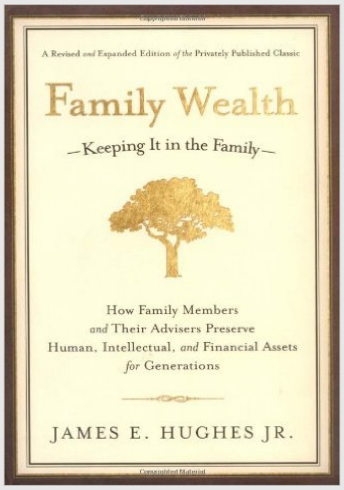


# Family Wealth

## Keeping It in the Family: How Family Members and Their Advisers Preserve Human, Intellectual and Financial Assets for Generations

James E. Hughes Jr.
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246 pages
Book: getab.li/3754

## Rating

8

8 Applicability
8 Innovation
8 Style

## Focus

Leadership & Management
Strategy
Sales & Marketing
Finance
Human Resources
IT, Production & Logistics
Career & Self-Development
**Small Business**
Economics & Politics
Industries
Global Business
Concepts & Trends

## Take-Aways

- Most families who become wealthy lose their money within three generations.
- The capacity to attain wealth is rare, and is often unappreciated by subsequent generations who may squander the family's accumulated capital.
- Families who seek to preserve their wealth must understand that their family is a business.
- The business should have a mission statement that is reaffirmed by each generation.
- Most families are so intent on preserving wealth that they focus too much on the current fiscal year. A family business can afford to take a long-term perspective.
- Most families err by fixating on numerical measurements of their success. Qualitative measurements are equally important.
- Capital is only one resource a family should leverage. Unless it builds human capital and intellectual development of family members, the family business is doomed.
- Many families establish a family bank that gives low-interest loans to members.
- Representative governance is the most effective method for families.
- Successful families endure by sharing family history that keep the family bonded.

# Relevance

**What You Will Learn**
In this summary, you will learn: 1) Why families must develop human capital to sustain their wealth; and 2) How, with proper governance, you can maintain family wealth for more than 100 years.

**Review**
Reading James E. Hughes Jr.'s book is like sitting down in an easy chair with brass rivets gleaming in burgundy leather, in a trusted old family friend's parlor, to obtain a kindly word of advice. You can almost smell the pipe tobacco and taste the brandy as you read. Hughes gently and wisely guides people who want to preserve their family's wealth on how to think beyond the current fiscal year. This book is genuine and straightforward, with insights gained over many years. Hughes covers creating a family mission statement, instituting a family bank or private trust company, mentoring the next generation, family governance, philanthropy and much more. His most important contribution, however, is the perspective he offers on the human side of the equation. Even the richest families are doomed to squander their inheritances, he cautions, unless they recognize the importance of the intellectual and human development of their family members. *getAbstract* highly recommends this book of sage advice to anyone who hopes to keep it all in the family.

# Summary

**Congratulations on Your Success; Who's Your Successor?**
A prominent industrialist who sat on several boards of directors had a favorite way of introducing new CEOs to the realities of corporate leadership. He would watch as a new CEO accepted heartfelt congratulations on the day his election was announced. Then, at just the right moment, he would congratulate the executive and immediately ask, "So, whom are you planning to groom as your successor?" His point was that there is no time to rest, because finding a successor is one of any executive's most crucial responsibilities, and one of the most difficult. Succession is critical to the long-term viability of any business.

*"A family's wealth consists primarily of its human capital and its intellectual capital, and secondarily its financial capital."*

This is even more vital in a family business, where the ability to thrive over the long haul always comes down to the effectiveness of succession. The common saying in the succession planning business is, "From shirt sleeves to shirt sleeves in just three generations." This warns that just as quickly as a family makes its fortune, it can lose it due to poor governance or bad succession. Even financial success does not make up for poor succession planning. Families attempting to preserve their wealth over time must understand that they are in business, indeed, that they are a business. The goal of their business is to enhance the quality of lives of family members through mutual success. And just as any corporation focuses on succession, the family business must do so as well. As has so often been observed, a failure to plan means you're planning to fail.

*"Every family I have observed that is successfully 'wealth preserving' is itself a reflection of the five virtues of truth, beauty, goodness, community and compassion. Transcending all of these is its reflection of love."*

**Failures of Fortune**
Those who don't have money may be surprised to learn that wealthy families usually lose their money within a few generations. Typically, those in the first generation work very hard to eke out a meager living and provide for their children's education. The people in the second generation are university-educated and financially successful; they eventually, attain high society status. The third generation, by now many in number, grows up in the lap of luxury. They are typically spoiled, lazy, lavish spenders. They soon squander all of

the family's money, with the result that the fourth generation is left to start all over again, often as manual laborers.

