For families-in-business and families of wealth . . . Today and Tomorrow

Taking Risks
by Dean R. Fowler, Ph.D.

The Saga:

We've all heard the saying --

"from rags to riches to rags in three generations"

But what lies beneath the rags to riches to rags saga?

A recent research study conducted by the Family Office Exchange and Harris myCFO explored how threats to intergenerational wealth are more complex than poor investment choices or the failure to implement solid financial or estate planning.[1] The rags to riches to rags saga is as true for families of wealth, as it is for families-in-business, where 70% of family businesses fail to transition successfully to the next generation.

The authors of the research study argue that this repeated saga is rooted both in the failure to manage downside risk , and perhaps more importantly, in the failure to capitalize on new opportunities by developing and encouraging a family culture of risk taking.

To identify the most critical risks facing a family, Dean R. Fowler, Ph. D. developed assessment tools that measure twelve key dimensions of risk in the areas of family dynamics, the development of the next generation, the management of either the business or of financial assets, and finally the ownership transition plan. By completing a comprehensive questionnaire online, a forty-two page report is created that includes an assessment of the risk in these critical areas and provides specific recommendations related to these risks.

Dean Fowler Associates' Assessment Tools are available for the following situations. (For more information on the Assessment Tools please go to: http://www.deanfowler.com/assessment.php

The Family Wealth Dynamics Assessment Tool™
- for intergenerational transition of family wealth

The Family Business Assessment Tool™
- for intergenerational transition of family businesses

The Business Partners Assessment Tool
- for siblings, cousins or non-related partners in business together

Managing Downside Risk:

Known risks are perhaps the easiest risks to manage. And most professional advisors provide solutions to known risks. Estate planning, financial planning, insurance planning, even strategic business planning are all methods to deal with known risks - taxes, retirement, death, and competition to name a few.

Unknown risks are more complicated, but a regular process to review such risks helps mitigate these unknown dangers. While many unknown risks (threats) are from the outside - such as government regulations, world events, and the natural environment -- others are internal and rooted in the soft side emotional issues that can undermine family unity and a shared commitment to the future if not properly addressed.

C**reating a Risk Taking Culture:**

Beyond managing downside risk for multigenerational success, families must also create a culture that encourages risk taking. For most families, the wealth created in past generations was built by taking entrepreneurial risks; in fact, family stories of wealth creators and business founders are usually stories of amazing risk taking. Starting a business during the Great Depression, or mortgaging the house and all other assets to buy a piece of equipment, or taking on bank debt on the same day as the newest child in the family was born.

Creating a culture of risk requires creating a culture of experiential learning. Without real experience in the real world, the next generation will never learn how to take risks. And without taking any risks, the wealth created in one generation will be lost in future generations.

Too many families create a culture of conservation rather than a culture of risk. Experience in risk taking involves learning by doing, and making mistakes. For both families-in-business and families of wealth, too often the next generation is "sheltered" from decision making, and consequently gain little viable experience addressing risk and making tough decisions.

The failure to create a culture of risk - which is necessary for the multigenerational success of a thriving legacy -- is rooted in two interrelated issues. First, is the senior generation's need for control, and the consequent lack of delegation of responsibility to the . For wealth transitions control is often maintained through the structuring of trusts (designed to minimize estate taxes) which put control in the hands of trustees and provide little exposure to real life experience for the beneficiaries. For family business transitions control is often maintained by the senior generation until the death of the second parent. Recapitalization of the stock (designed to minimize estate taxes) creates passive owners who have little or no voice in the decision making of the corporation.

Actions to Consider:

To avoid the "rags to riches to rags" saga I encourage my client families to involve the extended family - both generations - in designing a shared future. Planning should not simply be driven by the demands of the tax code, but must also be designed to foster a shared dream as well as supporting the individual dreams and passions of family members.

In this spirit, consider implementing the following for managing downside risk and fostering a culture of risk taking.

- Discuss the "soft side of hard issues" at least quarterly through structured and facilitated Family Council meetings to address the emotional dynamics that may undermine family unity. To read more about Family Council meetings, go to: http://www.deanfowler.com/articles/the_family_council.pdf
- Regularly discuss risks in three major areas -- your family, your investments, and your business --- and prioritize these risks in order to develop plans for managing the most strategic risks.
- Be proactive within the family and with your advisors to improve regular and structured discussions about managing risks, and also identifying opportunities for growth that involve taking risks.
- For families-in-business:
    - Complete The Family Business Assessment Tool™ process to identify the risks facing your family.
    - Set a policy that family members must work outside the family business for several years to develop their own personal and financial independence.
    - Delegate more responsibility to capable family members employed in the business to make decisions and gain hands-on experience.
    - Include the buy-out of the senior generation as a key element of the transition of ownership between generations so that risk shifts to the next generation.
- For families of wealth:
    - Complete The Family Wealth Dynamics Assessment Tool™ process to identify the risks facing your family.
    - Require that individuals generate their own personal income rather than living totally off of inherited wealth.
    - Have some portion of inherited wealth under the direct control of the next generation to encourage their own risk taking and learn through their own experience.
    - Evaluate the impact of the way that trusts are designed to avoid fostering co-dependency and undermining individual authority and responsibility.
    - Clarify the roles, responsibilities, and expectations for the communication and interrelationship between trustees and beneficiaries.

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[1] Contact Anna Nichols (anichols@familyoffice.com) at the Family Office Exchange in Chicago to request a complete copy of their fifty-two page research report entitled "Managing Threats and Opportunities through Effective Risk Planning."