RAGS TO RICHES AND BACK AGAIN?

Eesha Arora and **Sophie Wettern** offer some ideas for navigating intergenerational conflicts in wealthy families

> **KEY POINTS**
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> **WHAT IS THE ISSUE?**
> Advisors to successful families often find that intergenerational conflicts arise as children grow up.
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> **WHAT DOES IT MEAN FOR ME?**
> It is crucial that advisors maintain their independence and are not afraid to be straightforward in their approach, while being cautious of conflicts of interest and ensuring that decisions are objectively justified.
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> **WHAT CAN I TAKE AWAY?**
> Different ways in which successful families can both benefit from and maintain their wealth while still involving members from different generations, including family investment companies and partnerships.

Around the world, there is a recognised maxim that family wealth rarely lasts in the long term. In Japan, the adage is 'rice paddies to rice paddies', while the Scottish saying goes: 'The father buys, the son builds, the grandchild sells, and his son begs.'

But what accounts for this expectation? Intergenerational conflict plays an increasingly significant role, and managing this has gradually become an important part of the advisor's job. With only 12 per cent of family businesses surviving into the third generation,[1] advisors to affluent families should consider conflict management strategies as an intrinsic part of preserving and capitalising on family prosperity.

THE RISE IN INTERGENERATIONAL FAMILY CONFLICTS

LIFE EXPECTANCY

Increased life expectancy around the world must account in part for a rise in intergenerational conflict. Today, a patriarch or matriarch who has created a successful business is unlikely to want to step out of the picture the moment they turn 65. This can lead to conflict between the head of the family (who is often the founder of the business) and their grown children, who may wish for more active involvement in the business. Adult children involved in their family's business often develop strong views as to its management, and may be keen to test out new ideas that the parent views as too avant-garde.

This issue aside, the fact that many people are now living for longer may also lead to issues of mental capacity, which can be a significant problem in businesses controlled primarily by one founding individual.

SOCIAL SHIFTS

Recent years have seen a move away from a strictly hierarchical society, arguably leading to a decrease in deference to the older generation. Where historically patriarchs or matriarchs might have been viewed as 'elders' of the family and their views deferred to, now there is often a sense that the patriarch or matriarch lacks understanding of today's rapidly evolving technologies. More generally, in a world where globalisation has rapidly expanded, social norms are shifting. This can lead to conflict between the older generation, who may subscribe to more traditional attitudes, and a younger generation that has been exposed to different values.

Alongside intergenerational conflict are inter-familial issues, which have been exacerbated by increasingly complicated family set-ups. High rates of divorce and remarriage have led to a need to consider what benefits should be given to ex-spouses and stepchildren, among others. An additional question of who should be entitled to a share in the family assets arises when family members marry: should all members of the family be required to obtain a prenuptial (or postnuptial) agreement? And what will happen if a family member refuses to do so? Similar considerations may arise where individuals choose not to marry, but live together as cohabitees for many years.

DIFFERENT APPROACHES

It is ever more likely that several generations will be actively considering the approach taken to the wealth of the family

simultaneously. Different appetites to risk can lead to conflict, as the elder generation may wish to capitalise on existing family wealth while younger family members are keen to pursue a more entrepreneurial path, or riskier investment options. This is exacerbated where, as is often the case in the sphere of high-net-worth individuals, family members are scattered over several continents. The different income needs and differing tax profiles of various family members, compounded by the family's expansion, can lead to tensions as to how wealth should be managed and distributed.

These factors can be particularly significant in relation to a family trust, where there may be friction between the desire to produce income for the current generation (particularly where there is a life tenant) and the aim of maintaining capital for future generations. Similarly, the question of whether beneficiaries should receive similar levels of distributions before or after tax is a significant one when some beneficiaries are living in higher-tax jurisdictions than others.

MANAGING CONFLICT

Having identified potential and existing conflicts and the various risk factors associated with these, what can a family advisor do in order to minimise their effects?

IMPARTIALITY

As an advisor, it is vital to remain outside the scope of any family infighting, with any decisions being objectively justified. One way to minimise the risk of significant family conflicts is to ensure that you are aware of and constantly monitoring family dynamics. This will assist with resolving issues as they arise, before they become divisive. While it can sometimes be difficult, advisors should not be afraid to be straightforward and open in their approach.

FAMILY CONSTITUTIONS

Another way to minimise conflict is to flush out any issues before they become significant. Creating a charter or constitution for the family forces everybody to sit down together and talk through the approach that the family will take in different situations, resolving potential problems. A family constitution can be tailored to each family's wishes, but may include the roles and powers of different family members, the processes by which decisions are made, and the reporting of these decisions. Where relevant, the constitution can draw distinctions between ownership of the family business, management of the business (which may involve non-family members) and personal family affairs. Deciding on the preferred approach means that the family will identify and discuss key issues that could be divisive, and so minimise the risk of future conflict.

STAYING CONNECTED

Forty-three per cent of family firms do not have a succession plan in place, a key feature to ensure sustainable family wealth.[2] Regular family meetings can assist with minimising the risk of significant divisions, while also ensuring that the younger generation feels involved and invested.

It is important that meetings are structured in a meaningful way. Although it may once have been realistic for the three brothers who co-founded a business to meet every three months, the same approach is probably not going to be as workable three generations later, when each of the brothers has moved to a different country and has children and grandchildren of their own. One way to ensure this solution remains workable is to nominate a representative from each branch of the family, or from each generation, to ensure all parties remain involved in a realistic manner. Alternatively, the family could select a rotating committee of family members.

STRUCTURING FAMILY WEALTH

It is crucial to consider how family wealth should be structured. Of course, many have traditionally opted for trusts; however, there has been a shift towards alternative forms of wealth structuring in recent times.

One option is a family investment company. Typically, an individual transfers assets into a structure that enables them to continue to fund their current lifestyle and pass wealth down to their children while still retaining control in relation to investment decisions (for example, by acting as director). Using this structure, a patriarch or matriarch can co-invest alongside any children, gradually transferring control to them as appropriate. Similarly, a family limited partnership can be an effective and tax-efficient method of enabling parents to transfer assets to their children while effectively retaining control of those assets for an indefinite period.

An alternative is the 'family bank', an arrangement whereby the elders of a family set aside a portion of the family wealth (e.g. by placing this portion into a trust). This share is designated for loans to family members, to encourage the younger members to pursue their own paths while remaining engaged with the wider family. The process can be as formal or informal as is desired – e.g. requiring a written plan and loan application from the borrower, similar to that required by a commercial lender, and periodic updates to the family bank.

Empowering the next generation and ensuring that they feel invested in, not entitled to, the family wealth is key to preventing it from falling victim to the maxims we all know so well.

1 *Family Business Survey 2016*, National Bureau of Economic Research. Family Business Alliance **2** As above, note 1

EESHA ARORA TEP IS A SENIOR ASSOCIATE, AND **SOPHIE WETTERN** IS AN ASSOCIATE, AT MAURICE TURNOR GARDNER