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The reality of the family office, and the influence of Buffett

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Family offices, which manage and invest the assets of the extremely wealthy, are developing a higher profile. A wide range of the stocks and many asset classes they hold have rapidly gained value since the effect of the pandemic to the financial market started, and their private investments have also grown fast. The massive collapse of US investment firm Archegos Capital Management has highlighted the lack of transparency at family offices, but Archegos' high-leverage investment management strategy is considered not a typical investment style of family offices. But significant wealth faces challenge as well, including choosing a business successor. We took a closer look at the profile of the super-rich.

US research firm Campden Wealth estimated that by 2019 the number of single-family offices, which manage the assets of individuals or individual families would total 7,300 worldwide with a total of $5.9 trillion (about 670 trillion yen) under management. With the subsequent establishment of new firms and increased asset prices, that number is expected to grow further in the near future. In response to a survey of conducted by Campden this year, about 90% of wealthy individuals saw an increase in their assets over the past year.

Traditional family offices have managed family wealth for generations, but recent years have seen a noticeable increase in the number of new age family offices established for IT leaders. According to the Sovereign Wealth Fund Institute (SWFI), of the top 10 family offices in terms of assets under management, half were set up by American IT business founders. An increasing number of hedge funds are returning client funds and reorganizing as family offices. George Soros is a prime example.

The thrill of being involved in your own investments

The Hyatt Family Office, a single-family office headquartered in Toronto, was also founded by IT entrepreneurs. Michael and Richard Hyatt, brothers who founded an IT-related business, sold their company, and launched the family office 17 years ago with the proceeds. Its goal is to support both the next business and the next generation of owners.

Why did the Hyatt brothers choose to set up their own family office, rather than entrusting their assets to an outside wealth management service like a private bank or asset management company?

“The skillsets of world-class entrepreneurs and world-class investors differ, like a world-class hockey player compared to a world-class figure skater,” says Elmer Kim, CIO of the Hyatt Family Office. Kim was involved in the management of traditional family offices before he was recruited to be Hyatt’s CIO. He explains that one of the reasons high net worth individuals choose to set up a family office is for the joy of controlling the process of asset management of their investments themselves.

The Hyatt brothers are still young, in their 40s, and may found a new company. It will be a long time before their children are old enough to take over the business. The family office will handle all issues related to the family’s wealth, including asset management, tax planning, and philanthropy.

Because they are tech entrepreneurs, many of the Hyatt Family Office's investments are private companies in the high-tech space. Other investments include Lase Vegas hotels, funeral service companies, and rent-generating real estate. About 30% of the total investments are in listed companies, but most of them are in ETFs or Nasdaq listed companies.

Target return is 6% above inflation. If inflation is 2%, 8% would be the goal, a more conservative target than at a hedge fund or a large pension fund. Mr. Kim explains the investment strategy is plain vanilla: taking on very little leverage and investing in businesses they understand, in accordance with famed investor Warren Buffett's investment strategy.

"95% of investments found through personal referrals."

Interestingly, Warren Buffet's name came up repeatedly in interviews for this piece. Buffet's strategy of long-term investment in businesses he can understand seems to resonate among family offices, with their goal of preserving a single family's wealth for many generations. Many in the family office industry think that Archegos, which shook the market when its investments failed, is an outlier. Some people criticize financial institutions for allowing potential profits to blind them and failing to do due diligence.

A family office is also a rarified world of super rich people, closed to outsiders, where personal connections are everything. "95% of my network is built through personal referrals," says Amana Manori, CEO of Highness Global Capital, which acts an intermediary between family offices and businesses seeking funding.

Brian Weiner, co-founder of InnoVise Family Wealth Advisors, a multi-family office that advises families in the US, Europe, the Middle East, and elsewhere, points out that detailed background checks on managers at investment targets is an important part of due diligence.

In a fascinating anecdote, one of Weiner's firm's client families tried to invest in a private company, whose potential had already drawn the backing of large investment banks. It looked like a desirable investment opportunity, but the family narrowly avoided it because one of the senior executives let his cocaine addiction slip in front of a member of the family at the dinner table. The company went bankrupt 6 months after its IPO.

The burden of wealth, education starting at an early age

In addition to this kind of good judgment, "family governance" is an important consideration for running a family office. There are many issues to be addressed: for example, how to handle a family member's divorce, the moment when a founder dies and his wife takes over, or the best way to transfer the business to the next generation. According to Weiner, the burden of wealth and the fear of failure frequently leads to drug and alcohol addiction in wealthy families.

