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Costs and Rising Barriers Forcing Change in the Commercial Family Office Landscape

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The 2012 Global Private Banking Benchmark from London-based consultancy Scorpio Partnership shone the performance spotlight on the results of what it describes as "smaller players", or those with $18 billion or less in assets under management.

Summarized across key performance indicators including net new money, income and pre-tax profit growth, the study, which surveyed 201 firms across the international landscape, revealed that these smaller businesses had performed significantly worse on average than their larger peers in this competitive environment.

The consultancy is explicit in stating that while the global private banking sector's larger firms have also experienced rising costs due to their expansion and the impact of increased regulation, these goliaths, through scale, standardization, and generating net new monies in new markets such as Asia have been far better able to withstand the increased cost burden than their smaller competitors. For the smaller and mid-tier firms, such luxuries have been in short supply, constrained as they are by those above factors in reverse.

In a global industry of such diversity in size and with competition so fierce, any suggestion that a firm's size or shape or other collective descriptor might lead it to perform worse than the wider sector would certainly throw open the floor to questions around that "groups" future sustainability.

As such, our analysis led us to think of this weakness in terms of the family office sector, which, by its very nature - many thousands of small entities across the globe, all boutiques ultimately - must place it right at the very center of the pressures and performance impacts identified. What is the impact of these very well-known pressures on this community, itself a major participant in the world of private wealth management, if not a real focus of the Global Private Banking Benchmark study?

According to Scorpio Partnership's managing partner Sebastian Dovey, talking specifically on this theme and its relevance to the family office market to FOR: "We are aware that many family offices are finding it very tough to sustain their model in the market today. They often lack scale and also have not acquired sufficient business mass. One would have to question their future if things were to continue."

It is of course natural that the sector is not immune from the pressure being felt elsewhere and it would be odd to suggest otherwise. But what is the pressure being felt and what is its impact?

Well, in the US market, the daddy of the family office sector globally, the pressures are significant and again raise concerns with regard to the sustainability. Further, the impact is being felt on one type of family office vehicle in particular, the single family office. At least according to the 2012 outlook of private client law firm Handler

Thayer.

"Families are feeling very squeezed," says Chicago-based Thomas Handler, chairman of the advanced planning and family office practice group at Handler Thayer. "They are really getting financially hammered on both sides of the equation now. They are getting hammered in the drive for alpha which is increasingly hard to find, so they cannot access the kind of income stream of the past to sustain their lifestyles, forcing them to invest more in alternatives and out of their comfort zones, while at the same time their overall cost of operation have been increasing for years."

Handler referred to rising staff costs plus the real and very demanding regulatory and compliance measures such as Dodd-Frank which, all together, are making SFOs, that craved-for vehicle at the very top of the wealth pyramid, far less sustainable and with more onerous thresholds for entry.

The firm's outlook report concluded: "Escalating costs for Dodd-Frank compliance in addition to other operating costs are raising the bar to SFO formation and causing increased concerns regarding long-term sustainability."

As a result, Handler noted a "stagnation" in the size of the SFO market in both Europe and the US. Indeed, according to the firm's outlook document, that is driving a noticeable change in the shape of the family office market in the US with the proliferation of three other family office vehicles - the virtual family office, the international single family office and the multi family office.

This really is an interesting theme and a sign of our complex times. In other industries, of course, the process of creating sophisticated products and services is often supposed to filter down once the mechanisms and process of development and sales have been scaled. In the wealth world, however, it seems the pinnacle of wealth control, the SFO, is in fact becoming harder to achieve.

Interestingly, it is not just in the US that this trend is being seen. According to Corinna Traumueller, CEO of London-based Family Office Management Consulting, it is also happening internationally. She tells FOR, "There is still a big demand to have your own family office but now, much more than a few years back when it was a single family office that everybody wanted, that has changed. That is, again, another business and it is very costly and risky to set-up a family office." She continues, adding: "So where is the threshold now to have your own single family office? I always say 250 million in liquid assets, regardless of the currency, because it is not a set line. However, from my perspective the threshold is much higher. A single family office is 500 million and up and most of our clients are a billion and up as having a truly professional single family office set-up is very expensive."

So what is filling the gap beneath that level for families that are still mega-wealthy but not willing to stump up the costs of establishing and running their own single family office? As mentioned, one solution is the virtual family office or VRO, a far more flexible and less cost prohibitive offering.

Says Handler Thayer's Handler: "The virtual family office model has been picking up steam for years. A lot of families under the 200 million or 250 million level will look at that model and see that they can effectively outsource everything. It is also much more cost effective and they can still get all the benefits that a larger family office can provide such as governance, succession planning, corporate liability planning and so on."

Family Office Management Consulting's Traumueller agrees. "The threshold for single family offices is going up and up. For those clients that are below that threshold, they are also looking for a family office solution and need one because the complexity on their side has also gone up. For them, this is where a virtual family office or multi family office or a bank that can offer family office services."

Furthermore, according to Handler Thayer's Handler, there is also far more collaboration between offices now than was the case traditionally. Again, this is a clear result of the costs and complexities involved. For instance, he tells FOR: "Let's take for example a family that is for the most part running a traditional stock, bond and real estate portfolio, but seeks access to private equity deals. Accordingly, it searches out a family that has expertise in that sector and seeks co-investment opportunities." In addition to cost containment and navigating the complexities, there is also an element of 'the hunt for alpha' in that trend, he says.

What is happening is they are competing with the older model of the multi family office which, in today's market, according to Handler, "is being driven partly by larger single family offices looking to achieve scale, cost containment and sustainability, and thus setting themselves up as a multi-family office." Further, MFOs are also benefitting from the trend to outsource, according to Handler, particularly where a SFO lacks the internal expertise and therefore chooses to outsource to an existing MFO.

So there is change in the sector and, in a very real sense, quite significant change in terms of the business models at play. Looking at what we have heard, what this change in the shape of the family office market says to us at FOR is that the pure, family-needs-first model, the SFO, is in retreat, and being replaced by vehicles that are ultimately far more commercial and thus competitive. Let's see.

