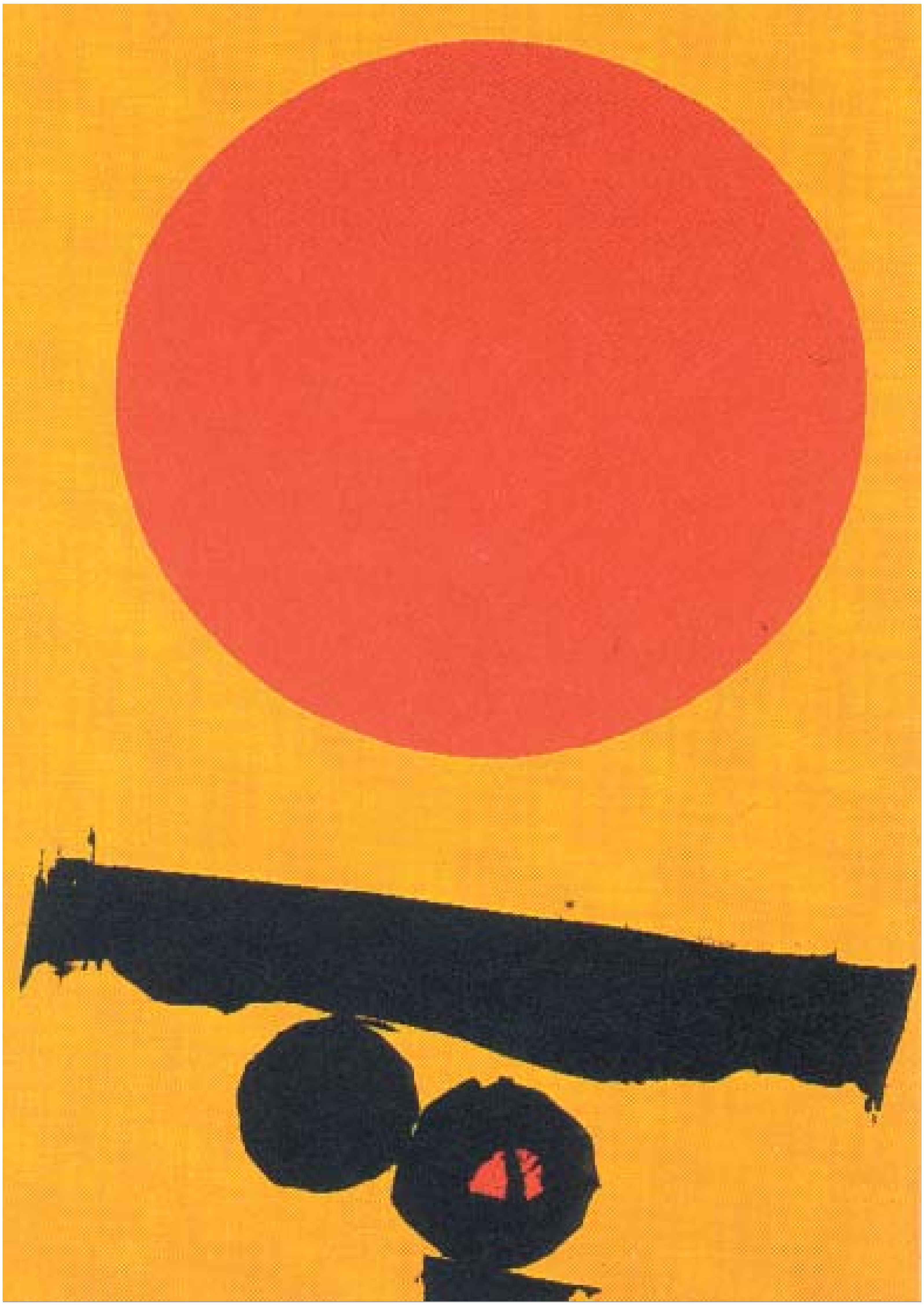

How to Preserve Capital in the Family Business

A New Identity for the "Family Office"

Beyond merely preserving assets and having a vehicle for diversifying investments, business families must think about how they are going to create and maintain their intellectual and human capital. Only by focusing on these two factors can one think about preserving economic capital in the long term. Conserving economic wealth must be a consequence, not an end in itself.

One of the keys to maintaining and increasing the family patrimony lies precisely in the way this concept is viewed. An accurate definition leads to preservation, while an erroneous definition can lead to it being squandered in the long term.

The old stereotype which states that the grandfather founds the company, the son maintains it, and the grandson dissipates it, ceases to be valid when we examine the realities of family-run companies and business families. Why does this growth and slump curve repeat itself as successive generations take over the reins? The causes behind whether or not a family-run company survives have been exhaustively analyzed from many different vantage points. However, examining the business family from the standpoint of the idea of family patrimony or wealth opens up new horizons of research based on the concept of a family balance sheet. This concept breaks with the limited scope of purely economic and financial assets, and expands its horizons to include other types of assets that are not solely material, the first and foremost of which is people.

