives of the program to support entrepreneurship must fit within the family's investment strategy, thereby avoiding any possible inconsistencies between new projects and the outlined roadmap of assets. Sometimes families opt to express this program to support family entrepreneurship within its Protocol.

The program should be designed so that new generations perceive the Family Seed Capital as an opportunity, rather than as a right. For this reason, it is very important to establish clear requirements for qualifying for this capital, as well as the mechanisms for monitoring the performance of the projects financed and their respective risks.

Based on these, although there is no single structure for carrying out a program to support family entrepreneurship, we recommend the following process:

Figure 21. Process for establishing Family Seed Capital

1. **Defining the objectives of the program supporting entrepreneurship as part of the business family's investment strategy**
2. **Establishing the amount of funds to be devoted to the program, the instrument through which it will provide funding, and the funding conditions**
3. **Defining what kind of projects are likely to be financed and what kind are not, as well as the requirements to qualify for such funding (presentation of a business plan, minimum and maximum investment, etc.)**
4. **Establishing a Committee, for example within the Family Board, which is responsible for approving and reviewing the performance of entrepreneurial initiatives**
5. **Establishing a plan of action in case of any non-payment**

Challenges addressed by Family Seed Capital

Table 10.
Diversifying family assets Financial support for the development of new entrepreneurial initiatives allows the business family to diversify its assets and explore opportunities in other sectors without jeopardizing the core business.
Promoting an entrepreneurial mindset among the next generation The new project is not only a potential source of wealth for the family, but also an excellent school for younger generations in their training to become the future owners of the family assets.
Flexibility to accommodate individual interests in the common project By explicitly supporting the development of new projects, the family manages to attract members of the younger generation and unite them around the common project, while giving them freedom to exercise their chosen role.
Developing areas for the selection of future leaders Supporting entrepreneurial business initiatives with family resources helps to create a space that facilitates the selection and development of the family's future leaders.

Comprehensive wealth management through the Family Office

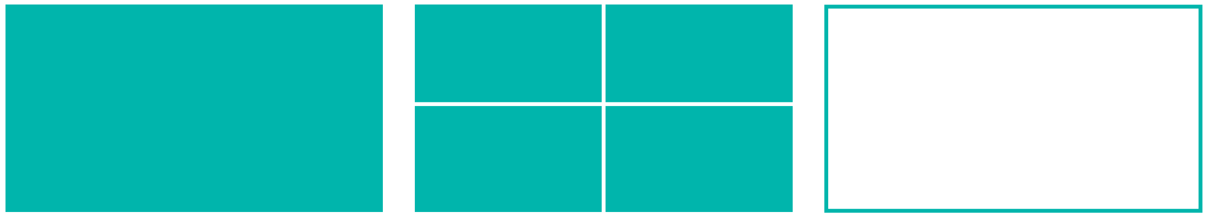
As shown in the first part of the White Paper, the change of mindset from a family business to a business family involves introducing mechanisms for globally managing assets, in order to seize all opportunities to create wealth. In this White Paper, we propose the "Family Office" as an ideal instrument to comprehensively manage the assets of a business family.

A Family Office (FO) is an entity designed to comprehensively manage the assets of one or more families, whether they are liquid assets, property, or assets invested in a family business, making their improvement, conservation, and benefits cohesively compatible among all family members.

There are several types of Family Office, including the following:

Figure 22. Types of Family Office[3]

Single Family Office (SFO)	Multi-Family Office (MFO)	Virtual Family Office (VFO)



Single Family Office (SFO)	Multi-Family Office (MFO)	Virtual Family Office (VFO)
An SFO is a private company that manages the financial affairs of one family. Its model and activities vary depending on the level of wealth, the complexity of the family, and the services that the family requires, as well as on the range of assets to be managed.	An MFO manages the financial affairs of several families, which are not necessarily connected. The services offered may be numerous and vary widely depending on the characteristics of the family assets.	Families looking to receive the benefits of an FO without establishing one, can opt for a VFO. Through a VFO, the services of a FO are outsourced to consultants or external service providers.

[3] Source: Credit Suisse, White Paper, "Family Governance: How Leading Families Manage the Challenges of Wealth."

Figure 23. Family Office Services[4]

[4] Source: Credit Suisse, White Paper, "The Family Office Dynamic: Pathway to Successful Family and Wealth Management."

Functions

FO functions develop as the assets to be managed become more complex. In many cases, the process of generational transition triggers the need to create an FO that covers a greater number of services to meet the growing and diverse needs of the business family. The main function of any FO is to manage investments that make up the family assets, allowing a clear separation between operating assets – which are linked to the family business, if any – and financial assets. The FO will manage the family's investments based on the roadmap that it lays out.

