Family Office Hurdles

Once you reach a certain wealth threshold the money itself tends to take a backseat to optics and status symbols. One of the newer status symbols for the richest of the rich is to have their own family office.

For the uninitiated, a family office is simply a private wealth management operation that handles all aspects of a family's money management needs. Family offices are typically reserved for ultra high net worth families and come in two flavors -- single family or multi-family offices. The idea behind the family office is to go beyond a typical money management or advisory firm and hire your own staff to take care of portfolio management, budgeting, taxes, charitable giving, generational planning and so on.

Those families who have the wherewithal and can find the right people can create a comprehensive financial planning operation that can take care of all investment, insurance, legal, estate and financial planning issues that may arise. According to surveys, there are roughly 5,500 to 6,500 family offices in the United States managing upwards of $4 trillion. Investment professionals are now clamoring for these positions because it means a relatively stable job with no need for fundraising since you're working for just one client.

The problem with the family office set up is it takes the right financial professionals to make it work smoothly. And even then it's a challenge because not every family has the resources necessary. The following comes from a recent Institutional Investor piece on this space:

Many family offices are eager for private equity returns without having to pay large fees to an outside manager. In a survey of 118 family offices that was released in May, Family Office Exchange found that on average two of the three investment staffers in each office focus on private equity.

"Direct investing gives family offices the opportunity to invest -- as a lead or co-investor -- in companies they know well and where they, on average, expect double-digit returns," Sarah Hamilton, Family Office Exchange's chief executive officer, said in a statement at the time.

All of this sounds great in theory. Who wouldn't want to earn double-digit returns without having to pay large fees to an outside money manager? That's part of the allure of the family office.

The problem here is that most family offices are woefully understaffed for this type of strategy. If the average operation has just three investment staffers, with just two to oversee internal private equity efforts, that's inadequate for all but the very best private investors in the world.

Private equity is not a strategy you can run passively. It takes a massive amount of work. Plus you have to know your competition. The biggest private equity firms look at thousands of deals a year.

They have specialists who handle deal sourcing, banking, financing, operations and more. Cutting out these firms and their huge fees does sound appealing until you realize how hard it can be to beat them at their own game. The competition in this space has never been greater.

Not only do you have to gain access to, and choose, the right deals, but you also have to monitor and help improve these companies once you buy them. This is operationally inefficient, to say the least. Here's what I had to say about this in my book, *Organizational Alpha*:

One of the most overlooked aspects of portfolio management is the time constraint that your investments can place on your organization. Operational efficiency can play a large role is helping institutions make better, more informed decisions. Operationally inefficient investment programs can miss the forest for the trees by constantly getting bogged down in the minutiae. There is much more that goes into investing in alternatives beyond talking to portfolio managers and picking a strategy. The due diligence is just the first step. Implementation and monitoring can be even more time consuming and confusing for those who aren't experts in the field.

First of all, the legal paperwork for the subscription documents and private placement memorandums (PPMs) for these funds can be overwhelming. We're talking 100-200 page documents galore. And the hedge funds and private equity managers have some of the best lawyers in the business (because they can afford it) who are able to make these documents basically indecipherable, save for those who know exactly what they're looking at. It's basically a requirement these days to have a lawyer on staff who knows the legal ins and outs of these documents when performing due diligence before signing on the bottom line to make an investment.

For many in the wealthy class, investing in alternatives represents something of a status symbol. And while there are world-class organizations out there who have the ability and resources to compete in this space, most family offices are better off outsourcing this style of investing or avoiding it altogether.

Private direct investing is not an easy game to play.

Source:
The Allure of the Family Office (Institutional Investor)

Further Reading:
Are Private Equity Returns Overstated?