

Facilitating alignment IN COMPLEX FAMILY AND ADVISORY SYSTEMS

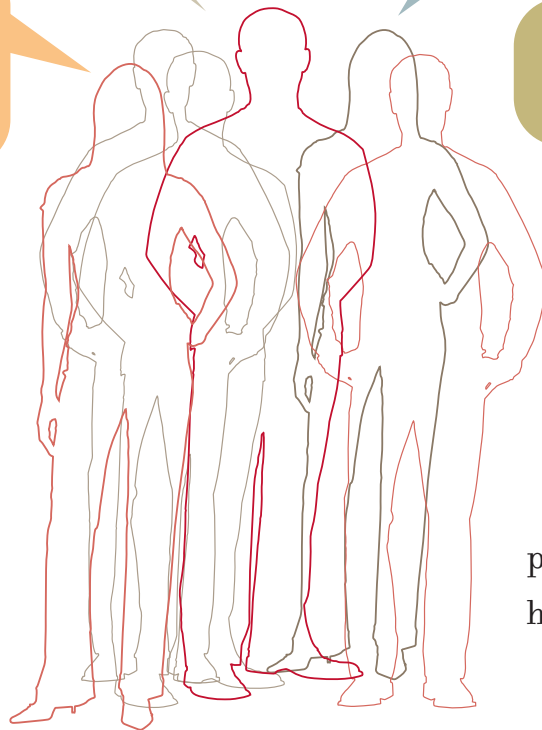
By GREGORY T. ROGERS and G. SCOTT BUDGE

Where do I
turn for sound
advice?

What am
I paying
for?

Fire
the
bums!

Whom can we trust?



THE SHOCK OF LAST FALL'S economic Chernobyl may well be wearing off, but the cacophony surrounding it continues. Even as clients have begun to adjust to a "new normal" in the global markets, the din arising from

their uncertainty and anxiety about what happened shows no signs of abating. As for the drumbeat in the financial press that clients will be changing advisors *en masse*, well, that potentially overhyped rhythm certainly has everyone keenly tuned in.

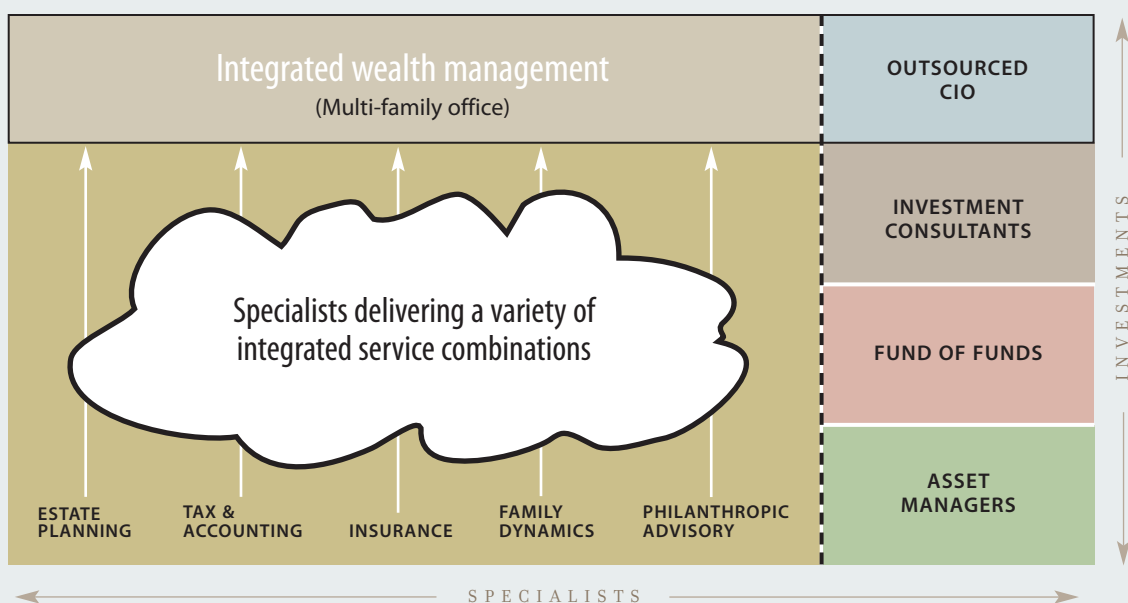
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So, where does that leave us? This symphony in a minor key needs to be seen for what it is: Part of a larger composition that describes the probable end of the post World War II United States super-cycle. While the million dollar question remains unanswered—how deep and broad the resetting of the world economy and markets will be—there is little doubt that a next generation of opportunity is emerging for high-net-worth investors and their families.

