CHAPTER 1

The Wealth Management Challenge

COPYRIGHTED MATERIAL

The United States has always been the land of opportunity. Nearly anyone with a good idea and considerable drive can find a way to begin a business, nurture it, watch it grow, and hope to pass it on to children and grandchildren. In fact, it's estimated that 80 percent of American businesses are closely held or family enterprises the owners have built for themselves and succeeding generations.

How many of today's entrepreneurs put their names on the door and expect the business to fail? Probably none, but if they were to return to Earth within two generations, in most cases they would find that not only was the family name gone from the door, but also that the business itself had failed. According to a 2012 *Harvard Business Review* article by George Stalk Jr. and Henry Foley, "Avoid the Traps That Can Destroy Family Businesses," 70 percent of family-owned businesses, which hold the entrepreneurial founders' hopes for their families' futures, will be gone by the third generation. Most of them will fail or be sold before the second generation takes over, and only 10 percent will function as privately held companies by the third generation. The dreams of family legacy will be faint memories, perhaps preserved only in old newspaper clippings or pictures tossed into a shoebox.

The adage "Shirtsleeves to shirtsleeves in three generations" became a well-known prophecy because it is, unfortunately, true. And it appears to be true in virtually every culture. In Ireland, the saying is, "Clogs to clogs in three generations." In Italy, it's, "Stable to stars to stable" in the same time frame. In Japan, "The third generation ruins the house." The Chinese proverb is, "From paddy to paddy in three generations." Brazilians say, "Rich father, noble son, poor grandson."

What it often means is that the first generation works hard to build the wealth and a better life for the family; the second generation, which has known both the frugality required to make a fortune and the advantages wealth confers, understands the value of hard work and either maintains or even expands the family's assets. The third generation, which has never struggled, is less likely to see the relationship between work and reward and more likely to spend down the money—and the cycle must begin again.

Consider, for example, the Vanderbilts, who are the poster family for the diminishment of wealth. It's a well-known cautionary tale. The first-generation patriarch, Cornelius Vanderbilt, took a $100 loan from his mother and built it into a $100 million fortune by the time he died in 1877. It's reported that the money he left to his family was more than the United States government held in its Treasury at the time. In the second generation, William Henry Vanderbilt, who died only eight years after his father, doubled the family fortune to an amount equivalent to $300 billion in today's economy.

But by the third generation, the Vanderbilts abandoned the wealth-creation strategies of Cornelius and William and began a cycle of spending more than they were creating. The four sons of William Henry spent fortunes on some of the most imposing dwellings in the country. Cornelius Vanderbilt II constructed a 154-room home—the largest private residence in New York—on West 58th Street. Next came The Breakers, a seventy-room "cottage" in Newport, Rhode Island. This Italian Renaissance palazzo was modeled on those of sixteenth-century Italy and was crammed with priceless antiques and art.

Cornelius's brother, William K. Vanderbilt, also built a summer home in Newport: Marble House. According to the Preservation Society of Newport County, Marble House was inspired by the Petit Trianon at Versailles and cost $11 million, $7 million of which were spent on 500,000 cubic feet of marble.

Frederick William Vanderbilt, the most private of the brothers, built an imposing mansion at Hyde Park, with furnishings purchased from Napoleon Bonaparte's Malmaison Palace.

And in Asheville, North Carolina, the youngest of the four brothers, George Washington Vanderbilt, erected his country home, the Biltmore, America's largest private estate, which contains 250 rooms and features extensive grounds and gardens. At the time George owned the property, it comprised 125,000 acres—the size of several American townships combined. Today the property encompasses 8,000 acres, but the gardens, outbuildings, and the house itself remain almost beyond belief in their scope and attractiveness.

The lifestyles of the family members, which also included top-of-the-line yachts, horses, and other expensive pastimes, were as lavish as the family's residences (ten of them on New York's 5th Avenue). Their excessive spending came at the cost of mortgaging the family's financial future.

As Michael Klepper and Robert Gunther point out in their book, *The Wealthy 100*, by the time of the first Vanderbilt family reunion in 1973, less than a century after Cornelius Vanderbilt's death, there was not a single millionaire among the 120 members of the descendants in attendance.[1] The family was spending, but as later generations married, had children, and increased the size of the Vanderbilt clan, no one was rebuilding the fortune. They had forgotten an important lesson: As a previous generation passes away, the next generation becomes the first generation, responsible for maintaining and increasing the fortune for the growing family. That didn't happen, and it was a recipe for disaster. The wealth was static, the family was dynamic, and the Vanderbilts didn't recover.

