Running the family office

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This paper comprises excerpts from a joint KPMG-The Table Club (TTC) *Wealth in transition: Family offices in plain view* report of October 2021, detailing findings from a survey conducted in late 2020 to early 2021. TTC is a private membership group founded in Australia in 2009, connecting over 1,300 family offices/ultra-high-net-worths (UHNWs) across 10 geographies.

The survey comprised quantitative and qualitative engagements with over 80 Family Offices and UHNWs across Australia, Asia, and New Zealand. The aim was to learn more about the evolution of family offices in the region, and to understand how participants were managing macro-challenges.

Overview

As families and their family offices become more financially sophisticated and professional, we wanted to understand what impact this has had on the operation of the office and administration of family wealth.

Within the family office, respondents said the most significant costs related to the running of investments were salary and remuneration, technology and IT infrastructure, and third-party investment management fees. Other administration costs, such as asset custody, have decreased as a consequence of new technologies.

In most family offices, there are also costs related to the management of non-income-producing assets such as yachts. Managing these costs requires confirming exactly whose responsibility it is for their maintenance and costs, and formalising that process.

Data-driven family offices

In today's data-driven environment, there are numerous options available to family offices to help collect data, analyse it and share that information in a meaningful way. We found that increasingly, family offices are looking for solutions from both service and software providers based in the US and Europe. The growth of virtual conferences makes this possible.

Often, these providers do not take ownership of assets in any way. Instead, they aggregate data from several sources and then present that information back to family offices through customised reporting.

Legacy technology

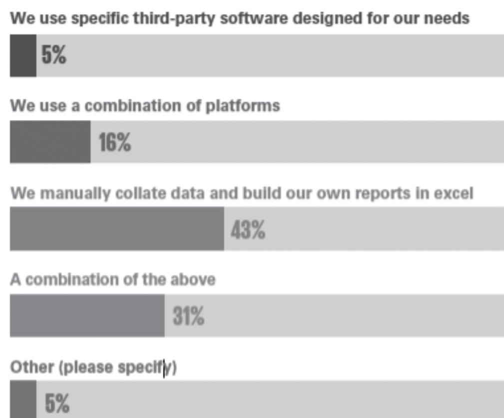
Despite their interest in new technology solutions, several responses suggested that many family offices are currently relying on legacy technology to support reporting capability. Figure 1 on the next page shows the extent to which family offices use specialist software as part of their investment reporting.

Over 40% of family offices reported they were collating data manually to build their own reports in Excel. Another 16% used Excel in conjunction with other reporting software, and 30% used another combination.

One respondent suggested that family offices are lacking awareness of the costs of the manual administration:

Excel is an excellent tool; it is customisable and inexpensive in terms of

Figure 1. To what extent do you use specialist software in your investment reporting?



software costs. What we don't see taken into consideration is staff costs for manual management of assets. I think if family offices broke down the time and effort it takes to manage the reporting and data analytics, there would be more moving to digitisation.

We also found that a number of family offices have not invested time to become familiar with technology that could enable deeper and more insightful sharing of information with family members.

For example, in response to the question, 'How do you use technology when reporting to family members?', the emphasis was to rely on tried and trusted methods of communication—largely email (72.72%) (see Figure 2).

While this form of communication may not enable the rich data reporting that some specialist software can provide, it could also expose family office to cybersecurity risks.

Cybersecurity risks

When it comes to cybersecurity threats, our research found that over half of the respondents had received several threats to their IT security. Just over one-quarter (26%) of respondents had experienced a cyberattack. Close to 60% said they were actively considering how to manage cybersecurity risks as part of their risk management process (see Figure 3).

Further, over 53% of respondents reported being subject to cybersecurity threats.

A recent study from Boston Private (now part of law firm Dentons), *Surveying the risk and threat landscape to family offices*, reported that several factors affected the capacity of family offices to manage risks.

These included:

- lack of risk awareness among family and family office staff
- general complacency or prioritisation of convenience over security
- underestimation of the threats

Figure 2. How do you use technology when reporting to family members? (multiple responses possible)

Figure 3. How are you managing the threat of security risks?

- difficulty in identifying appropriate vendors suitable to the family office market.

Family offices now need to be more vigilant in the management of risks in general—not just investment risks.

Staffing—recruitment and retention

As a family's financial affairs become more diverse, there is often an increase in the number of staff employed by

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The quote

Family office employees often have influence, a broader remit, and greater control of outcomes.

the family office. Some have over 100 staff across separate operations and functions, doing everything from managing a family's farming assets, captaining boats or piloting helicopters.

