CLARK MORGAN
VICE CHAIRMAN,
HEAD OF STRATEGY AND DEVELOPMENT

The key to successful *wealth transfer*

Affluent families are, by their very nature, subject to several hurdles when considering how to preserve wealth over subsequent generations. Is the aim to leave a legacy or just the leftovers?

Obviously, a key determinant of the approach to be taken is what, exactly, is the intergenerational objective. If the plan is to leave the family a legacy, how do you turn your success into a family tradition and ensure the privileges and responsibility of wealth are passed on?

Open communication is key to successful wealth transfer

Succession planning is an emotional task. The way issues and conflicts are handled and the level of open communication have a far greater impact on the actual successful transfer of wealth than individual investment decisions.

Families, in general, are complex and dynamic. They often include unique and strong personalities with different philosophical ideals. Aligning them may not be possible, nor even required, but giving them a voice and creating an environment of inclusion will be.

Families, in general, are complex and dynamic...Aligning them may not be possible, nor even required, but giving them a voice and creating an environment of inclusion will be.

Making money may be easier than keeping it. In the past, a common approach was to avoid discussions about intergenerational wealth transfer and, in some cases, an approach of secrecy was adopted. Until the next generation actually received its inheritance there was a lack of clarity, and that's when the disputes usually started. It was mysteriously thought that if the family's financial affairs were kept secret, any problems might be avoided. In fact, they were simply deferred. The result was that opportunities were suffocated.

Thankfully, we have seen a marked shift in the approach taken by wealthy families, perhaps reflecting a change in society's attitude to wealth accumulation. Past generations' preference for secrecy sometimes reflected a negative attitude within society broadly towards those who had been successful—an attitude often founded in jealousy.

I recall a client who had to decide what the future management of the family business would look like. His eldest child was involved in the family business and another, who was successful in his own right, wasn't. He had to decide who should run the business, how would the income and capital value be shared, and how would tactical and strategic decisions be made.

He determined that the business would be best run by the sibling already managing the business with provision made for the other son. Tactical decisions would be made by the son operating the business, but strategic decisions had to involve others, including the son who was not involved in the day-to-day management. Such conversations are often difficult and, in this case, while the discussion was direct, it was resolved relatively easily and undertaken respectfully with a positive outcome, but it certainly wasn't straightforward. In many instances, the outcome may not be fair, but it does have to be spoken about. Communication and structured conversations are critical. We have seen the affluent sector of society grow over the last few decades, and with that there appears to have been a change in attitude and approach. That will hopefully be reflected with more open dialogue in families or, at least, a recognition of the need to address issues and eradicate surprises and future disagreement.

Intergenerational wealth transfer requires a plan and framework

Notwithstanding the growing awareness of the benefits of a more open discussion, management of intergenerational wealth transfer requires a plan and framework. The main factors to be discussed in order to protect family cohesion and smooth succession should include family values, family history, business/investments, approach to philanthropy, role of a centralised family office, structure of future interaction/engagement and understanding the asset base.

While it's far more than just commercial undertakings and investments, for families the transfer of a family business is a real and present global issue. According to the Family Firm Institute, 70- 90% of global GDP is created by family businesses—however, only 3% of businesses survive the fourth generation. "From shirt sleeves to shirt sleeves in three generations" is as applicable today as it was when first coined.

History shows that those who have inherited wealth have done a poor job at preserving the asset base, let alone growing it. For every successful dynasty, there are many examples of families who have struggled with asset transfer and growth and who haven't handled the internal family issues successfully.

Family wealth isn't the sum of the financial assets alone; more importantly, it is leveraging the human capital embedded in each family member. Any successful transfer will be shaped by the values imparted, often to a far greater degree than initially thought.

In this regard, some families find it useful to set up family meetings and even establish a family council if a more structured approach to communication and involvement of the next generation is required. Conversations focus on values, decision-making, estate planning, the need for a family council or less formal regular family catch ups. Family councils are not always required, and often meetings that are held when needed or at regular intervals are an effective way to commence the process and achieve a smoother transition to a more purposeful agenda and meeting schedule if that's required.

A formal constitution is a popular tool used by families to document the family strategy, as well as address broader strategic family purpose. While a constitution sounds rigid and introduces a degree of formality, it can be as simple as a brief statement of values, key objectives and how family members should interact with each other and make decisions. Even a conversation around whether a constitution should be created often crystallises some core issues and can assist in aligning family members behind key objectives.

Reversing dynamic erosion requires prudent investment and disciplined controls around spending

The question remains—why it is so difficult to preserve an asset base across generations? The most powerful eroder of family wealth is the growth in the number of family members. If the capital base remains static and the family grows in number, wealth will obviously diminish. A fortune of $100 million held by one individual would place them amongst the very wealthiest individuals in Australia. The same wealth shared amongst three siblings, and perhaps, in turn, nine grandchildren, very quickly delivers each individual a comfortable existence rather than a privileged one. Maintaining wealth at the founding generation's per capita level is of itself an unlikely proposition. However, reversing dynamic erosion resulting from the growth in the number of family members requires prudent investment and disciplined controls around spending. Other factors inhibiting wealth transfer include the isolation that can accompany considerable wealth, family discord (including the permanent breakdown of relationships), the potential abandonment of family core values, and a loss of investment leverage resulting from the wealth being divided into much smaller ownership units. However, all of that can really be wrapped up and described as a lack of focus on succession generally and not recognising the emotional issues involved. Critical conversations involving family members should not be avoided but initiated, sometimes with the support of an independent professional to ensure the result is positive and the emerging issues are dealt with.

A structured, inclusive approach is needed

Intergenerational wealth transfer is complex. The solution isn't always straightforward, but the issues can be addressed, and the privileges and opportunities optimised if a structured inclusive approach focusing on clear communication is adopted. There are qualitive and quantitative aspects that must be recognised.

Often, a convenient place to start is a discussion around family values and what matters most to the family, while developing a clear understanding of how the wealth was generated, which should include a discussion around values, work effect and skill development.