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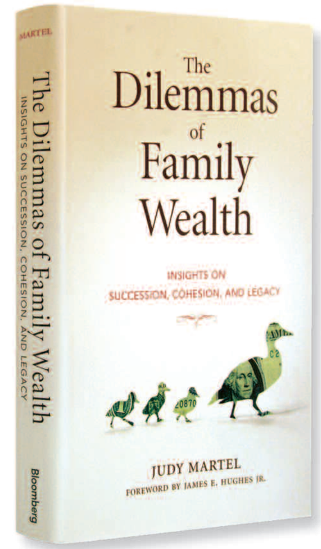
Personal Finance

Insights on Succession, Cohesion, and Legacy

The Dilemmas of Family Wealth



by Judy Martel

THE SUMMARY IN BRIEF

Successful families are those whose members understand that preserving the family is a precursor to preserving the family's wealth. So many go from "rags to riches to rags" because they don't communicate, they don't elucidate a set of collective values, and they don't educate future generations on how to handle wealth. When a family understands its common purpose, its members are able to build a legacy that is inclusive and supportive of individual, as well as family goals, further strengthening the unit for the current generation, as well as its subsequent offspring.

Judy Martel's *The Dilemmas of Family Wealth* recognizes the power of money to enhance or distort a family's destiny. Her research has revealed the many ways this circumstance plays itself out as each generation deals with the opportunities and burdens of wealth. In this summary, she shows how to recognize and understand the dilemmas that affect families' well-being and provide considerable hindrances to sustaining wealth. If a family makes the right decision in any of these situations, it can overcome many obstacles and enjoy success across multiple generations. If it makes the wrong decisions — and plenty do — the family will find its greatest blessing (financial capital) can also be its greatest curse.

IN THIS SUMMARY, YOU WILL LEARN:

- How to let go of a business.
- How to keep future generations connected.
- How to bring up future wealth generators.
- How to keep the family together.
- How to integrate new family members.
- How to prepare future generations to handle wealth.
- How to plan an estate.

CONTENTS

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THE COMPLETE SUMMARY: **THE DILEMMAS OF FAMILY WEALTH**

by Judy Martel

The author: Judy Martel, CFP, is a former vice president at Asset Management Advisors (AMA), a major multifamily office and subsidiary of SunTrust Banks, Inc. Martel is a certified financial planner, and regularly writes a column for *Vive* magazine. She has also contributed a number of articles on wealth and family dynamics for *Report Worth, Town & Country,* as well as *Vive*.

Succession and Letting Go of A Business

The Dilemma: It's time to plan for succession, but I don't know how to let go of the business.

Succession is surrounded by emotions that touch every part of a business founder's existence and that of his family, yet he must plan for and accept change — the long-term survival of his business and fortune depends on it. There are many ways to relinquish control — the key is for the founder to set up a vision for the future, but allow the next generation to modify it and live out its own dreams. The melding of family and business goals is one of the key benefits of having a family business, but the same business ties that bind may choke if pulled too tightly by the founder.

Failing to Transition

Most businesses fail to make a successful changeover from one generation to the next. Succession planning is crucial for families seeking to pass on the company they have spent a lifetime building. If the business fails between the first and second generations, the family will likely lose its wealth. A rift in the family can also result if the transition is handled poorly. Though unfortunate, it is quite often the case that many people do not know how to plan so that both the family and the business remain intact.

Often, the fear of letting go drives founders to make decisions that are inconsistent with what makes sense for the business. Creating a succession plan that removes that fear will go a long way toward resolving any lingering issues of trust. However, many succession plans fail because the first generation tries to impose its dreams on the second, setting up a cycle of dysfunction and collapse.

Another reason successions fail is the founder's failure to follow through with a process for the transition. The founder might wish (or even insist) that the successor continues to run the business as he himself would. The first item on any succession agenda should include a process and policies that help the founder overcome his worries and enable both him and the successor to trust each other.

Choosing a Successor

The first and second generations often find difficulty predicting how successful a succession plan will be. While the original players (the first generation) are still active and in control of the business, there is no family history of transition on which they may draw. Initial optimism can easily give way to frustration as unanticipated challenges stall succession decisions.