Weiner provides an educational program for members of wealthy families, starting at an early age, to help them become people who aren't afraid to fail. A family office also needs to act as a kind of therapist or social worker for the wealthy.

The infrastructure surrounding family offices in the US is still being developed. A financial institution that leverages the strength of a network of family offices in its investment banking business is one example. Cambridge Wilkinson, based in New York, connects large family offices with businesses that are looking to raise $25 — 500 million in equity or corporate bonds. Rob Bolandian, head of Global Investment Banking for the firm, explains that "some companies prefer to raise funds from family offices, because they see the terms as more flexible than what they would get from investors like private equity." This shows that family offices are playing a critical role in the capital markets.

The Ultra High Net Worth (UHNW) Institute is a research organization dedicated to solving the problems faced by the super-rich. The nonprofit organization, founded in 2019, has a team of volunteer lecturers who provide information for the ultra-rich. Since 2020 it has been a membership organization for ultra-high-net-worth individuals. Founder Stephen Prostano explains that the purpose of the organization is to provide comprehensive support addressing the unique and complex financial and non-financial issues faced by ultra-high-net-worth individuals and family offices "in 10 domains, including asset management, inheritance, business succession, children's education, health issues, philanthropy, and family governance."

There are also networking organizations for wealthy people to connect to each other. Tiger 21, which has been active for more than 20 years, is a leading example.

Increasing wealth around the world has been accompanied by a growing number of newly founded family offices both inside and outside the United States. In recent years Singapore, with its concentration of wealth, has been drawing global attention.

The magnetic pull that drew Ray Dalio to Singapore

Ray Dalio, the founder of the world's largest hedge fund, Bridgewater Associates, established a family office in Singapore this year. According to a Bridgewater spokesperson, "Mr. Dalio has built long-standing relationships with China and Singapore and thought it was the right timing to open an office." Bayshore Global Management, the family office of Google co-founder Sergey Brin, also opened an office there last year.

Singapore's preferential tax treatment and incentives for asset management companies have drawn a growing number of companies to set up offices there to receive funds from overseas. Pan Asia Advisors, which serves high net worth individuals in Japan, is among them. It runs a multi-family office in collaboration with a local partner, providing asset management and advice to young Japanese entrepreneurs from various industries including IT. Most of its clients are wealthy individuals with a net worth of several billion yen.

Young Japanese entrepreneurs aspire to the Western model

Traditionally, wealthy people in Japan managed both their businesses and their family assets through one entity, but young entrepreneurs aspire to a Western-style family office. There are a growing number of high-net-worth individuals in Japan, in particular IT entrepreneurs, with assets in the tens of billions of yen. Satoshi Okamura, the founder of Pan Asia Advisors, offers consultations on a wide range of issues including asset management, corporate succession, relocating overseas, and children's education. He also supports wealthy families who send their children to boarding schools overseas.

Just like in the US, his client network is built through personal connections. As a Tokyo University alumnus and a graduate of prestigious private institution Nada High School, Mr. Okamura has a lot of influential friends in key places. A growing number of wealthy Japanese are approaching him for services because "acquaintances from university are the most trustworthy."

The Archegos scandal raised the profile of family offices in Japan. Criticism of the "privileged class" and calls for regulation abound, but many are based on misunderstandings. Most of the people involved in the family offices are working out how to start their next business and worrying about passing on their assets and educating their kids. How do family offices, with their rising profile, fulfill the responsibility that comes with wealth? The influence of successful people can go beyond just the financial markets to impact society as a whole.

Family Offices

There are two main types of family office: the single-family office, which manages the assets of a single individual or family, and a multi-family office, which performs the same service for several individuals and families. Both have a typical corporate structure, employing a CEO, CIO, lawyers, and accountants.

They perform diverse roles. In addition to asset management, they assist with the preparation of wills and trusts, tax mitigation, divorce and inheritance, and charitable donations. In some cases, asset management is conducted in-house, while in others it is entrusted to external managers such as private banks or asset management firms.

There are many theoretical origins of this type of business, but it's believed that the first were set up to manage the property of European royalty. They were first established in the US in the 19th century to serve families like the JP Morgans and the Rockefellers; the general popularity of the modern family office dates to the 1980s.