Today, some of the family, such as Gloria Vanderbilt and her son, Anderson Cooper, are highly successful, but their current affluence comes from their work in art, fashion, and media rather than as a result of inheritance, much of which was eaten up in lawsuits that took place when Gloria was a child.

In the early days of the Vanderbilt dynasty, it's possible the family believed the sheer size of their holdings protected them from any untoward outcomes, so spending was unabated. However, most families, even those with substantial wealth, are aware that if they don't plan well, an end point is possible. In fact, if they fail to plan, they are unknowingly planning to fail.

Of course, successful wealth transition involves careful financial planning that encompasses such factors as tax and investment strategies, asset management, information management and reporting, and the consequences of growth as successive generations marry and have children, to name a few. None of these factors exists in a vacuum. Everything from climate change to regional wars to a technological crash may affect investments and financial planning, and a failure to appreciate risks and rewards can have significant deleterious effects on the maintenance of a family's wealth.

However, in their book, *Preparing Heirs: Five Steps to the Successful Transition of Family Wealth*, Roy Williams and Vic Preisser show that even the best tactical planning is not enough. Their research with more than 3,000 families over a period of twenty-five years demonstrated that:

- *60 percent* of unsuccessful wealth transitions could be traced to a breakdown of communication and trust within the family.
- *25 percent* were caused by inadequate preparation of the heirs.
- Only *15 percent* were brought about by all other causes, and of those, only *3 percent* had to do with professional failures in accounting, legal, financial, and tax advice. The rest usually could be chalked up to the family's failure to have a family wealth mission or consensus.[2]

Families with great wealth are still families. Like other families, they may interact with one another based on emotions such as love, passion,

resentment, anger, jealousy, and fear. And even if most of the family members get along well, money problems can create bad feelings, ranging from spats and squabbles to intrafamily lawsuits.

The Robbie family is a case in point. Prior to his death in 1990, Joe Robbie, one-time owner of the Miami Dolphins and the stadium in which the team played, made serious estate planning blunders. Although he had trust documents in place and everything appeared to be in order, problems arose. The trust was to receive the proceeds of his estate and provide income for his wife, Elizabeth, as long as she lived.

However, most of Robbie's estate consisted of nonliquid assets that didn't provide enough money for his widow. She therefore decided to ask for the 30 percent of her husband's $70 million estate to which she was entitled under Florida law.

In forgoing the trust income to take her percentage, she triggered millions of dollars in estate taxes. Since there was insufficient cash to pay the taxes, the team and stadium had to be sold to settle the debt of approximately $45 million. Discord arose before and during the sale, and the heirs, many of whom already were at war with one another, lost the legacy their father had created and the chance for an amicable wealth transfer. Tactical planning had failed, and the family was fractured. Had Robbie attended to the more strategic aspects of the management of his estate, things might have been very different. As the family discovered, adding dollars to an already unstable relationship can be like adding gasoline to a fire. Smoldering resentments can burst into flame and the resulting conflagration may burn the house down.

The challenge most wealthy families face is that they do not take an integrated approach to family wealth management—an approach that incorporates both a strategic outlook and exceptional tactical performance. Families like the Robbies, who concentrate too heavily on traditional wealth management, generally do not do well in preparing for long-term wealth impact.

Conversely, other families may miss wealth-creating opportunities because they put too much emphasis on harmony and don't question actions and decisions made by other family members who seem to be in charge. Or they simply rock along, content with today's gains and thinking little about the future. By giving scant attention to interpersonal dynamics and communication, these families may set themselves up for failure when the economy takes a turn or a family member makes a unilateral and spectacularly bad investment decision. Furthermore, the traditional providers of wealth management services such as banks, brokerage firms, registered investment advisors, insurance agents, accountants, and attorneys focus primarily on traditional wealth and estate planning and neglect to address the strategic issues that account for 97 percent of the reasons families fail to sustain wealth. What is needed for multigenerational wealth management and sustainability

is the amalgamation of both strategic and tactical planning and execution. The families who have been the most successful in running the family business also put the same kind of effort into managing the business of family.