Additionally, the FO also provides other services, as shown in Figure 23. These include some of the services described in this White Paper, such as carrying out Family Governance and philanthropic activities through the Family Foundation, and effectively managing assets. This makes the FO a key element for the comprehensive management of a business family's assets, establishing a structure that channels all activities related to the management of these assets.

Using any type of Family Office provides numerous benefits to family businesses, since it not only provides protection for family wealth, but also, increasingly, it provides protection for the family's human and socioemotional capital.

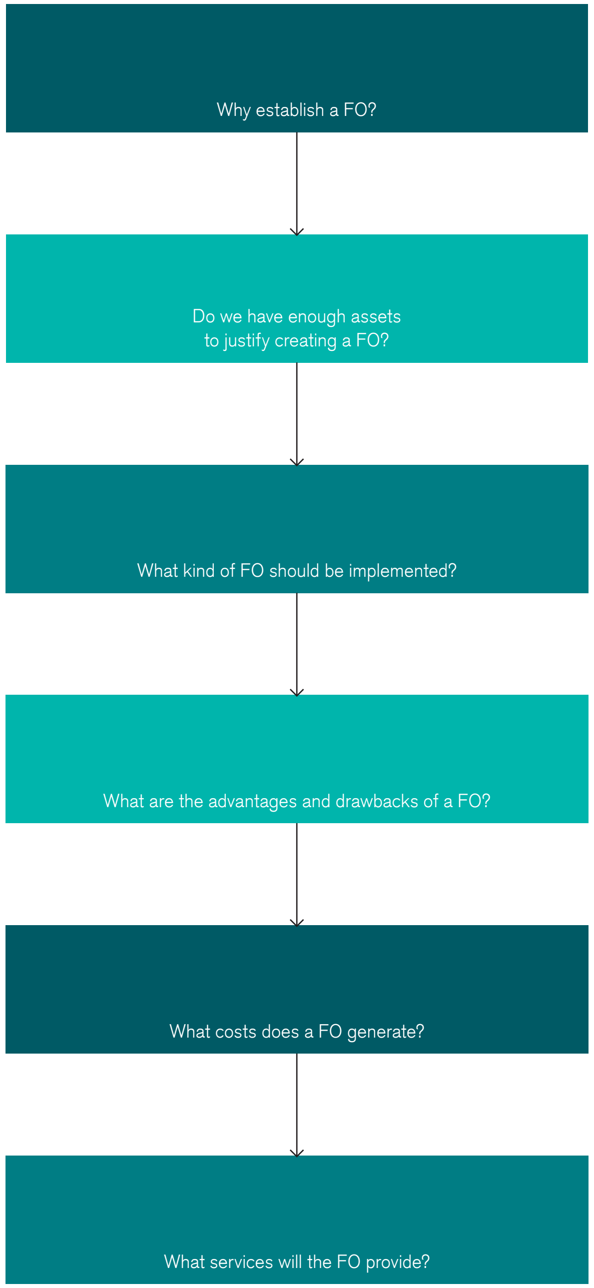
Despite the advantages of having a Family Office, there are costs involved in its implementation. As such, it is necessary to carefully analyze the cost-benefit, particularly in relation to in-house processes vs. outsourcing. For this reason, it is highly advisable to go slowly and incorporate services into the Family Office, deliberately increasing its structure in a way that mirrors the increasing complexity of the assets to be managed.

Challenges addressed by a Family Office

Table 11.
Achieving the more professional management of assets Depending on the needs of each family, the FO comprehensively offers business families a wide range of services, thereby providing more efficient asset management.
Diversifying and protecting the family assets Creating a Family Office allows a separation of – or at least a distinction between – the family business and family assets. It helps to diversify the family assets by enhancing the pursuit of new investment opportunities without risking the “core assets.”
Flexibility to accommodate individual interests in the common project Investment planning is carried out while taking into account the risk-return profile of the various generations, as well as their liquidity needs.
Educating the next generation on the concept of responsible ownership It helps to educate family leaders on financial matters. It provides management and governance structures that can transparently handle the complexities of family wealth, helping the family to avoid future conflicts.
Confidentiality Confidentiality is guaranteed in an FO since the asset management and other advisory services provided to members of the family are grouped under a single family-owned entity.
Uniting the family around a common project The FO becomes more important as the family begins to grow and disperse geographically, which can make maintaining family values and the family legacy complicated. Creating an FO helps to define the common objectives of shared assets, unifying the family members around a common project.
Promoting an entrepreneurial mindset among the next generation The FO takes an active role in managing family funds for intrafamiliar entrepreneurship, while establishing clear mechanisms for assessing and allocating these funds. Additionally, support and coaching services can be provided to new entrepreneurial projects depending on the capabilities and size of the FO. The FO can become a business in itself by offering its services to non-family third parties
Developing areas for the selection of future leaders The FO can be used as a platform for new generations entering the family business and beginning their training to become future leaders of the business family.