Although perhaps not as wrenching, change has been engulfing the wealth advisory business, too, for some time now. New organizational and service models have arisen to address the complexities of families and family offices. The events of 2008, however, appear to have exacerbated the sense of uncertainty about the pace and breadth of this change. Modern day family complexities alone have raised the stakes for

identifying anchor service providers, particularly as the cost and complexity of global investing has increased across asset classes and geographies. At the same time, the jury is still out on how best to integrate the broad disciplines of wealth management—tax, accounting, insurance, estate planning, family communications and philanthropy—into the delivery of services to families. And to make matters worse, there is much confusion regarding the comparison of various industry players, many of whom are claiming to provide the same services, and at first blush are undifferentiated. However, dig a little deeper and it becomes evident that there are significant differences across providers of wealth advisory services related to business incentive structures, relationship management interfaces and investment competency, as well as integration and delivery of non-investment services.

The perplexing landscape of wealth advisory services



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One of the most pressing questions facing those involved in advisory work is if—and how much—families value the integration of broader wealth management services relative to the quality of traditional investment advisory functions. The answer is not easy to tease out, especially in view of the fact that many families are divided about whether and how they want these services delivered, and lack a true understanding of the service provider landscape.

As high-net-worth individuals and families strive to make sense of this fluctuating environment (perhaps by seeking a new provider or set of providers), it has become abundantly clear that the cost of getting these partnerships wrong is extremely high not only for families but for advisors, too. Such is the reality of challenging economic and market conditions: it intensifies the awareness of investment program implementation risk as well as the problematic decision-making that plagues so many families.

Which brings us back to the question posed at the beginning: What should an investor do?

The Case for Alignment

The answer lies in something we call *alignment*. What do we mean by that? Alignment describes the extent to which a family and their advisors—comprising a “system” with family and non-family expertise—work together to advance a family’s goals. By no means does alignment imply perfection. Rather, it encompasses a realistic understanding and evaluation of the most effective way for the system to work on behalf of a family’s desired outcomes. This requires a unique ability to anticipate how potential changes in the family-advisory system may impact evolving client

objectives and expectations. This process is made more challenging by the ever-dynamic nature of each and every component of the system – family member, family unit, single advisor, inter-advisor collaboration—and calls out loudly for structures and solutions that emphasize simplicity.

So strong is our belief in alignment that we think that *everything* must be subordinate to it—even the perceived confidence assumed by working with a close and trusted friend. Why? Because alignment requires that these two living systems—the family and its advisory team—know themselves well enough to recognize whether they share the same compass, guidance systems and willingness to support each others’ needs and ways of working together every step along the way.

Several developments have brought us to the point where alignment is becoming more urgent and important as the framework for interaction among families and advisors. Broadly, these developments include:

- > **A sea-change in the investment world.** Not long ago, investing was relatively simple—it was only 1969 when the Ford Foundation published its seminal paper accepting stocks as a viable asset category for institutional investors. That followed into the 1970’s and 80’s, when investors pursued a limited menu of investments from which to choose—U.S.-centric stocks, bonds and cash. The financial world of yesteryear seems quaint—almost antique—compared to the varied and complex investment landscape of

Facilitating alignment in complex family and advisory systems

today. Fast forward to 2009 and we find that opportunities exist across an array of asset classes without regard to geographic boundaries. Financial instruments involving securitization, leverage, derivatives and risk management have been developed as have hedge funds and other eclectic investment vehicles. Similarly, over a 30 year period, the asset management industry has exploded from a few dominant providers to thousands of fragmented players. Today's investing dilemma over the counterforces of both deflation and inflation, as well as shifting global power dynamics, are only heightening the need for extremely competent investment navigational advice. Few advisors today are capable of covering the breadth and depth of issues that are required to make coherent investment assumptions on behalf of a vast set of client parameters.

- **The rise of behavioral finance.** As supply and demand in the investment world has evolved, so, too, has the understanding of human behavior as it relates to money. The archetype of the rational, self-interested investor is giving way to a more sophisticated, nuanced portrait of the psychological and social forces that drive our relationship to wealth. As it turns out, both lay *and* professional investors are captive of these basic drives—a humbling reminder that when it comes to financial matters, powerful, even primal, urges trump even the most well-trained, analytical minds. One has only to look at the events of 2008 to know that mixtures of greed, fear, anxiety, control and mistrust are what govern human financial behavior across world markets. Place these animal spirits into the family-advisor system and you get the day-to-day experiences of frustration that we all encounter.