*"I am convinced that, without this spiritual component, a family cannot succeed in preserving itself, since its value system will fail and with that failure will come disintegration."*

This classic three-stage process proves the adage that what goes up must eventually return to earth. There is a period of energy and creativity, followed by a period of stability and maintenance, followed by a season of dissipation and loss. This process actually reflects the laws of physics, as energy first creates a new form, which undergoes a period of stasis, followed by dematerialization of the energy, or entropy. The decay from a highly ordered state to chaos is considered as natural as, indeed, the ball that you throw high into the air dropping back to earth.

*"Successful long-term wealth preservation requires the creation and maintenance of a system of governance or joint decision-making, to the end of making slightly more positive decisions than negative ones over a period of at least 100 years."*

Attitude plays a big role in this cycle of boom and bust. One way to counter this tendency is to teach family members that they are all part of the first generation. It is only when they no longer view themselves as pushing the frontier of family success forward that family members become vulnerable to decline. Second, most cultures measure wealth preservation in terms of the accumulation of money. This completely overlooks the fact that there are three forms of capital, and financial is only one of them. The others are human capital and intellectual capital. A family with an abundance of the first, and without the other two, is an accident waiting to happen. To thrive over the long term, a family must not focus on its financial capital to the exclusion of the accumulation and development of intellectual and human capital. Families that make this mistake do not understand what wealth is and, therefore, are prime candidates to preserve the adage of shirtsleeves to shirtsleeves in three generations. In fact, sometimes it doesn't even take that long.

*"The history of long-term wealth preservation in families is a catalog of failures epitomized by the universal cultural proverb, 'Shirt sleeves to shirt sleeves in three generations'."*

Failing to realize that preservation of wealth is a dynamic, rather than a static, enterprise is the second cognitive error that many families make. When your wealth is inherited, it's difficult to appreciate how hard it is to generate. Rarely are later generations motivated by the same emotional or psychological factors that fueled the productivity of the original creator of family wealth. Indeed, often their experience with the relative who made the money in the first place is negative. Family members must respect the rare ability to generate wealth. A family that assumes its members will all be equally adept at business and magically endowed with the creative instincts needed to generate wealth will soon be sorely disappointed. Such families typically go out of business in rather short order. A wiser approach is for the family to promote its human and intellectual capital, to exercise sound stewardship and to position each successive generation as a new leading generation responsible for wealth building. They must understand that there is no status quo, or stasis, when it comes to wealth. Capital flows and moves and changes hands, and it never finds a blissful state of equilibrium. Families seeking to preserve their wealth must plan accordingly.

*"It is only when a family generation fails to perceive itself as the first generation that it begins to risk resembling the status quo of a second generation or the decay of a third."*

**Long Term Thinking**

Families make the classic mistake of underestimating the time frames needed to preserve wealth successfully. Wealth wasn't built in a day. The measure of time for a family seeking to preserve its wealth should be one generation. In family terms, short term is 20 years. The mid-range of time projection is 50 years. Thinking long term for a wealthy family involves a span of 100 years. The problem with the short-term thinking that affects so many families is that they become focused on financial goals for the current fiscal year. Then, to meet those goals, they take risks that simply would be unacceptable if viewed from a longer time frame of, say, 20 to 50 years. What's good for your portfolio this year is rarely good over the long-term, and family wealth is a long-term business. While the passionate desire to show results on a year-to-year basis is certainly admirable, it can also be counterproductive.

A family business's big advantage is its ability to be patient. Future generations of family leaders are always waiting in the wings, and the family's goal is for the family business to thrive in the long term. This patience opens up opportunities unavailable to other investors who may hear the clock ticking on their various investment strategies. Investors par excellence Warren Buffett and Philip Carret demonstrate the success of long-term thinking. The fact is that for a family to preserve its wealth, it must increase its wealth. There are no laurels to rest on when it comes to preserving capital. Failing to exercise patience has an even greater effect in the arenas of developing the human and intellectual capital. As demographics change and people live longer, families can afford to invest more in developing their future leaders' intellectual capital, because they will live longer and have longer periods of productivity before retirement.

*"Many family members who have inherited financial wealth have no concept of how difficult it is to create, and often their experience of the wealth creator was negative."*

### Quality of Life

Yet another place where families go awry is that they focus on quantitative rather than qualitative measures of success. They emphasize balance sheets and statements of net worth. Family members prepare detailed statements of revenue minus expenses, and total them to paint a picture of the waxing or waning of the family fortune. This approach overlooks the reason the money is being accumulated in the first place, namely, for the sake of the family's quality of life.

