

# Creating True Wealth Transfer

## A Shift in Mindset

By Kathryn Dreghorn Linden and Fredda Herz Brown, PhD

Family wealth transfer has become so trendy that even characters in popular literature are dealing with it. In the recent bestseller *The Girl Who Kicked the Hornet's Nest*, Lisbeth Salander gives her financial advisor an opportunity to make a lot of money by taking her as his only client. After several years in this arrangement, the financial advisor has this to say:

This is so much money that it scares the sh\*t out of me. I don't know how to handle it. I don't know the purpose . . . besides making more money. What's all the money going to be used for? . . .

[M]oney can become an end in itself. It's crazy. That's why I've decided to call it quits when I've earned ten million for myself. I don't want the responsibility any longer. . . .

But before I call it a day I want you to decide how this fortune is to be administered in the future. There has to be a purpose and guidelines and some kind of organization that can take over.

This excerpt reflects what family wealth transfer is all about: a huge, complex responsibility.

It demands a clear sense of the following:

- what is being transferred and the purpose of transferring it,
- who it is being transferred to in what length of time, and
- structures and processes necessary to deal with the complexities.

The intent of wealth transfer must be communicated and understood by capable recipients. This is not a simple undertaking for the client or wealth advisor because all of these elements are interrelated and iterative.

Incorporating all the moving parts of true wealth transfer requires a few preconceived ideas/assumptions to shift and a few additional markers of success to be defined.

### What is Wealth Transfer?

Wealth transfer traditionally has included skillfully crafted financial vehicles that preserve the greatest amount of wealth while reducing financial risk and liabilities in light of needs, values, charitable interests, and goals. This model connects financial and human capital, but it fails to broadly and deeply address the issues that need to be addressed to sustain multiple generations.

First, let's think about "what" needs to be transferred to future generations. A family's wealth is far more than financial assets. It's best defined by the family's uniquely held and reciprocally related human and financial capital. We call this "family capital," and it includes the emotional, spiritual, social, and intellectual capital (i.e., human capital) as well as the economic resources (i.e., financial capital) shared within families. All of these assets need to be considered, developed, and planned for as a family prepares for transfer.

This expanded definition of what is being transferred—family capital—requires considering the ways in which risks to both the financial and human capital can be minimized.

Williams and Preisser (2003) highlight the importance of human-capital

risks. They found that among 3,500 families studied around the world, only 3 percent of those that failed to achieve three-generational sustainability suffered tax and financial errors. Far more failures resulted from human-capital mishaps such as unprepared heirs or faulty family communication. Clearly any wealth advisor who fails to consider all the family's resources contributes to the risk that grandchildren will make the round-trip back to their grandparents' humble beginnings.

As Lisbeth's advisor makes clear, making and transferring money for money's sake loses interest. Most wealth transfers are tax-driven initially, but transferring money with meaning and purpose makes the transfer more successful and sustainable. Those who prepare wealth transfer plans have a responsibility to broaden their views about wealth and help clients think about transferring nonfinancial wealth and the purpose of doing so. And when wealth transfer includes human capital, then the definition of the client broadens to include the next generation—the recipients—who need to be prepared to sustain the family's financial and human resources.

### Who is the Client?

Wealth transfer advisors' clients go way beyond wealth-generating individuals or couples. These advisors are dealing with at least three generations of a family, which can encompass scores of people. The wealth holder may engage the advisor, but the rest of the family is the ultimate client.

Given the typical three-generation barrier to preserving wealth, it makes sense that recipients are the key to suc-



cess. What the recipients do with the wealth, their understanding of the purpose of the wealth, and the impact that the wealth has on individual members and the family as a whole determine how the wealth is managed.

This is why the client is inevitably the family and why human capital demands to be purposely incorporated in the planning process.

Consider the following example:

Jim, a second-generation member of a large real estate family, sought our consult when a wealth transfer plan he had devised had gone astray. With his advisor's assistance he had developed a plan to pass on his real estate holdings to his children. He was very clear that his intent was to be tax-efficient but at the same time preserve the next-generation's relationships. He reported that he discussed with the advisor the negative consequences in his own generation where his father, without his knowledge, left him as trustee and managing partner of all of his own and two older sisters' property. Upon his father's death, his sisters sued the estate for control of their own assets. He sought to prevent the same difficulty and therefore had established four separate trusts for his four children's holdings so that they could have control of their assets. Only one of these offspring had experience with real estate and was made head of the management company that all of the trusts would engage to handle their holdings. He had not discussed this idea with the son who would be managing the properties and had done little to prepare the others for their wealth.