The benefits that a FO can offer may vary depending on the family’s individual characteristics; therefore, before implementing this mechanism, it is necessary to answer, among others, the following questions[11]:

Figure 24. Questions to ask before setting up a Family Office



[11] To learn more about the concept of the Family Office, see: Credit Suisse, White Paper, “The Family Office Dynamic: Pathway to Successful Family and Wealth Management”.

Case study 2

Family History
In 1998, Mauricio Hernández finally decided, after 50 years of hard work, to sell his food business to a multinational that had been operating successfully in Chile for 10 years. As a result of the sale, the family obtained a considerable inflow of funds and Mauricio decided to create a small FO to personally manage the income he received with the help of his financial advisor. Sadly, one year after the sale and soon after creating the FO, Mauricio died of a heart attack, leaving his five children with a large estate to manage consisting of a variety of assets – both liquid and illiquid – which were invested nationally.

The five children decided to continue with the FO, but since they all had their own careers, the task of managing the FO was too much for them to handle. Moreover, they considered that, although their father had done a great job, the FO must be professionalized in order to be of service to the family, which currently comprises 30 members of different ages, levels of education, and professional interests.

The Family's Objectives
The Hernández siblings sought to establish a mechanism that allows them to achieve the following objectives:

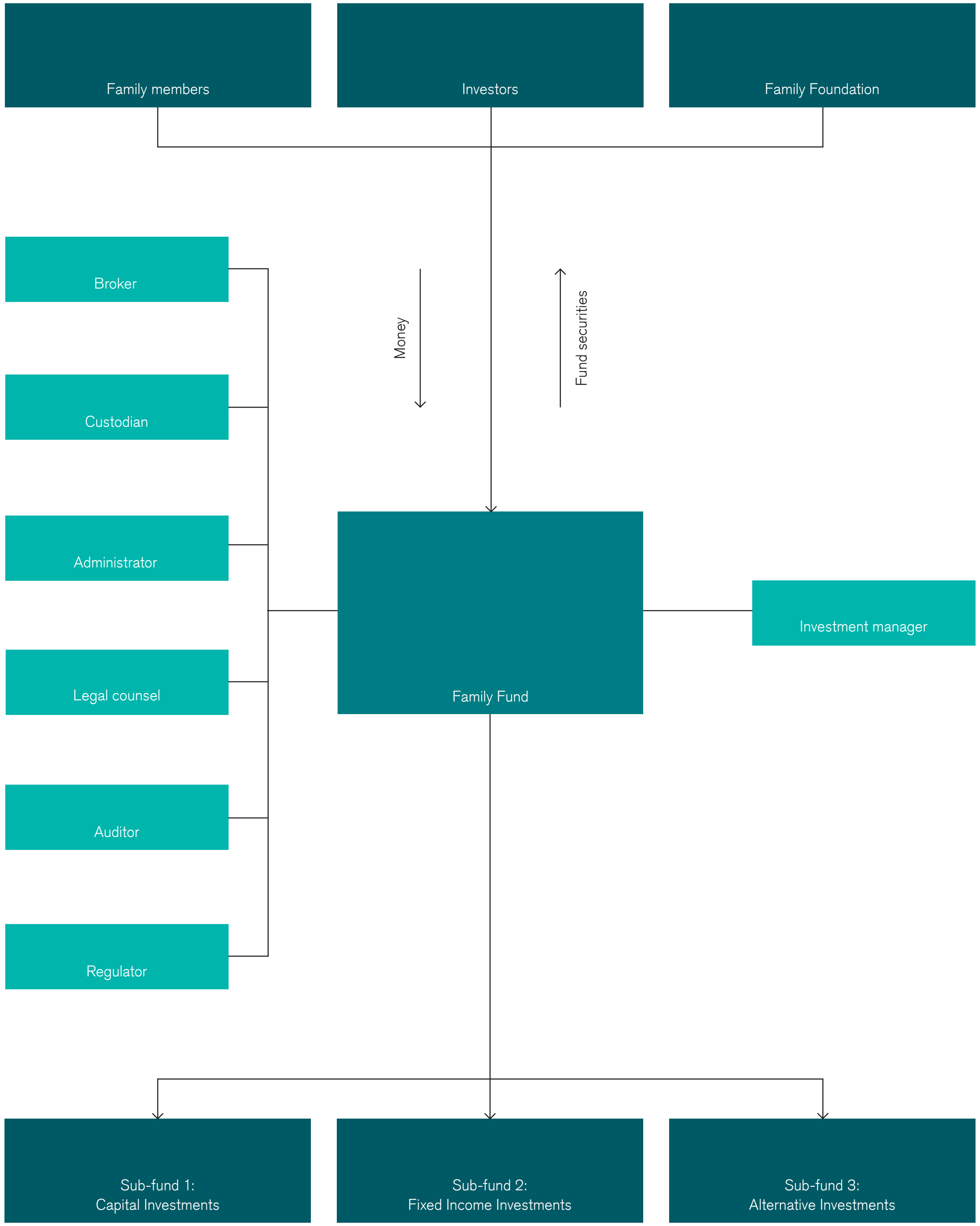
— **Professional asset management**
"As a family, we want to implement a mechanism to help us preserve the wealth that was generated, while at the same time helping us to establish the necessary structures for the transfer of assets."