Within the family office itself, role descriptions and responsibilities can typically be unclear. The chief financial officer may double as the chief risk officer, with an overlap in managing regulation and compliance with the chief investment officer.

Consequently, benchmarking a market rate of remuneration is not straightforward. Likewise, it can be complex to set specific performance goals from which a discretionary bonus may be paid.

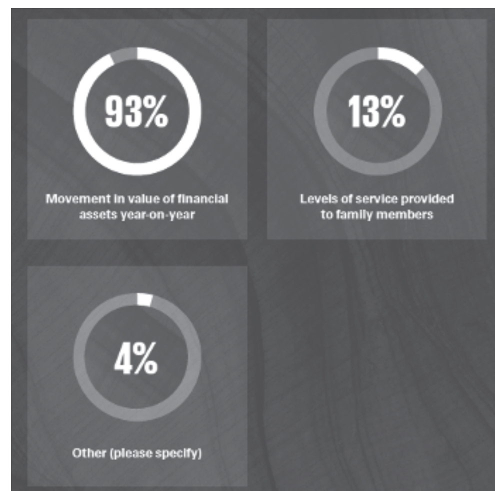
While some may find a lack of formal structure disorientating, family offices are becoming increasingly attractive places to work, competing with larger institutions for quality staff. Family office employees often have influence, a broader remit, and greater control of outcomes.

Globally, the demand for experienced family office staff is being met with an increase in recruitment dedicated to the family office market.

Performance assessment

We asked our participants how the performance of the family office was measured, and the most significant measurement was the movement in the value of financial assets year-on-year (see Figure 4).

Figure 4. How do you measure the performance of the family office/wealth structure? (multiple responses possible)



It follows that in assessing individual staff performance, the movement in the value of financial assets remains a key measure. Our study suggests that individual performance is measured as a combination of 'qualitative and quantitative' factors, with over 65% of Family Offices using both.

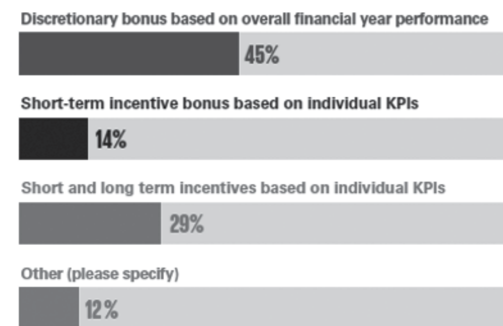
Recognising the focus on the performance of financial assets, we asked whether certain executives were allowed to invest alongside the family. Several executives would probably have played a role in reviewing investments and undertaking operational due diligence.

Roughly 60% of respondents said that, where appropriate, this co-investment was possible. However, a sizeable minority preferred to separate family investments. With family offices generally not offering long-term equity incentives, the incentive of co-investing alongside the family represents a compromise. To what extent the development of more sophisticated 'shadow equity' reward arrangements are made remains to be seen.

Note: A shadow equity arrangement grants employees a right to receive compensation based on the value of the company's equity. In cases of private companies, the arrangement would specify how that equity is to be valued.

With regard to rewards, Figure 5 indicates that discretion still dictates both whether a bonus is paid, and the amount. Just over 40% of respondents suggested that

Figure 5. How do you reward staff by way of additional incentives?



additional staff rewards were calculated based on the achievement of KPIs.

Most family offices prefer to exercise discretion when rewarding executives by way of a bonus. However, increasingly, family offices are looking to benchmark family office roles and understand how others are structuring rewards.

Conclusion

While some family offices are struggling to understand how technology can increase their back-office efficiencies, others are embracing new software to drive powerful data and analytics for decision-making.

As threat actors rise, so do the cybersecurity risks for family office operations, with security incidents increasing locally and globally. While risk management needs to be proactively managed, family offices are more reactive and may underestimate the likelihood and impact of risks beyond investment risks.

Third-party technology platforms able to collate data efficiently and accurately will continue to be more easily accessible and drive down administration costs.

Family offices are now attracting talented, skilled staff by offering a higher level of autonomy, flexibility, and the ability

to have meaningful impact on investment decision-making.

Moreover, family offices will need to benchmark their performance, culture and purpose as a basis for competing for talent. This will result in an increase in the costs of hiring for and managing family offices in relation to salary and wage costs. **FS**

The quote

Increasingly, family offices are looking to benchmark family office roles and understand how others are structuring rewards.