*"A family that imagines or, worse, assumes that every member of the family will be a wealth creator, or even that in every generation someone will have the creative instinct to be a great financial wealth creator, is fooling itself. Such a family is in entropy and will swiftly go out of business."*

Qualitative measures are notoriously difficult to evaluate, compared to the hard data of financial performance. But the family that fails to do so risks missing the point. Human and intellectual capital changes annually. The family balance sheet will always be incomplete until it takes quality of life into account, as represented by these elements. When you analyze each family member's qualitative balance sheet, you come to grips with crucial questions, such as: Is each family member happy, productive and thriving? Is there a harmonious relationship between family leaders and family followers? Do individual family members understand how they can exit the family business, should they choose to do so? Does each member of the family perceive that the family leaders are meeting their responsibilities to the benefit of the each individual's pursuit of happiness?

*"For a family to wealth preserve, however, it has to increase its wealth."*

### The Family Compact

Families fall short of their goals in two other areas. One is that they fail to understand that preservation of family wealth over an extended period is extremely hard work. It involves balancing risk with the prospect of a somewhat distant reward. Secondly, in part because it is a difficult and challenging process, families sometimes fail because they stop telling the family's stories. Family stories give members a sense of the values that form the foundation of the family's success. They relate who the key figures were and are, and how they overcame important challenges through hard work, resourcefulness and persistence. Often, stories are the adhesive that binds family members together, and it's not a good sign when relatives stop sharing family stories.

*"Almost every family I encounter is trying desperately to ensure that every year brings additional financial wealth to the bottom line of the financial balance sheet."*

To preserve wealth, a family must create a "social compact" among its members. This compact will reflect the family's shared values. The family must also agree upon a system of representative governance. In other words, it must create a structure for decision making that reflects the family's values, goals and aspirations. Each successive generation must reaffirm this system. And, naturally, the family must also have a means of amending the system of governance as time moves forward, so that it will continue to be satisfactory to the governed. The family must strike a balance between the adaptability of the system and the stability of the system. You don't want members to be able to change the governance system on a mere whim, nor do you want institutional restrictions cast in stone.

**The Family Mission Statement**

Every family, like every well-managed business, must have a mission statement that defines its goals and objectives, based on shared values. To encourage family members to consider what that mission statement should say, ask a few stimulating questions, such as:

- What are the 10 values you believe are most critical to the long-term success of the family?
- If you were 105 years old and celebrated your birthday today, what advice would you give your family members about what was really important in life?
- How would you describe your family 20 years from now if everything works out perfectly?
- What do you believe are the most important events in your family's history?

*"For families setting their long-term financial wealth preserving strategies, time is a friend in a way it is not for most investors."*

These questions will help family members discover their shared values and agree on a mission statement. Advisors should caution family members, however, not to expect specific outcomes from any given meeting. That could lead to frustration or anger if the group doesn't fit the convening individual's expectations. Remain open-minded and understand that the group may freely elect a course of action different than the one that appears most desirable to one or more of its members.

The family bank gives members a place to go for low-interest loans on terms that are not available commercially. The goal is to give the family opportunities to grow its financial wealth, while also encouraging the intellectual growth and development of individual members. Apply proper lending procedures.

**Preserving Wealth: Mission Impossible?**

Your family can set up a system that enables it to preserve its wealth successfully over more than a century. Any such system must include a structure of governance that is founded on a shared set of values that express the family's unique qualities and direction.

*"Failure to take advantage of time is a waste of a valuable family asset."*

The Rockefeller family has successfully preserved its wealth over the long haul. All Rockefeller family members are invited to meet once a year. They discuss issues on a generation by generation basis, recognizing that each generation has unique matters of concern and importance.

John D. Rockefeller Sr. made one of the best wealth-preserving decisions in history when he decided to release his son from the family business, because his son felt that his true calling was in philanthropy. As a result, John D. Rockefeller Jr., in turn, encouraged his children to pursue work that made them happy. The family's human capital increased accordingly. Now, 120 years after the creation of its fortune, the Rockefeller family clearly understands that its success depends upon the human and intellectual capital accumulated by its valued members.

# About the Author

**James E. Hughes Jr.** is a counsel at Day, Berry & Howard. As an attorney and estate planner, he has written several influential journal articles on family governance and wealth preservation. He specializes in multigenerational family meetings that result in family members drafting mission statements, and resolving governance issues. He is a frequent speaker on topics related to estate and trust planning.