— **Estate planning**
"In order to make our family's assets profitable and spread the risk, the family objective is for the assets to be jointly invested according to the risk-return profiles of the family members."

— **Passing on family values**
"We do not want to lose our family values. They should be passed on to future generations."

— **Philanthropy**
"Our goal is to combine the various philanthropic interests of our family members and support a particular social cause. By doing so, we want to give back to society what we have received from it."

Solution: Family Office (incorporating the Family Fund and philanthropic Family Foundation)
Given the Hernández family's objectives, one of the most efficient mechanisms to meet their needs was the Family Office, through which a Family Fund and philanthropic foundation can be managed.



How would the scheme be established?

1

The Hernández siblings divided the structure that their father created, deciding to “professionalize” the management of the Family Office.

— In order to spread the risks and invest the assets more efficiently, they decided to create a Family Fund managed by the Family Office
— All assets that made up the estate were consolidated and are now managed through the Fund. The board of the Family Fund is made up of two of the Hernández siblings
— An investment manager was hired who was responsible for the investment decisions of the Fund and for regularly informing the family about its progress. Specifically, the investment manager reports to the FO board, in which three of the siblings are involved
— The asset investment roadmap was established in line with the philosophy and objectives of the investment based on the five siblings’ objectives
— Depending on the investment strategy set, three sub-funds are to be established and managed by the FO team. Through these sub-funds, the family can attract new investors (often other members of business families) who are interested in their investment strategy

2

The family decided that the best way to preserve and convey family values to future generations, while also uniting the philanthropic interests of the family members, was to establish a foundation to be managed through the Family Office and led by one of the Hernández siblings.

3

Lastly, to facilitate the generational transition, the family tasked the Family Office with creating Family Governance structures and developing a Protocol.

Added value: objectives met

The Family Office has enabled the Hernández family to achieve the following objectives:

Family Fund

The Family Fund managed by the Family Office will allow the Hernández family to jointly invest all of their assets, taking the different profiles of the various generations into account.

The Family Fund will promote risk diversification, a personalized investment strategy and protection of family assets.

Family Foundation

The corporate purpose of the Hernández siblings’ philanthropic foundation is to integrate people with disabilities into the workplace.

The new generations will be integrated into the foundation’s Board so that they can collaborate with the implementation of social projects.

Through the foundation, the family seeks to support a social cause in which they are highly engaged, while passing onto future generations the values that have always underpinned their family: hard work, respect, and learning.

Family Governance

The Hernández siblings have developed a Family Protocol, where they have established – among other things – the rules governing the generational transition process and the transfer of shares.

Moreover, a Family Board has been set up to ensure compliance with the Protocol. The Board is made up of the Hernández siblings.

The greatest challenge for business families: A combination of solutions for a complex task

In the second part of the White Paper, we analyze the existing solutions to address the complex challenge of "Transferring assets without killing ambition," an analysis that is summarized in Table 12.