Many of the problems that business families experience are most likely caused by focusing on a single purpose: conserving the family's economic capital. Although this is certainly a prime goal for those who have taken on the job of managing the family patrimony, focusing myopically on this task can be counterproductive because it can backburner the drive to develop other types of capital. Whether or not the human and intellectual capacities of the family members are developed directly conditions the sustainability of the economic capital, since these people will be the ones to act in the future, either following in the footsteps of the first entrepreneurial, responsible generation or, on the contrary, taking on the role of the proverbial third generation that squanders and ensures the dissipation of the patrimony handed down from their parents and grandparents.

Thinking about patrimony while bearing in mind this new type of asset gives the family a new perspective on its wealth, which "multiplies," transforms and fulfils the meaning and functions of the family office. Traditionally, the family office is associated with managing, conserving, and making the most of the economic wealth, that is, wealth management. If we view family capital as going far beyond the economic facet, the logical consequence will be that the family office is also concerned with these issues related to the creation and development of intellectual and human capital, which are the two fundamental pillars of any successful family enterprise.

Thus, if managing the family patrimony must necessarily encompass new factors, the business family must also adopt new tools for analysis. One of these tools is the family balance sheet, which can contribute to revealing the true state of a business family and offer ideas for managing and growing the family patrimony, starting with the development of both human and intellectual capital. Only in this way will it be possible in most cases to aspire to increase economic capital, which, in turn, becomes the cornerstone allowing the individuals in the family to develop.

Executive Summary

How can we define the wealth of a business family? Should it be limited to mere calculations, a penny up or down, of the economic patrimony? What measures should the family organization adopt in order to maintain this wealth and increase it over time? Wrong answers to these questions can lead to a loss in economic patrimony over the years, despite the previous generations' efforts to generate it.

Family patrimony is more than just money, investments, and real estate. Each member of the family is part of this patrimony, which must be properly managed. Only by doing so can we ensure that economic patrimony is conserved and, even more importantly, that it can contribute to the welfare of all family members.

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Preparing the family for the patrimony

The history of family-run companies shows that if there is no ongoing flow of information, if training is not provided, and if each family member does not participate with their effort, the result is a family free-for-all. As soon as a man and a woman form a family, a system of governance and the process of creating and preserving the family patrimony somehow get underway. From then on, the governance and development of the patrimony are based on the values that should have previously been defined in order to facilitate proper development of the family wealth in the broadest sense. As the years go by and new generations come onto the scene, this system of governance should continue to be capable of achieving these objectives of economic, human, and intellectual development by upholding a principle: the goal is not to adapt and prepare the company patrimony for the family, rather to prepare the family for the company patrimony.

A "different" kind of balance sheet

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Assets	Liabilities
People	Personal liabilities Other liabilities
Economic Assets	Family capital

People: They are the family's most important asset, that is, each of its members. Consequently, and in order to "balance the books," this point includes the need to define the family "perimeter": Who - for these purposes - do we consider to be part of the family? Only the current owners? Those who will be owners in the future? Only the family members in the blood line…?

Assets: The entire set of economic assets: companies, shares, real estate, etc.

Continuing on with the logic of a balance sheet, in the liabilities we have to identify and pinpoint both the personal liabilities (physical and emotional status of the family members, possible shortcomings, etc.) and the non-personal liabilities (debt, taxes, inflation, etc.).

In the realm of enterprise, it is often thought that business leaders should spend far more time and effort managing assets than liabilities. If we shift this principle to the concept of family balance sheet and family-run companies and business families, a business family must make an effort to develop its human activities, not just its economic activities. And just as it is important to manage liabilities in an organization - such as achieving savings on taxes - it is also accepted that these cut-backs will never be as important as the opportunity cost of the income not earned as a result of inadequate education and training of some family members.

Soundly Managing Assets: People First

Thus, once we have decided to manage the assets, we have to continue examining and breaking down the different types of assets within the major categories that have been defined:

Assets	
People	Human assets Intellectual assets
Economic assets	Economic assets Emotional Non-emotional Leisure assets used jointly

People

Human assets. This category includes all factors related to each family member: characteristics, personal skills and talents, physical and emotional health, values, character, attitude, and circumstances. In short, it entails their degree of happiness measured by their esteem and respect for themselves and others. The physical and emotional well-being of individual

Figure 1: Family Balance Sheet

	Assets		Liabilities
People	• Human assets • Intellectual assets	Liabilities	• Clashes and loss of joint values • Illness, death, divorce, family secrets • Risks to personal safety • Debts • Taxes and inflation
Assets	• Economic assets • Emotional • Non-emotional • Leisure assets used jointly	Capital	• Human • Intellectual • Financial

members of the family has to be the most important goal. Management of the human assets must be concerned with the following factors:

- Taking care of the physical and emotional well-being of each family member, setting up the mechanisms to meet their basic needs and the systems to protect them in special situations, should they arise.
- Developing and conveying the culture of effort and work as a key value in the individual.
- Ensuring that each family member is familiar with the family's governing system and their role within it.
- Developing a global, international mindset.
- Internalizing and developing the agreed upon, declared family values.