Historically, advisors have pointed the finger at their clients as “dysfunctional” due to many of these “normal” behavioral challenges. In reality, advisors have been as much a part of the problem as the clients. An empathic acceptance of human biases is now needed. Creating functioning family-advisory relationships requires working within a more natural (not necessarily rational) set of expectations driven by the behavioral make-up the entire system. Most advisors today are ill-prepared to wade into this psychological cesspool.

- **The creation, segmentation and organization of wealth.** The unprecedented creation of wealth in the 1990's has had an enormous impact on the financial services industry. For starters, a whole taxonomy has grown up around the arrival of the “high-net-worth individual.” That category has since been re-classified, segmented by amounts of liquid net worth into “affluent,” “high-net-worth” and “ultra-high-net-worth” subsets. Over time, recognition that these “individuals” are in fact routinely nested in families with interlocking legal, financial and operating ties has led to the evolution of the idea of family wealth management and the movement to pinpoint the best ways to preserve wealth across generations. These dynamically complex, taxable clients have exercised greater buying power and have in many cases sought greater customization of services and solutions from a new class of professionally trained financial advisors. Cycles of forming, repositioning and dismantling single

Facilitating alignment in complex family and advisory systems

family offices are further evidence of the difficulty in managing alignment at the high end of what have essentially become virtual, global enterprises. It boils down to this: complexity, complexity, and more complexity for everyone from the wealth progenitor confronting the harsh reality of what it takes to become a savvy investor (and how few trusted advisors there really are to help) to the principals and managers of family offices, who must now consider reshaping their service model and augmenting their expertise if they are to be effective stewards of significant assets. The result—no single family client is the same. Each family brings a unique set of its own human capital, experience levels, decision making processes, family office resources, operating business interplay and relationship interaction styles.

Micro-segmentation

Blunt forms of matchmaking between families and advisors are giving way to the need to begin with a more sophisticated form of micro-segmentation on the family (buy side) of services and an examination of the implications this has for choices and tensions advisors face in developing their businesses. Micro-segmentation simply means that two families with \$100 million to invest may have very little in common with respect to what their needs are and their relationship to the wealth and processes to manage it. In fact, they may vary so widely along some dimensions as to not be appropriate for the same service providers at all.

In this connection, we have developed a framework that families and advisors can use to begin the process of effective and aligned partnering. For the family, this framework describes 18 dimensions through which families can examine their own needs and resources. These dimensions incorporate the emotional, resource, and relationship needs and preferences as a first step to self-understanding as a family. This helps avoid the variant of the proverb that says, “if you don’t know what you want, you’ll probably get it.” Advisors in turn can use these dimensions to profile clients and rationalize services that target families of certain types, where the impact has big time strategic and profit implications. *(Please see RayLign’s Family-Advisor Alignment Facilitator on the next page.)*

Provider Implications

How, then, is one to architect an organization in this market environment? The micro-segmentation complexity has both invited and pressured providers out of highly boutique and entrepreneurial business variants and into a mode requiring business leaders to challenge their supply-side thinking and to begin to face tough decisions that track some of the ranges of client needs, not just to better know clients but to know in a milieu of limited resources what bets to place and what businesses to really be in. What can sometimes be lost in all of this is the fact that client-advisor alignment isn’t just to find and retain good relationships, it’s to make sure that the nature of the business that is taken on by providers does not put you out of business. It is still very difficult, under the best of circumstances and even with deep pockets, to marry comprehensive wealth management services with truly global investment expertise across all asset classes. Families are being asked to make very difficult judgment calls related to investment management

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Family-Advisor Alignment Facilitator[®]

1) EMOTIONAL ALIGNMENT involves working together to support the sensitivities of the family wealth, related to its meaning, impact on relationships, behavioral interaction, risk-taking, advisor trust and social priorities.

- > Family diversity
- > Relational and behavioral complexity
- > Asset "meaning"
- > Risk orientation
- > Basis of trust
- > Social commitment

2) RESOURCE ALIGNMENT is achieved through complementing family resources that include human capital, operating businesses, limited or extensive family office resources, financial/investment management experience and decision making style.

- > Family geography
- > Family operating business
- > Client side infrastructure
- > Wealth management expertise
- > Investment sophistication
- > Leadership and decision style

3) RELATIONSHIP ALIGNMENT is based on clarifying the items that drive interaction between the family and advisor, including tax orientation, structural complexity, objectivity, customization, service integration and communications.