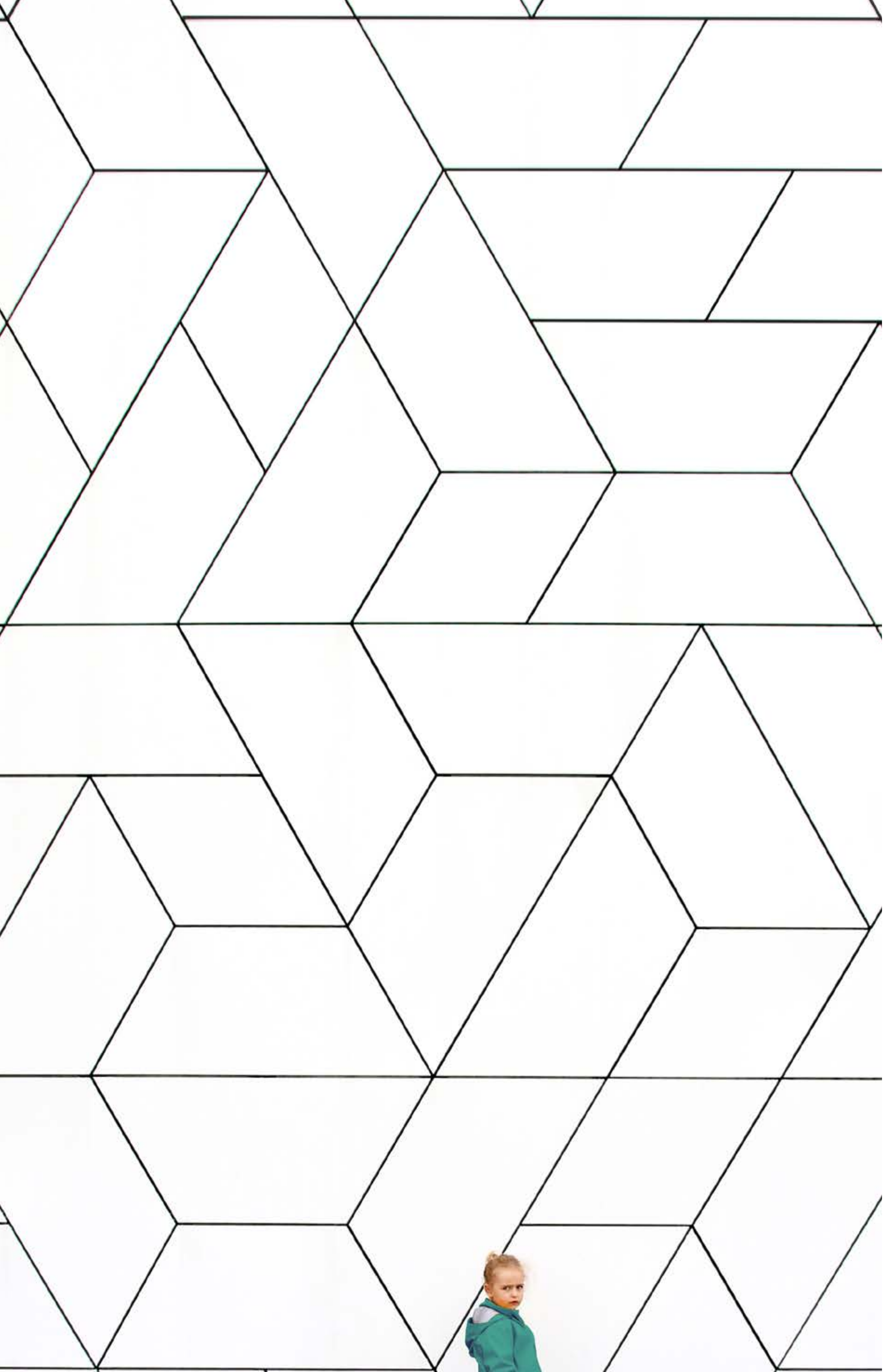
As shown in the Table, we discover that some of the solutions are primarily designed with the aim of changing the mindset of the new generations, promoting the handing down of family values, and unifying the family members around a common project. Such is the case with Family Governance or the Family Foundation. However, others, such as holding companies or trusts, set their scope on developing a toolset that enables a more professional management of family assets and/or their diversification and protection. In any case, Table 12 clearly shows how none of the proposed solutions alone is able to address all challenges of the generational transition, as identified in the first part.

Of all the solutions analyzed, the Family Office proves to be the most comprehensive in this regard; when it is well planned, it provides the business family with the necessary tools for professional asset management, while encouraging the pursuit of new investment opportunities. Nonetheless, as shown in Table 12, creating a Family Office does not, in itself, guarantee that the family values will be preserved or that the family unit will be maintained. As such, it is advisable to combine the creation of a Family Office with other solutions such as developing a Family Protocol that sets the rules for the management of shared assets.

This represents, therefore, the greatest challenge for business families: finding the best combination of solutions to successfully continue creating value over generations, that is to say, to successfully transfer the assets without destroying ambition.

Table 12. Challenges and solutions

		Governance, Protocol, and Agreements	Holding Company	Trust	Family Foundation	Family Fund	Family Seed Capital	Family Office
Mindset	Promoting an entrepreneurial mindset among the next generation	—					—	—
	Educating the next generation on the concept of "responsible ownership"	—	—		—			—
	Uniting the family around a common project	—			—	—		—
	Passing on family values	—			—			
Toolset	Flexibility to accommodate individual interests in the common project	—				—	—	—
	Achieving a more professional management of assets	—	—	—		—		—
	Setting the rules for managing shared assets	—	—					
	Confidentiality			—		—		—
	Facilitating the transfer of property to subsequent generations	—	—			—		
	Developing areas where the future leaders of the business family are selected and developed	—	—		—		—	—
	Diversifying and protecting the family assets		—	—		—	—	—



Conclusions
A new model for managing family wealth

The research carried out in this White Paper shows that the NEXT GENs are demanding a paradigm shift in the way we address the challenges of business families.
In an increasingly complex world, the future owners of family assets are aware that the traditional model – based on the survival of the family business over generations – is no longer valid. In actual fact, for these new generations, the great challenge is how to maintain an entrepreneurial mindset while achieving more professional management of the assets generated.