While this man was trying to prevent difficulty, he repeated a fatal flaw of the previous generation: He failed to

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communicate with and prepare the next generation. Because plans are always for the future, those who will live with them need to be part of the planning. Jim's advisor needed to be thinking beyond Jim and considering consequences for the rest of the family, too.

#### Family Evolution: The Numbers Game

One of our clients recently said, “The problem in our family is that we, my cousins and I, keep looking up three generations at grandpa's existence and see a billionaire and fail to understand that we will never again have that in our lives.”

Successive generations result in family population explosions. Often adding just one generation can mean that family population doubles, triples, or even quadruples. Even at a good rate of return on investment, assets typically cannot keep pace with family growth.

Think about a sole proprietor who leaves a business to three grown children. The children marry and the population doubles. Each couple has children who marry and have children and the population again doubles or even triples. Unless this is an entrepreneurial family, the assets won't have grown accordingly.

But some families do achieve sustainability, and the Laird Norton family is a good example (Steen 2008). This family took opportunities to diversify and prepare for changes in the industry and within the family. Chalan Colby, the family president, explains how her family no longer is involved in the legacy business in the timber industry. Rather, the family now views itself as

a family that has long-term business partnerships and currently is involved in financial services, real estate, and next-generation investments. This family is now six generations out, has 400 members, and is thriving financially. The family doesn't equate family membership with ownership; family members may exit from holdings while maintaining membership in the clan. When a family can separate membership and ownership, this allows for the individual diversification of assets and interests and promotes an entrepreneurial spirit, which is a benchmark of a sustainable family. The Laird Norton family has achieved sustainability by considering family capital and thinking about the long term.

#### Family Evolution: Demographics and Emotions

By the third generation a family is large and it is diverse in geography, ages, and interests. This presents risks and opportunities. It's harder to communicate with people who don't live under one roof, let alone in one area of the country. Types of membership expand as the family grows. Typically over time more family members won't work in the family business than do, and this creates differences in perspectives that a family will need to address.

A family's values shift with each generation, too. The third generation makes up a branch family, i.e., a clan, that often introduces power struggles. Family dynamics start to resemble those of political parties. Families that share the ownership of financial and physical assets also share risks and opportuni-

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ties. A shared mission, vision, and plan prepares members for joint decision-making and supports a collective family understanding and awareness of what is required to sustain the family over time.

A family with a sustainable vision sees the opportunities in developing the family's human capital, which can in turn grow financial capital and vice-versa. When a family can make this shift in thinking and leverage the knowledge, interests, and capabilities of its members, then it can see all its resources and integrate all its assets.

### Structures, Processes, and Experiences

Recall Lisbeth's advisor's comment that "there has to be some guidelines and some kind of organization that can take over." That "organization" is the function of governance and governance is what "takes over."

All families have inherent governance, a way that they make decisions and organize themselves. Families that share ownership of assets have more-complicated decisions and need decision-making and organization that are more systematic and overt.

A successful business requires organizational structures, processes, and procedures to remain viable over time, and so does a family of wealth. Governance is the chosen set of structures, processes, policies, and procedures that accommodate the family vision, account and respond to change over time, and transfer family capital across generations.

Families that view family capital more broadly than just financial capital and acknowledge the synergy between financial and human resources can create structures to support their vision and mission. These structures and processes must be deliberate and explicit to

outweigh inadequate or even destructive family patterns of behavior.

Wealth advisors and their clients shouldn't discount the powerful tendency to revert to old patterns of relating and decision-making. No matter how accomplished we are or how many years since we left home, we've all experienced the holiday or family event where we've returned to disturbing patterns with siblings or parents.

Boards, committees, task groups, and family meetings are all examples of governance structures, and they all provide experiential learning for the next generation. Through the process of establishing and participating in governance, young and old learn how to make decisions together. This provides the older generation with opportunities to teach and develop and the younger generation with opportunities to learn.

### Conclusion

True wealth transfer focuses on the synergies of various forms of family capital. We support shifting the definition of "success" from the singular transfer of financial wealth to helping the family develop a plan that considers the family's human capital and its relationship to the sustainability of the family's financial capital.

As Lisbeth's advisor said, wealth can be an opportunity and managing it can be overwhelming. Our intention has been to help expand wealth advisors' mindsets so they can help clients turn wealth into greater opportunity and sustainability.

This new mindset means that advisors begin developing ways to assess family human capital the same way they assess financial capital when they engage clients. Giving human capital equal consideration from the beginning gives clients a different context for mea-

suring the advisor's success as well as a different way to examine their own.

True family wealth transfer is a process of intricate details and broad scope. Advisors need to ask how much they can do themselves and how much is beyond their scope of skills or resources. A team approach may be the best approach to the complexities of and hard work needed to achieve true and sustainable family wealth transfer. 

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