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Managing Risk in Family Businesses

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Linda Bourn
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While advisors fiddle with asset allocations, families may face disaster

Most family businesses are at risk much more than they realize. When family firms begin, their risk profile is relatively simple. They then grow in complexity over time, often evolving into substantial family enterprises in the second, third or fourth generation of ownership. Sometimes, the operating business is replaced by a family office that's responsible for the family's wealth and assets. In these cases, the family itself often gets left out of the organizational risk management plan. According to a new study benchmarking risk management preparedness, *The Family Enterprise Risk Index*, which Crystal & Company created in partnership with Family Office Metrics, less than one-third of risk management plans for family enterprises cover risks to the family itself. Some examples of family specific risks that could impact the whole enterprise include roles of trustee or independent directors, global travel and security and ownership of unique assets, such as airplanes, that may also be used by the business. Advisors and family members all too often don't communicate about these risk items, which can have a serious impact on the entire enterprise.

Often, the absence of communication between advisors and family members at complex, multigenerational family enterprises stems from advisors having their roles limited to their areas of technical expertise, usually the business or asset management side of the enterprise. But, to properly counsel these clients on matters of risk management, an advisor needs a full line of sight into the family and its business and lifestyle activities, not just their investments.

To understand more about why advisors and clients are so disconnected and how to best address these communication gaps, we sat down with Eugene Lipitz, Chief Investment Officer of his family office, and Barbara R. Houser, lawyer and long-standing family enterprise expert, and asked them to share their perspectives.

Lipitz and Hauser both said that the lack of awareness of the need to incorporate the family and inability to determine risk management priorities are often major obstacles, and much of the responsibility for risk management decisions depends on the structure of the enterprise. The more formal the structure of the enterprise, the more regimented the communication process tends to be. For example, some family enterprises have risk management committees as part of their governance structure or operating company associated with a Board of Directors. At the other end of the spectrum, discussions about risk management may occur during casual family gatherings.

Lipitz noted that if the family initiates a conversation about risk, then that's already a red flag. "A family office should be looking at everything through the lens of risk management, otherwise, a disconnect occurs right off the bat," he says. Instead, the family's interdisciplinary team of advisors should fold the discussion into their ongoing communication with the family owners.

“For example, in the case of my family,” says Lipitz, “where the operating business was sold, it was the family office’s responsibility to initiate discussions about risk management with regard to important family issues.”

The skill set for advisors having these types of conversations requires a person with a high emotional intelligence quotient. According to Hauser, an advisor needs to be aware that discussing risks, particularly those that could impact the family directly, is a sensitive topic. Building trust with the organization and developing a strong relationship is crucial before addressing areas that are personal to the client. It’s not always easy to have conversations about a death in the family or what to do if someone is kidnapped.

An advisor’s job should extend beyond bringing awareness to risk management needs to helping clients develop plans and processes to addresses their risks. Scenario planning, for things like succession planning and business continuity needs, is also important. “Be proactive about running ‘fire drills’ to model potential hazards to the family’s assets, and establish and regularly test business continuity plans, documenting relevant crisis plans in a binder,” recommends Hauser. Follow up with in-person meetings to evaluate where the gaps are and continuously improve the plan. Hauser also suggests going a step further to tackle tough subjects, like what would happen to finances or leadership if the founder were suddenly not available. Discuss where the wealth would go, and who would be in charge if certain scenarios play out to help take some uncertainty out of a very stressful situation.

Ultimately, Hauser and Lipitz both agree that advisors and families need to align themselves when it comes to both addressing risk and communicating about it. The best asset allocation is for naught if ongoing risk awareness and education are missing.

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