This need to strike a balance between "exploring" new ways of generating value and efficiently "using" existing resources is not exclusive to business families, but is likely to be the greatest challenge faced by organizations in the twenty-first century. Throughout the White Paper, we discover, however, that there are certain aspects that make this challenge particularly complex in the case of business families.
As such, the goal is not only to create financial value, but also to achieve an optimal balance between economic and socioemotional aspects, which are an integral part of the family legacy to be passed on. With this in mind, the new generations require equally complex solutions that are able to comprehensively address these challenges.

That is why the solutions set out in the White Paper are intended to be much more than a mere "manual of good practices" that every business family should adopt.
When analyzing in-depth how each family responds to the challenges faced in a generational transition, the objective is for each family to choose – with the right advice – the optimum set of solutions to help them successfully continue generating value over generations. This, in turn, involves the great challenge for professionals who assist business families in finding "bespoke" solutions, tailored to each business family's situation, as there will be many possible combinations of solutions and types of business families. Despite this diversity, as demonstrated in this White Paper, all of the solutions set out should be based on the same philosophy: to replace the traditional "operational mindset" of the business family members, by focusing on managing family businesses with a "more investment-driven approach" to make the whole estate grow. Deciding which tool(s) to use to successfully bring about this change in mindset is, undoubtedly, the greatest challenge.

We hope that this White Paper serves as a guide to help both business families and their professionals to work together in order to overcome the great challenge of generational transition, which is none other than: "Transferring assets without killing ambition".

Appendix
Research methodology and descriptions

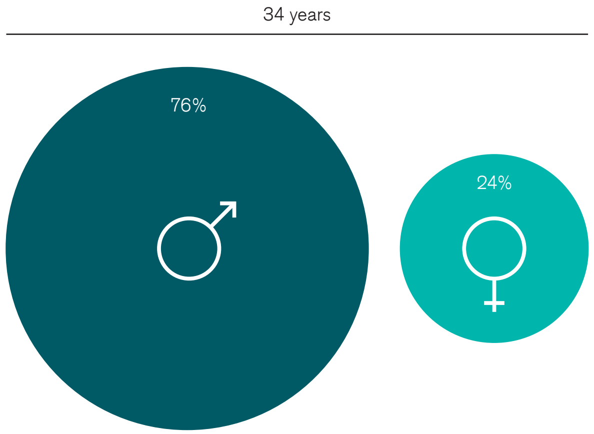
Research methodology A survey was prepared in order to learn more about the challenges faced by business families during the generational transition process. The survey was sent to 350 “NEXT GENERATIONS” and 200 responses were received. Participants were given three months to respond.

Figure 25. Research methodology

In addition, a sub-section of the surveyed NEXT GENs was interviewed in order to better interpret the survey results.

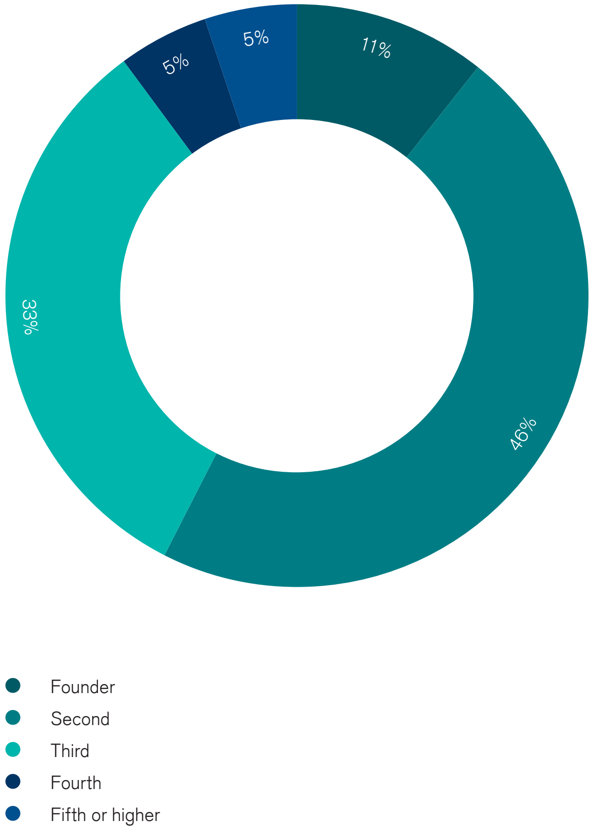
Characteristics of “NEXT GENERATION” individuals: age and gender. 76% of survey participants were men and 24% were women. The average age of the NEXT GEN individuals was 34.