Along with the traditional wealth management responsibilities, these families continually mine the nonfinancial elements that affect the growth (or loss) of the family enterprise. These issues include:

- *Family history and values:* Who are we as a family? What lessons can we learn from the wealth creators or the concept of wealth creation? How did our forebears build the family fortune? What do they have to teach this generation? Do we have the same values they did, or have we developed a different moral compass? Do we as a family share multigenerational values? If so, what are they?
- *Family vision and mission planning:* What do we stand for as a family? Do we have shared vision or purpose for the wealth and the family into the future? What matters to us? What do we want our family legacy to be? Do we agree? If not, how do we resolve differences of opinion about what we want our legacy to look like?
- *Communication planning:* How do we currently communicate with one another? Does that method work or should we develop new modes of communication? How can we continue to improve communication between and across generations? Would we as a family benefit from a more consistent and formal communication process?
- *Family governance:* Should we manage our wealth as a unit or should we divide and manage it independently? Right now, who's handling the wealth on behalf of the family; that is, who has the greatest say in how wealth is developed and used? Is this the most effective way to carry out the family's mission and values? What are the rights and responsibilities of each family member? Are they clearly understood and communicated? How do we ensure individual family member accountability while allowing for expedited decision making?
- *Leadership development and assistance:* How do we prepare the next generation of leaders? What skills do we need, and how do we identify who has them? What education and training should the family provide for those who will fulfill major responsibilities in the future?
- *Role clarification:* What roles currently are being played by various family members? Are there gaps we need to fill? Do we need additional members to assume new roles? How do we determine which family members are best suited for which roles? Do any roles conflict with one another? Are there roles that served us well in the past but that now can be pruned as we look to the future?

- *Family education:* How do we develop an ongoing educational program designed to prepare and train family members to successfully manage and steward wealth on behalf of themselves and the family? Should such education be carried out by the family, by other advisors, or by a combination of experts both inside and outside the family?
- *Risk:* How do we balance risk and reward? How can we avoid the risks that might undermine the family mission? How do we deal with risk if it threatens our values? How does the family priority rank and manage risks based on the likelihood of specific types of occurrences and the level of impact they would have on the family?

Using a process that is clear, well-communicated, and well-orchestrated increases a family's opportunity for long-term cooperation and unity, generational understanding and happiness, and financial prosperity.

This book helps readers answer the vital questions above and discover ways to integrate strategic and tactical wealth management tools in planning for successful wealth building and generational transfer.

MULTIGENERATIONAL BUSINESSES ARE STILL GOING STRONG. HOW DO THEY DO IT?

A big name and a huge fortune do not ensure the continuation of the family enterprise. The family name may remain on the business and the heirs represented on the board, but the founder's vision can be diluted if the family steps away from the leading roles. The table below names some businesses that have found a way to pass a family legacy from generation to generation. Family members are still active in the businesses, and these companies have grown, changed, and adapted with the times. It appears they have planned well on every front, both strategic and tactical.

Family	Business/Year Founded	Generations
Zildjian Family	Cymbals/1623 (United States in 1929)	15
Hicks Family	Plant nurseries/landscape design/1853	6
Yuengling Family	Brewers/1929	5
Schoedinger Family	Funeral and cremation services/1865	5
Zambelli Family	Fireworks/1893	4

FORTUNES LOST TOO SOON. WHAT WENT WRONG?

In addition to the Vanderbilts and the Robbies, the families in the following table also lost the family business and the money that accompanied it by the third generation—or earlier. In most cases, planning seemed to be almost nonexistent, and spending was rampant.

For example, published reports indicate that Huntington Hartford II, grandson of the founders and heir to the A & P fortune, invested heavily in businesses about which he had little understanding: art, movie production, the newspapers, and others. He also had several failed marriages that cost him millions of dollars, and his real estate holdings, including a home in London and an unsuccessful Paradise Island resort in the Bahamas, eventually drained the coffers. In general, it appears that those who lost their inheritances did so because they lived beyond their means for long periods of time.

Mark Twain lost it all while he was still alive, and most of his $10 million fortune disappeared because he had little business acumen and made a series of poor investment decisions.

Family	Business/Year Founded	Generations to Loss
Hartford Family	A&P Groceries/1859	3
Pulitzer Family	Communications/1878	3
Woolworth Family	Retailing/1879	3
Clemens Family (Mark Twain)	Author/Speaker	1

Notes

1. Steve Hargreaves, "Squandering the Family Fortune: Why Rich Families Are Losing Money," *CNN Money* (June 25, 2014), money.cnn.com/2014/06/25/luxury/family-wealth. Retrieved January 12, 2016.
2. Roy Williams and Vic Preisser, *Preparing Heirs: Five Steps to a Successful Transition of Family Wealth and Values* (Bandon, OR: Robert D. Reed Publishers, 2003), pp. 36–46.