Intellectual assets

This category includes the content and package of knowledge and education - both formal and informal - received through training and experience or through family tradition and culture, and esteem and respect for the family and society. In this sense, and in the context of an increasingly global society, the wealth of a business family will be based on its members' training, which must become a solid, adequate basis for making decisions. Thus, managing the intellectual assets must achieve the following:

- Developing personal intellectual capacities to their full extent through top-notch training plans.
- Fostering each family member's different skills by providing them with high quality international training.
- Implementing information and communication systems within the family governance that are clear and easy to use for everyone.
- Providing for the needs of cohesion among different generations.

Assets

Economic-emotional assets

These are the assets which, in addition to their economic content, represent yet more for the family: the efforts and toil of previous generations to develop the family's company, its products, brands, or human teams (part of the family members' life is in them). Thus, management of and decisions on these assets cannot solely be based on parameters of profitability and financial opportunity cost. At times, even a real estate asset can be identified with the life and tradition of the family, so that in addition to its economic value it also has a high emotional value for the family.

- Defining the mission and vision of these assets (shares from the traditional business, certain real estate holdings, etc.).
- Agreeing on under what conditions or circumstances they can be gotten rid of.
- Outlining the rights and obligations involved, so that they can be accepted by all family members.
- Setting criteria for ownership and use of these assets.

Non-emotional economic assets

This includes assets that are purely financial and real estate investments that are totally devoid of emotional connotations. Their management and government can and should be solely based on market criteria.

Leisure assets used jointly.

Vacation homes, as well as other assets related to leisure, entertainment, and the like that require agreed upon rules and criteria for use by family members in order to prevent conflict.

Knowing the bottom line, the first step to safeguarding and increasing family health

A balance sheet aims to measure the economic health of a company at any given time. The family balance sheet (a complete version of which appears in Figure 1) strives to measure how a family has organized all its assets. However, the liabilities, as listed in Figure 1, are more difficult to manage. They represent risks that must avoided or limited as far as possible. By analyzing and managing assets, the people at the helm of the family can find out how they are doing and, more importantly, the status of each family member in his or her quest for individual happiness.

If the individuals at the head of the family are familiar with these human and intellectual assets, they can ensure that

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they are preserved in the long term and that the family's overall risk profile decreases. Without human capital there is no family. Without intellectual capital, an under-educated family, though enormously wealthy, will be unable to make informed decisions systematically: their errors will outnumber their sound decisions. The upshot? The family wealth will dissipate as a result of misguided decisions.

A system of family governance on par with what we want the family to be

Once we have understood that managing human and intellectual assets is key to ensuring the preservation of the family assets in the long term, and that financial capital must be used to support this, it becomes crystal clear that we must have a system of governance on par with these goals.

Applying the business criterion of concentrating on and prioritizing the management of assets over liabilities, let us examine what this system of family governance should look like. A constitution, protocol, or family code might help define it, but it must always take into account the following factors and principles:

1. There must be a joint vision and mission among all the family members based on identified, agreed upon values.

2. It must define the model and type of family company it wants to be and why. Reasons for staying together.

3. It must provide for the appropriate governing bodies and systems, such as a family assembly and council, with their corresponding rules. These give all family members a voice and should mainly have a horizontal focus as opposed to a more hierarchical approach (since everyone in the family is equal).

4. It must define set, recurring processes and habits, not just occasional ones; it should foster dialog based on information and communication systems.

5. It must stipulate a governing approach that is closer to caring motivation - that is, that an investment is made in every family member, in the individual - than to caretaking - "I give," "your turn," "I distribute to you when I dole out"…

6. It must make a priority of setting up a training framework and realistic, comprehensible plans that create a situation in which all family members can be trained and develop their skills to the maximum. It must set mainly qualitative objectives - and follow up on them - as opposed to quantitative ones.

7. It should allow family members to be "independent," yet ensure that this is compatible with the sense of depending on each other for help, comparing opinions, etc.

8. It should organize a family office with a clear goal in mind: family happiness. The family capital administered by the family office should provide adequate support so that the family has the resources and systems it needs to foster family members' human and intellectual capital as much as possible.

A sound system of family governance aimed at achieving the well-being of each family member will enable the family capital to be preserved in the long term. However, just like anything else, this cannot be taken for granted: it requires effort. Organizing the family office means laying the cornerstone so that current and future owners will have a shareholder's center that will help them to identify more closely with the concept of business family, thus ensuring its survival generation after generation. ■