One option to consider is allowing the company's board of directors to resolve the issue based on policies previously set by the board and the family. This provides a much-needed method for "letting go" of the business. While it takes time and careful thought to establish such a set of policies, it is worth the effort because the policies will continue to help guide decision-making, particularly the messy decisions that typically accompany being both a family and a business. Some policies to consider include the following:

- **Mission and vision for the business.** These keep both the family and business on track.
- **Method for communication.** Set the method and time to disseminate information.
- **Procedures for hiring family and non-family.** Objective standards for hiring are invaluable, particularly when applicants must be turned down.

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- **Compensation guidelines.** Objective guidelines keep people from feeling cheated.
- **Performance reviews.** Include specific criteria and a path for advancement.
- **Training programs.** Never assume that employees have "soaked up" the business just because they're family.
- **Communication with shareholders.** Communica-tion should include people in the family who are not active in the business.
- **Philanthropy and community service.** What is the company's vision for a legacy?

Aiding the Succession

The first and second generation can work together to ensure the business transitions successfully. The post-succession period is a critical juncture for family business success because a new operating model has to be instituted. The business is likely being led by a partnership of siblings, often with one of them in a leadership position. Decisions can no longer be made by one person — collaboration is the key to success. The family must take stock of its business as it moves forward in order to throw its full effort into aiding the succession.

Going Public

Family businesses don't always stay in the family. Sometimes the family must relinquish full control of the business and move to outside leadership for any number of reasons (the business grows too big for them to handle or competition becomes too tough or the nature of the business changes). Families must realize the shift in dynamics that occurs when the business goes from being a family concern to a more impersonal professional situation.

Families can, however, retain influence and control over the company even if outside assistance is brought in, as long as the family still maintains a controlling ownership of the company.

Keeping Future Generations Connected

The Dilemma: I sold my business at the right time and have more than enough to take care of my family, but I feel alone and uncomfortable in my new position of wealth. What do I do with my time, and how do I preserve a connection with the family wealth in subsequent generations?

After building a successful business or two, the role of bystander can seem formidable for ambitious, Type A personalities. Founders who still possess the energy and drive they used to build their business must find a new outlet for that energy and drive. The next generation has also lost some of its connection to the family identity and must write its own chapters in the family narrative.

The entire family is seeking a new identity. It has wealth it can use to enrich the dreams of everyone, but first it must understand the transition it is going through and take steps to preserve its family heritage.

Redefining the Role

Some founders find it difficult to slip into a quieter role once the family business goes public. Type A founders, who just can't seem to stop, sometimes evolve into serial entrepreneurs, starting new and different businesses because they can't envision a life without the structure that being a leader requires. The hardcore entrepreneurial founder who doesn't want the regimen of running a new startup can turn to mentoring to provide next-generation entrepreneurs with the benefits of his experience and wisdom. Those founders who prefer to veer away from the company life will find a range of pursuits outside the business world — mentoring others, getting involved in managing their own portfolios, or serving on boards.

Still others keep active in family concerns, instilling the family legacy of values that are focused on providing a healthy and supportive environment for future generations. Experts applaud such an approach to preserving the family narrative.

Remembering Other Family Members

The entire clan is adjusting to the loss of the family identity and is contemplating what its next move might be. This is a perfect time to form a family council, if one is not already in place.

A successful family council coordinates wealth with the family's relational estate (its history, heritage, interpersonal relationships, etc.) across the generations. The family decides who will be on the council and proceeds to define it and decide what to do with the wealth. Deciding how to manage the family's wealth is but one opportunity for the family council to be active — it can also guide the family's pursuit of charitable interests, new businesses, and how to transfer wealth to future generations.

Keeping the Past Alive

After the company is out of the family, either because

Family Ventures and the IRS

The Internal Revenue Service will calculate imputed interest if it deems a loan among family members to be interest-free, or if the interest rate is unusually low. The lender will be responsible for the taxes due on the phantom interest income. If there is no interest charged, the IRS will treat the phantom interest as a gift and apply it toward the lender's annual gift tax exclusion.

it has been sold or has gone public, the final challenge is preserving the family history for future generations who played no part in building the wealth. Sometimes it is the retired founder who takes on the task of compiling this history. Other times, it is someone a generation or two removed from the business, who understands and appreciates the value of what was accomplished and seeks a way to keep the legacy alive.