- > Structural complexity
- > Wealth management integration
- > Tax focus
- > Personalization
- > Advisor objectivity
- > Privacy and security

The Family-Advisor Alignment Facilitator is a tool developed and used by RayLign Advisory to initiate a dialog among family members to better understand their own wealth management needs. The results from this conversation prepare the family for designing and managing their wealth management advisory resources. If you would like to discuss the Facilitator process, please contact Greg Rogers at (203) 742-5451 or Scott Budge at (203) 742-5452.

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quality, relationship manager interface, senior investment professional access, and integrated wealth management benefits. Just as families do not routinely come in completely on the same page with respect to what they need now and generationally, so too are providers faced with dilemmas around building today in preparation for an ever-transforming future. Questions need to be answered related to the technology, employee profiles and training, central vs. decentralized office facilities, and coverage and reporting on asset classes across the global opportunity set.

For advisors, being honest with themselves with respect to whether they might work in greater alignment with a single wealth creator with an aggressive risk profile and unrealistically high expectations for long-term returns versus a multi-generational family who live around the world, speak several languages, are primarily inheritors, and want brand relationship recognizable in several countries, becomes paramount. Building each business will be very different, and have varying effects upon some of the following:

- > How ownership, co-investment among owners and employees, and employee incentives are structured.
- > The types of relationship management skills and processes required.
- > Requirements for local office presence in various markets.
- > Forms and amount of client education that takes place.
- > The span of investment coverage and decisions about what classes are captively developed or outsourced.

- > How accessible the senior most investment professionals are to clients.
- > How operations, reporting, wealth management and non-financial service processes are configured.
- > The presence or absence of services related to family businesses and other operating entities.
- > How value creation and pricing is conceived and agreed upon.

Concluding Thoughts

The days of families casually picking four or five firms from a list recommended by an advisor or friend, visiting each and making a decision should be numbered in our view. This is because of the ease with which mismatched alliances between families and advisors begin and the expense to each of a bad fit. A more careful internal review on the family's part of its needs could not be more warranted now, even as wealth advisory businesses need to understand the clients they are genuinely prepared to service and the capabilities and tradeoffs they will need to make to build out the right services at the right price. Both families and advisors need further introspection about this and the stakes are rising. In the end, alignment in the family-advisory system is key to the formation of partnerships that will generate sustainable value for each over the long term. >>

Facilitating alignment

IN COMPLEX FAMILY AND ADVISORY SYSTEMS

About the authors

Gregory T. Rogers, Founder & President, RayLign Advisory LLC

Greg founded RayLign Advisory LLC to “perpetuate well-being for families through the generations” based on cross-disciplinary principles he developed over twenty years as a member of his own family’s investment consulting business, builder of a strategic consulting practice and leader of a publicly-traded, family-driven, asset management and family office enterprise. Prior roles: EVP & COO, John A. Levin & Co.; Managing Director, BARRA Strategic Consulting Group; Director, RogersCasey & Associates. Affiliations: General Partner, Rogers Investment Partners; Director, Rogers Family Foundation; President, RayLign Foundation; Member, TIGER21; Member, Family Firm Institute; Board Chair, Ackerman Institute for the Family; Advisors Council Member, Fairfield County Community Foundation; Teaching Faculty, IPI Wharton Private Wealth Education; Adjunct Professor UCONN “Skills for Financial Independence”. Education: MBA International Finance, NYU Stern School; Brown University, BA Economics and Organizational Behavior & Management.

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Scott is an expert in the dynamics of wealthy families, having worked directly with hundreds of entrepreneurs, corporate executives and their families. He has also worked extensively as a developer and educator of wealth advisors, which is the focus of his recent book, “The New Financial Advisor: Strategies for Successful Family Wealth Management” (John Wiley & Sons). Scott has published several articles, including works on the psychology of investments, family wealth and family businesses and spoken at numerous domestic and international industry conferences. Prior roles: Scott founded two companies focused on delivering internet-based management services to single- and multi-family offices, and financial advisors throughout the US and Canada; Senior Vice President, SEI Investments where he co-developed their family wealth management unit; Board Member, “Family Business Review”; Founder & Member, creative team at Shaking the Tree Foundation, a professional theater group whose productions focus on challenges faced by families of wealth. Scott is a Fellow at the Family Firm Institute; Founding Member, Money and Family Life Project at the Ackerman Institute for the Family. Education: PhD in Psychology from New York University.

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eLigns are published periodically to help families safely negotiate the big bends in the road, the ones that really matter.

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