Figure 26. Age and gender of NEXT GENs



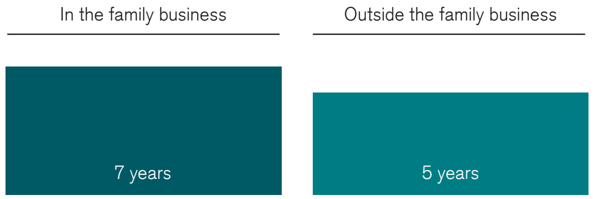
Generation. As indicated in Chart 11, the majority of NEXT GENS surveyed are part of the second or third generation in their family businesses (46% and 33%, respectively).

Chart 11. Generation to which the NEXT GENS belong (%)



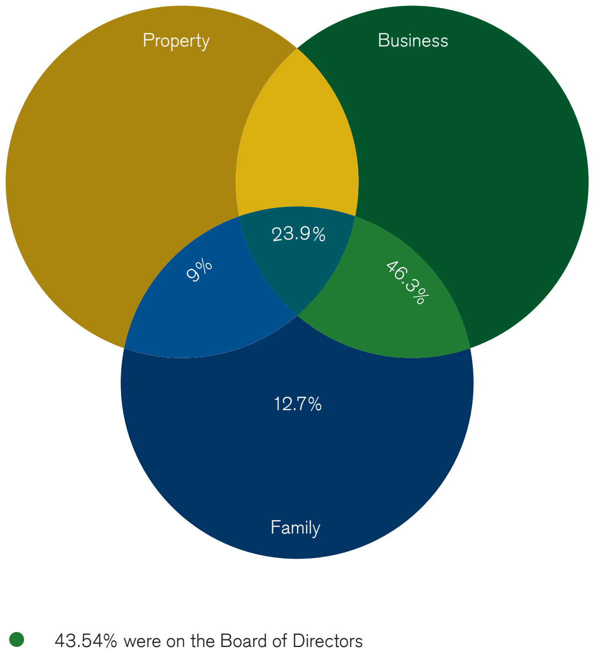
Professional experience. Survey participants had an average professional experience of 7 years in the family business and 5 years outside it.

Figure 27. NEXT GENS’ professional experience



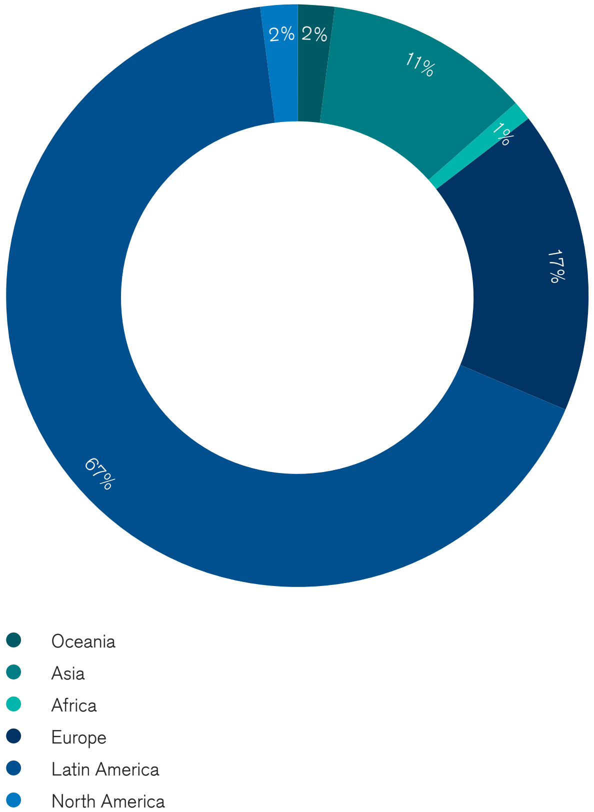
Role. As you can see in Figure 27, most of the survey participants (46.3%) hold a position of responsibility in one of the family businesses, and many of them are on the Board of Directors but are not shareholders yet. 33% are shareholders, and of these, 9% are not involved in managing the company. 12.7% of survey participants currently have no role in the family business, whether as shareholders or directors.