Future Wealth Generators

The Dilemma: As the family grows, the original family fortune is not enough to support everyone. How can I support and encourage future wealth generators to add to the family coffers?

As many founders toiled to make a better widget, they dreamed of intellectual professions for their progeny — lawyers, doctors, professors, and the like. What some founders fail to take into account is that future business entrepreneurs are vital for wealthy families. While the family begins to write a multigenerational narrative that will be funded through the wealth created by the founder, the money is being stretched to pay for more members who come into the fold.

Quite simply, new family entrepreneurs are required to replenish the financial capital. Rising family entrepreneurs have access to the original base of financial capital, and shrewd founders will realize that this capital can benefit the family "bank" and fund the development of future generations. When families lend to their own, they encourage and support the next generation in its dreams, even as they add to the family coffers.

Depleting the Fortune

Families often fail to realize how wealth is lost through generations when there is no crop of new family entrepreneurs to feed the fire. Consider this scenario: If you start out with $100 million and have four kids, and they have four kids, you're down to one-sixteenth of the fortune per child. Assuming a 10 percent return, with 4 percent going to taxes and 3 percent to inflation, you can't spend more than 3 percent of your assets and still have any growth in your portfolio.

The numbers can get even worse if the family members fail to consider erosion to the original capital base as the founder moves from building a business to living off the capital. Additional expenses are incurred as the founder loosens the purse strings and steps up his lifestyle. That $100 million can be cut considerably with the purchase of bigger homes, vacations, boats, and the like.

The immediate need is for an additional influx of financial capital. By making a financial loan or grant to one of its members, the family fosters its own growth as a whole unit, as well as that of its individual members.

Professionalizing the Process

Family venture committees, created for the purpose of investing in new family start-ups by lending money to entrepreneurs, are an effective way families can structure themselves to encourage entrepreneurial quests and increase financial capital. The committee convenes to set parameters for loans and guidelines for what is expected of applicants. The entrepreneur, or borrower, is responsible for providing regular business reports to the committee, including all financial information.

The committee should have a written policy for applicants to review so there are no surprises and no future accusations of being treated differently from another family member. The objectivity afforded by the written policy, as well as a written agreement regarding the specific terms of the deal, will help families preempt any emotional outbursts in the event the start-up crashes.

Mentoring the Next Generation

In the ideal situation, young would-be entrepreneurs learn business principles at the feet of the founder and later enjoy a mentoring relationship as the seeds of the new business yield success. The founder retains a valuable role when he leaves the business and his expertise will be appreciated by a new generation.

Families engage in different stages of mentoring and teaching as the next generation grows into its business roles. They may begin with teaching and coaching skills, and evolve into true counseling and mentoring roles. That evolution may take the following form:

- **Stage 1:** The first generation strives to create a work ethic and a sense of passion and drive in their children so they don't have a sense of apathy.

- **Stage 2:** The first generation helps the second develop skills and encourages them to see what is possible when they master these skills. Good communication is crucial — families cannot give mixed messages about what is expected of the second generation.
- **Stage 3:** When the next generation wants to go in another direction, with help from the family business, the decision-making process should include a board of directors, which will share with the family the responsibility of drawing up the rules around loans for new business ventures, as well as the appropriate review process.

Keeping the Family Together

The Dilemma: I want the wealth to enhance our dreams, but don't want it to be the only reason we stay together.

When family members argue about money, what they are really arguing about are their differing core values. If members of the family think their values are not being compromised, they're more likely to work toward the greater good.

Families must communicate regularly in order to build and transfer wealth, and do it from a base of common values. As obvious as it sounds to say that families need to talk, there are many reasons why it is difficult. Many families need a process to help them get started, to remind them to continue to communicate, and to provide a framework for how the family continues to work as a unit. Families must learn to communicate as a prerequisite for working together.

