Separating family wealth from the family business

"While successful businesses benefit from disciplined operations and strategic planning, the management of family wealth is often eclipsed by the needs of the business and improperly delegated to trusted business executives. Ostensibly practical, this approach of embedding the Family Office inside a business can result in a loss of critical long-term financial benefits as well as expose the family to unnecessary risks."

Family Office Exchange (FOX)
Boundaries That Matter: Managing Family Assets Outside the Family Business (2021)

Ask any executive in a family business what they do for a living, and you may be met with a puzzled look. Describing the breadth of their daily responsibilities is no easy task.

Beyond managing operations and delivering on the business plan, family business executives are pulled in many directions. From overseeing non-core investments and paying private bills to mediating family disputes, their role frequently extends far beyond traditional business boundaries.

As family businesses grow, so do the needs of the families behind them - yet resources often don't evolve at the same pace. This misalignment can leave executives juggling responsibilities that blur the line between business and family.

Best practice is clear: private family matters should be kept separate from the business. A dedicated Family Office achieves this by providing all family members, whether involved in the business or not, access to services that are difficult to justify as business expenses, including wealth management, family education and philanthropy. It also establishes a distinct governance framework, helping families maintain oversight and a shareholder perspective.

While families often cite cost and convenience as reasons for not properly resourcing these functions, the true cost of getting it wrong can be significant.

In this article, we explore the risks that can arise when family wealth and business affairs become intertwined, and why separating the two can support stronger governance, better outcomes and a more enduring legacy.

1. Distraction of executives

Executives are recruited for their business expertise – not to manage investment portfolios or private expenses. Yet, many find themselves doing exactly that.

This raises important questions: What trade-offs are being made? What opportunities are being missed because leadership attention is diluted? Importantly – does this create an environment where underperformance can be rationalised?

2. Favouritism among family members

Family members working in the business often have greater access to executives and corporate resources than those outside it. This can create imbalance, fuel resentment and place executives in a compromised position.

As FOX notes: "Managing family wealth inside the company can create a 'second class status' for family members who aren't working in the business".

3. Poor investment performance

It's unrealistic to expect executives to maintain full oversight of business operations while managing share portfolios and investment properties. The lack of focus can lead to costly mistakes, such as poor investment decisions - or even no decisions at all.

"Managing private business and integrated wealth management strategies are two very different undertakings and shouldn't be combined. Each venture requires different skills, employs different service principles and ultimately serves the family members in very different ways." explains FOX.

4. Overshadowing the family identity

When the business is a family's primary source of income and attention, it can dominate family life.

It's important for families to define their vision and legacy independently of the operating business, to avoid corporate responsibilities dominating other aspects of family life. As FOX observes: "Embedding a Family Office within a family business perpetuates the dominant influence of the business, giving it an even bigger presence in the private lives of family members."

5. Poor governance

Blending business and investment activities weakens governance and capital management. New projects or acquisitions in a family business are not often assessed with the same rigour as external opportunities, leading to over-concentration and increased risk exposure.

6. Inadequate systems & processes

Business systems aren't designed to manage complex personal investments. Forcing share portfolios or investment properties into business platforms or spreadsheets creates inefficiencies and increases the risk of errors.

A dedicated Family Office allows access to specialist systems (investment administration software, property management systems and tax compliance platforms) that improve accuracy and reporting.

7. Discounted business sale price

Poor governance can diminish the appeal of a business to prospective buyers, particularly when owners are unable to present a clean set of financial statements. When personal expenses, such as school fees or private vehicle costs, are routed through the business, it signals weak control, lack of discipline, perceived risk and reduced transparency. As a result, the purchaser will likely discount the valuation.

8. Privacy risks

Families entrust advisors with highly sensitive and confidential information. When those advisors also serve as executives in the family business, the risk of unintended disclosure increases. As FOX notes: "Even when employees are well-intentioned, there can be incidents where documents are left on a printer, files are accessed through the company network or a phone call is overheard. Regardless of how the information gets out, it's easy for sensitive family matters to become common knowledge when housed in a business setting."

9. Heightened key person risk

The departure of a key executive can be highly disruptive for any business. When that executive also manages private family matters, the risk is heightened. As FOX explains: "… by diverting company executives to spend time on personal family finances, the family risks concentrating too much critical financial information with one person. Not only is this person a valued and essential business employee but they are now also central to the family's financial well-being so that the two become intertwined. If that person leaves, the family incurs a double loss."

10. Legal risks

Co-mingling assets exposes family wealth to business liabilities. When a business holds non-core assets - such as properties, surplus cash reserves or other investments – those assets become vulnerable if the business faces a major legal liability, such as a customer claim, an OH&S incident or a breach of banking covenants. The fundamental principle of asset protection is clear: segregate assets to quarantine risk.

11. Hidden costs

Embedding Family Office functions within the business may appear cost-effective, however it is often a false economy. As FOX notes, "Saving $400k on up-front costs and fees is of no value if the family later misses out on millions in tax savings or investment gains."

When the time comes to unbundle Family Office and Family Business Wealth

As families grow in size and complexity, there comes a point where the business can no longer meet their evolving needs. This is when it becomes critical to address the management of their personal financial future with the same diligence that goes into managing the future of the business.

FOX data shows that over one-quarter of Australian Family Offices expect to change their operating model in the next three to five years.

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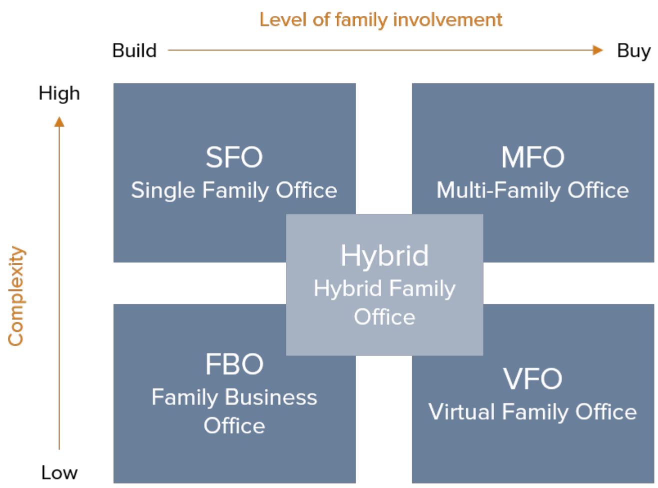
Many models were originally built to meet the immediate needs of the founder, rather than the broader family over the long-term. Over time, these models begin struggling to support increasing complexity and cost.

When families reach this tipping point, there are typically three models to consider – a Single Family Office, Multi-Family Office or Virtual Family Office.

The right model comes down to two key variables – the level of complexity, along with how involved the family wants to be in day-to-day management and operations.



Complexity is driven by:

- Family dynamics
- Ownership structures
- Family Leadership & Governance
- Management Roles & Responsibilities

The **Build vs. Buy** decision depends on:

- Control vs delegation
- Time commitment in office
- Preference for employment vs outsourcing

Mutual Trust works with families to clearly define where the Family Business ends and the Family Office begins, designing an approach with greater intention. This enables executives to focus on running the business, while ensuring the family's financial affairs are managed appropriately. The outcome is a fit-for-purpose approach that supports effective wealth stewardship and remains purposeful and relevant over time.

To discuss how to structure your family's financial affairs to protect and grow your wealth for generations to come, please contact your Relationship Manager.

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