Figure 28. Role of NEXT GENs (%)



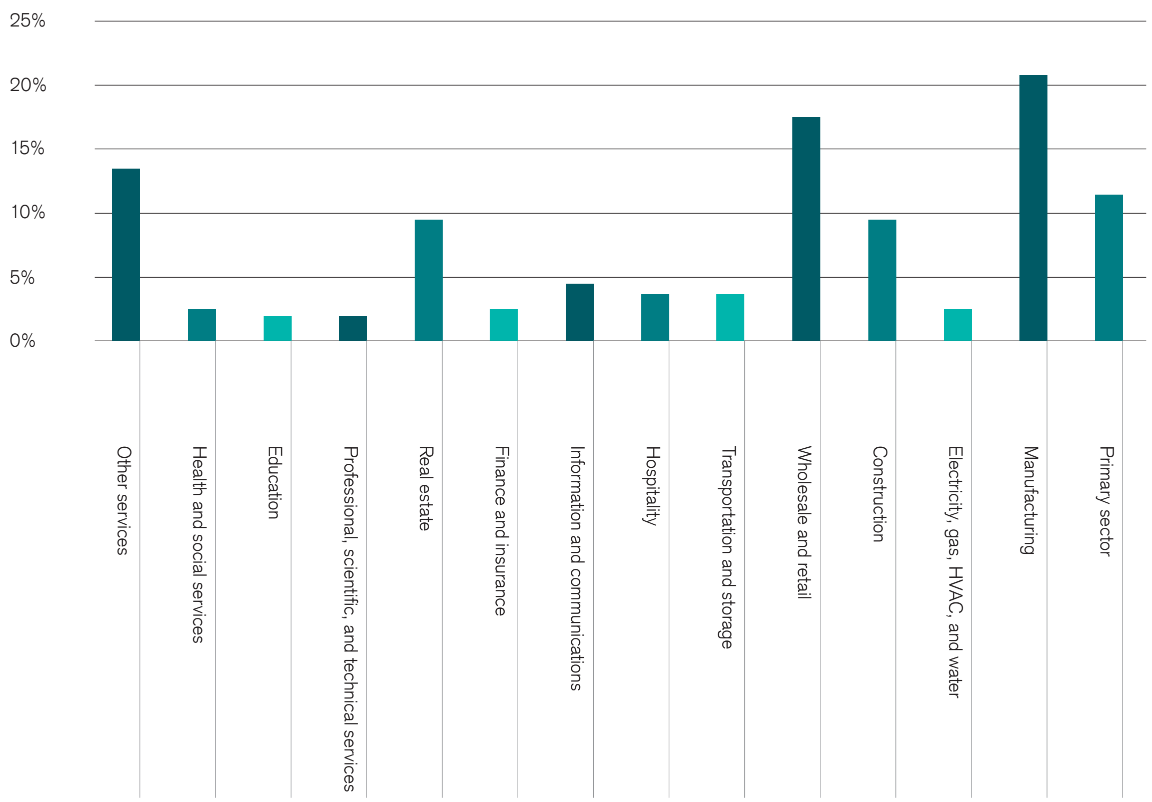
Features of family groups. Origins. Given the purpose of this research, the majority of the family groups studied were from Latin America (67%), but others were included in order to lend more diversity to the sample (see Chart 12).

Chart 12. Origins of family groups (%)



Industry. As shown in Chart 13, the majority of these family businesses are involved in the following industries: manufacturing (21%), wholesalers and retailers (17%), and the primary sector (11%).

Chart 13. Industries of family groups (%)



Resources

The following are resources which may provide additional information regarding the topics discussed throughout the paper.

Books

Anderson, Ronald C., Sattar A. Mansi, and David M. Reeb. "Founding family ownership and the agency cost of debt." Journal of Financial economics 68.2 (2003): 263-285

Gomez-Mejia, Luis R., Cruz, Cristina; De Castro, J.2011. "The bind that ties: Socioemotional Wealth preservation in family firms." The academy of management annals 5.1 (2011): 653-707

Pascual Berrone, Cristina Cruz, and Luis R. Gomez-Mejia. "Socioemotional Wealth in family firms theoretical dimensions, assessment approaches, and agenda for future research." Family Business Review 25.3 (2012): 258-27

Gómez-Mejía, Luis R., et al. "Socioemotional Wealth and business risks in family-controlled firms: Evidence from Spanish olive oil mills." Administrative science quarterly 52.1 (2007): 106-137

Credit Suisse White Paper

White Paper "Gobierno de Familia: Como las familias líderes gestionan los desafíos del patrimonio." (Family governance: How leading families manage the challenges of wealth).

White Paper "Funding as a Family: Engaging the Next Generation in Family Philanthropy."

White Paper "The Family Office Dynamic: Pathway to Successful Family and Wealth Management."

White Paper "Behavioral Finance. The phsycology of investment."

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IE Business School

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Important informations

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