Meeting Face-to-Face

Family meetings can take different forms, depending on the unique needs of the family. Instituting family meetings at home is not difficult, but it does require some sort of format. Here are some tips for families who want to initiate family meetings:

- Everyone is an equal at family meetings and should be treated accordingly. Even young children deserve to be heard and to feel that their input is being seriously considered.
- Stick to the established time for family meetings (weekly, monthly, etc.) to help ensure commitment to them.
- Give everyone a chance to speak, but don't let the meeting deteriorate into a gripe session.
- Plan for some meetings to take place in recreational settings to avoid negative association.
- Allow each family member the opportunity to be in charge of chairing a meeting.
- Compile a list of important issues to be discussed at each meeting.
- Practice good communication skills. Be specific. Avoid defensive postures.
- Practice good listening skills. Don't interrupt. Listen with an open mind and be certain you understand and are understood.

Guiding the Family

Once families have learned how to communicate and have unearthed their shared values through whichever type of meeting they prefer, they must then put those values into action by creating a mission statement — a written statement that outlines the way in which a family will live its values.

The mission statement is a point of reference for common understanding and a map for the family's future. It is an affirmative statement that reflects the values, commitments, and priorities of the family unit. As such, each family member should have input in making sure the family's common values are represented.

The mission statement should be considered a living document — just as the family's commitments and priorities might change or evolve over time, the mission statement would, in turn, change to reflect this. The statement should be revisited, reviewed, and talked about at family meetings, to keep it as current as possible.

Governing through Problems

Typically, when families look at situations that require structure, they get stuck in the emotional webs of one of three common governance crises:

- **When sibling rivalry provokes one party into refusing to participate in a family enterprise.** Even with a common set of values and a stated mission, families sometimes can't prevent one member from splintering off if he feels he's been mistreated. After all, until a crisis occurs, the family doesn't really have the opportunity to test its mission. When problems do erupt, it will help the family to regroup around its common values and reiterate the mission.
- **When a sibling needs to be fired from the family business.** When a family has to fire an unproductive member, it should be able to point to a policy as a guide for both gauging performance and carrying out the dismissal. The key to

being able to remove an unproductive family employee is in the documentation — gathering a documented record of unsatisfactory performance and all attempts on the part of the family to help the person turn things around. Families should also remember to be generous in helping the fired individual find a productive new path, whether through sabbatical, education, career counseling, or even therapy.

- **Management of common property.** Whenever families own an asset together, there is bound to be disagreement about its management. Add in the sentimental value attached to the property and the discussions become tainted with emotion. To address these issues, families must communicate and set up a clear governance structure regarding how decisions will be made. This communication must be among all family members, in order to avoid disagreements now and in the future.

Preparing the Next Generation

With the family mission statement as a guideline for values, the young members of the family — the third or fourth generation — gain knowledge about how the family operates as a unit. As they mature, they can be included as nonvoting members on the family board of directors or participate in the family's philanthropic initiatives, putting the mission statement into practice and beginning to learn how to work within a family unit.

Integrating New Family Members

The Dilemma: As new members come into the clan through marriage, how do I level the playing field if one partner is less wealthy, and what value do certain structures like prenuptial agreements offer me?

Unequal wealth can be the cause of great discomfort in a relationship. Compounding the problem, if the wealthier partner hasn't come to grips with the family fortune, it becomes nearly impossible to create a union in which each partner feels on equal footing, much less united to the extent they can mentor the next generation.

Tension is created because, while the wealth of one partner can enable the new couple to begin writing a family narrative together, the unspoken implication is that the one with the money has the right to more privileges and a greater say in how the wealth is spent. Equalizing the power comes only when the couple reaches a mutual understanding about the wealth.

Understanding Emotions Concerning Money

Well before a financially unequal relationship becomes serious, a couple should discuss how each partner feels about the unequal wealth. That will provide the basis for moving forward. Fiscally unequal partnerships can work if couples disclose their expectations about money and then take the steps necessary to make them both feel they're on equal footing, whether those steps involve prenuptial agreements, annual gifting programs, or equalizing assets during estate planning. The couple must have a common understanding before committing to a structure.

Easing Discomfort

When couples hash out their philosophies about money, it becomes a relatively easy asset to divvy up in accordance with their mutual agreement. Placing the less wealthy partner on firm financial footing also enables that person to feel equal on other fronts; indeed, most experts suggest the wealthier partner provide the other with enough to promote a feeling of independence.

However, when a couple examines structures like prenuptial and postnuptial contracts, estate equalization strategies, and even informal agreements, they must be certain that form follows function. Too many lawyers are more than willing to slap a form on the table without urging the couple to go through the emotional work of discovering their philosophies about money and its effect on the relationship.

When partners discuss money, they may be speaking from their own perspective, but the key is to see it from the other person's viewpoint. Both parties must value what the less wealthy partner brings to the relationship.

Considering a Contract

Prenuptial agreements are among the most popular and effective solutions for many couples. While some consider them romance killers, they do provide a forum for disclosure at the outset of the relationship, when it is important to clarify matters of the wallet, as well as those of the heart.

Prenuptials are neither recent nor novel solutions to relationship-related financial issues. Throughout history, marriage contracts were commonplace in many cultures. Prenups remain one of the most popular contracts for couples looking to equalize their estates. Most attorneys agree that virtually everyone would benefit from a prenuptial agreement, in terms of protecting current assets, as well as future or anticipated wealth.

Talking About Prenups

Talking about money in the context of a relationship breaking up is not easy, and to some it feels like a negative cloud over the pending celebration of marriage. However, time won't ease the discomfort, and when prospective partners know right off the bat how each feels, it will be less awkward. To ease the conversation, couples should choose a neutral environment, where both parties feel comfortable. Put all issues on the table (careers, schedules, duties, income, debts, anticipated inheritance, etc.). Full disclosure is important.

Although some couples feel that the most difficult element of a prenup is broaching the subject to their intended spouse, often the initial communication is only the first hurdle. Depending on the complexity of the agreement, the time it takes to negotiate and draft the document can be just as trying on a couple. No matter how difficult the journey, though, the conversations couples have in these instances are key, and the end result — a detailed agreement — will be a boon to the relationship.

Preparing Children And Grandchildren

The Dilemma: I need to prepare my children and grandchildren for the responsibility of wealth, but I'm afraid if they know too much, it will destroy any initiative to earn a living. How do I communicate this concern?

The founder is about to bequeath his fortune to young adult heirs who are ill-equipped to assume the mantle of great wealth if they have not been educated about money. How does the founder overcome his reluctance to hand over so much money — an amount so large that it will likely prevent the inheritors from attaining the same feelings of self-worth that he, the founder, enjoyed from his hard work and success?

The tension this situation presents is considerable. When a family goes from "rags to riches to rags," it typically realizes too late the negligence that contributed mightily to its undoing — the lack of understanding of the inheriting generation's perspectives and their subsequent lack of preparation for handling wealth. Intermingled with these circumstances are issues of communication, financial education, self-esteem, and productivity.

Parents typically fear if they tell their children they are rich, those same children will grow up believing they are better than their peers and don't have to work for a living. This results in confusion, which leads to either rampant spending or a timidity that causes heirs to fear even acknowledging the money.

Making It on Your Own

Haunted by terms like "idle rich" and "trust-fund babies," inheritors grapple with the psychological ramifications of a fortune they received without having to lift a finger and, in many cases, without knowing how to fit the wealth into their lives. A paralyzing hesitancy grows out of feelings of inadequacy when it comes to managing money and the knowledge that they don't have to work for a living. As adults, the heirs feel inadequate and worthless compared to their peers who have forged a career. Lack of communication and preparation about wealth are at the root of the problem.

Coupled with these things is a suspicion that the founding generation doesn't trust the next one to be able to handle financial matters intelligently. Especially when given an income from a trust created by parents, inheritors are denied the opportunity to prove their worth by forging ahead with that particularly American ethos of creating an identity and being able to declare, "I made it."

By not being required to earn a living, even at a career they might only be "trying on," the heirs fail to gain the sense of control over their lives that comes with knowing they will always be able to support themselves. Setting a plan with a goal will give the heirs a sense of control and accomplishment. A trust income can help inheritors reject situations that don't appeal to them — this can have positive or negative consequences. The possibility of wealth means heirs can pursue careers they're passionate about without worrying about the salary. For those who are adrift, though, the drive to succeed can itself be a lifeline.

Talking the Talk

Parents have to have conversations about money. Signs of impending fiscal irresponsibility loom large for parents who haven't figured out how to broach the subject of the family fortune. Avoiding discussion of the "family secret" is common among the very groups that should be preparing their heirs. As strange as it seems to some, inheritors often need help becoming psychologically equipped to handle being born rich.

Timing a discussion about money depends on the children's maturity, but the earlier, the better. Once parents know how the child feels about having money, they can broaden the definition of wealth by discussing such attributes as kindness, good humor, health, and fulfillment not tied to money.

Parents should be prepared to answer all types of questions from their children, but should fend off specifics, such as telling young children the exact amount of the family's worth. Preemptive communication adds to the education of the kids, so they have insight into the hopes, dreams, and values of the family founders.

Walking the Walk

Parents set the best example for fiscal responsibility and offer guidance on assimilating wealth into their lives. In addition to deconstructing the myth of wealth through communication, families need to demonstrate their resolve to allow (or force) their children to be productive. The results are enormously gratifying when the heirs develop into self-supporting individuals with a healthy attitude toward wealth.

Fairness In Estate Planning

The Dilemma: I plan to be fair to my children, but if I leave them unequal amounts of money, am I setting up a future battleground?

The dilemma for wealthy families who intend to bequeath their fortune to their children is to do it in such a manner that each child is provided for, and that fiscal responsibility and trustworthiness are rewarded. It also means structuring the bequests to those without good judgment or financial skills in a way that gives them the opportunity and incentive to improve.

Seeking Equality

There are so many issues parents have to consider when creating an estate plan. Often, the older generation cares very much about equality, but even the smallest details about the estate can complicate the decisions disproportionately. The quality of the assets being handed down — even if they're just stocks and bonds — could vary and incite arguments about those different values. The situation is exacerbated when one factors in items of sentimental value — jewelry, real estate, vacation homes, and other heirlooms with personal as well as financial worth.

While the intention of the older generation might be to divide assets equally, there are often reasons to treat some children differently (age, mental or physical incapacity, level of responsibility, etc.). One of the best ways to avoid years of misunderstanding and resentment is for parents to talk with their children about their intentions for distributing their assets. When the children understand the reasons behind an action, they are more likely to embrace it.

Making Intentions Clear

Aside from the desire to be fair, there are many reasons for parents to communicate to their heirs about the estate. If parents have developed a mission statement with their families, they will want to match their estate plan to that mission. If parents plan their estate around money, but don't discuss their values, the money will likely disappear in a way the parents didn't intend. By imparting values around money management, parents endow their children with a sense of stewardship over family assets.

Structuring Bequests

Trusts are favored ways to leave inheritances because they can save on certain inheritance taxes and enable parents to decide when their children will be mature enough to receive money and the amount of that inheritance. Other ways to protect beneficiaries include a college savings account for minor beneficiaries, to be used for higher education expenses.

For assets that have more sentimental than economic value, the best option is typically for parents and heirs to reach agreement while the parents are still alive about who receives what. If no decision can be made jointly in that manner (the children don't want to decide, or the parents are forced by some other circumstance to decide on their own), the parents may want to write a side letter to the will, explaining why they gave certain heirlooms to certain children and reinforcing that no heir was favored over any other.

Avoiding UGMA and UTMA

Parents considering leaving a college savings account might want to steer clear of Uniform Gift to Minor Accounts (UGMA) or Uniform Transfer to Minor Accounts (UTMA), because they usually pay out at the age of majority (usually 18 or 21), when the beneficiaries can spend the money any way they choose. Often these accounts are set up at the time of the birth of a child or grandchild and accumulate to a value far greater than what most account creators envision. The child merely has to show proof of age to take out the entire amount, at a time when the choice between paying for college tuition or buying a Maserati might not be as simple or logical a matter as one would think.