Europe's Family Offices, Private Equity and Venture Capital

An EVCA Special Paper

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About EVCA

The European Private Equity and Venture Capital Association (EVCA) was established in 1983 and is based in Brussels. EVCA represents the European private equity sector and promotes the asset class both within Europe and throughout the world.

With approximately 1,150 members in Europe, EVCA's role includes representing the interests of the industry to regulators and standard setters; developing professional standards; providing industry research; professional development and forums, facilitating interaction between its members and key industry participants including institutional investors, entrepreneurs, policymakers and academics.

EVCA's activities cover the whole range of private equity: venture capital (from seed and start-up to development capital), buyouts and buyins.

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IMD in Lausanne, Switzerland, is recognized as one of the world leaders in executive education. For over 60 years IMD has worked with leading global companies to develop and retain management talent. IMD is the "global meeting place": the most international of business schools worldwide. IMD offers learning based on innovative and highly relevant research. Learning that can be applied to business challenges - immediately. This is IMD's "Real World. Real Learning" approach. (www.imd.ch)

Disclaimer

The information presented in this report has been gathered directly from family offices active in Europe by IMD and EVCA.

Every effort has been made to collect information that is as accurate as possible; however EVCA and IMD cannot guarantee the ultimate validity of the information collected as no independent auditing or review of this data has been performed. EVCA and IMD do not accept responsibility for any decision made or action taken based on this report or the information provided herein.

Table of Contents

Foreword

Family offices have grown to become an integral part of the European private equity and venture capital market. Not only are they more actively investing in the asset class than five years ago, but also within EVCA and its activities, family offices have increased in number and visibility.

A survey among EVCA members in spring 2005 (1) showed that family offices supplied over 5% of the committed capital in close to 40% of the responding funds and over 10% in close to 20% of the responding funds. Encouraged by these findings, EVCA launched a more in-depth study together with IMD (2) on the growing role of single family offices in the European private equity and venture capital market. Especially IMD's experience and knowledge about family businesses and their management over several generations have been a valuable asset for the study.

The high level of discretion of family offices and the various channels they use for investing in private equity and venture capital, make it difficult to quantify their contribution to the European private equity and venture capital market. Generally, investments can be made either through a private equity/venture capital fund or via the intermediary of a fund of funds. Moreover, family offices have the third possibility to invest directly in companies.

Overall, EVCA estimates that there are around 500 smaller family offices active in Europe, of which between 80 and 100 can be considered as large, with over €1 billion of assets under management.

When planning the family office research project in 2005, EVCA had three trends in mind that would shape the private equity and venture capital market, and the role of family offices therein.

- As family offices manage private wealth, they are and will remain unregulated compared to limited partners such as pension funds, insurance companies and banks. Hence, their allocation to the asset class is likely to remain at relatively high levels, compared to other limited partners.

- Secondly, the generational change still to happen in many European family-owned companies will lead to a new accumulation of family wealth and the creation of new family offices in the coming years. As a result, more family offices will be established and are likely to follow their current peers investing in private equity and venture capital.

- Finally, family offices have a limited liability management when compared to pension funds and insurance companies. The main purpose when investing is the overall capital preservation and provision for individual family members. Consequently, family offices are very long-term focused and look at absolute market returns, which makes them particularly well-suited as investors in private equity and venture capital.

Keeping these three developments in mind, this study aims to:

- improve the private equity and venture capital funds' understanding - especially EVCA members - of European single family offices and their approach to the asset class;
- show new family offices interested in private equity and venture capital how their more experienced peers approach the asset class, and allow existing family offices to compare their approach with the study's findings.

(1) EVCA Barometer March 2005: "Family offices and their role in private equity".
(2) The International Institute for Management Development, Lausanne.

We would like to take this opportunity to thank on behalf of EVCA and IMD all the family offices and their members that have participated in this study, for their time and very valuable input. Without their contribution, this project would not have been possible.

We are very pleased to contribute to a better knowledge and understanding of family offices, and look forward to an interesting discussion and continued dialogue.

Georges Noël
EVCA Director

1. Introduction

1.1. Recent shifts in private equity and family business practices have been mutually beneficial

1.1.1. Increasing number and size of family private capital holdings

The past decades have seen an impressive growth in private wealth on a global scale. As a measure of this trend, *Forbes* magazine, in its inaugural ranking of the world's richest people 20 years ago, listed around 140 billionaires. In 2007, the list contained 946, an increase of 153 compared to 2006. Even with such a significant increase in large accumulations of private wealth, not much research has been done into the evolution and factors which influence the private wealth development process over time. As wealth creators, owners and then investors, families often adopt an entrepreneurial stance in running their company and managing other financial assets. However, outside managers such as non-family organizations and individuals are increasingly playing an important role in determining how high net worth families deal with their financial concerns and interests.

1.1.2. Changes in the relative drivers of superior private equity investment returns

During recent years, private equity and venture capital firms have also seen significant changes in the relative importance of certain factors which drive their superior investment returns. Increasingly, private equity [3] investors have been able to invigorate firms that drive these superior returns. This means spending more resources working with the management team on strategic development and implementation issues rather than relying mostly on cost cutting or restructuring, in the case of buyouts, or on focusing on public offerings in the case of venture capital. While private equity firms continue to be "temporary" owners of the businesses in their portfolios, the overall length of time that they hold on to these businesses has been increasing.

Why such an increase? To obtain a high exit value, markets are interested in long-term value creation potential. And in order to generate such value, private equity professionals must have made the right investments for the right amount of time in softer, more expensive and time-consuming aspects, such as marketing, strategy, and research and development. The ownership structure is such that it allows for a much better implementation of the corporate strategy than would be the case in publicly listed firms.

Taking as a starting point these developments in the private equity industry, and the family business landscape, this paper looks at why the private equity industry should pay close attention to the administrators of family wealth and family offices. It will illustrate the extent to which aspects as varied as family history, culture and interests affect the timing of the establishment of the family office, as well as its development and structure. All these factors, when combined with a family's exposure to a family business, its investment philosophies, multi-generational time horizons, broad networking abilities and the ability to move quickly in changing investment circumstances, determine the overall investment behaviour.

[3] From this point onwards, private equity will refer to both venture and buyouts.

1. Introduction

Figure 1: Main characteristics of family offices interviewed

1. Long-term investors, focus on building overall capital
2. Strong risk-taking entrepreneurial drive
3. Focus on absolute returns
4. Heavy tax and intergenerational wealth transfer concerns
5. Clear investment, operating and reporting principles
6. Philanthropic activities left to future generations

High allocation to "alternative" investments

Source: IMD/EVCA

1.1.3. Growing importance of private equity investments for family offices

This study presents family wealth, as managed by family offices, as a challenging new opportunity for private equity firms. As owners/managers of capital and businesses, family offices have a lot in common with private equity investors because they are closely involved in the running of their companies and are concerned about making the right decisions to drive long-term performance, particularly if they have a multi-generational perspective. Furthermore, because of their accumulated business acumen gained from exposure to family firms, they are also extremely entrepreneurial and thus constitute a nascent class of investors with great interest in venture capital opportunities.

Private equity intermediaries have played a significant role in the realization of the liquid wealth of many families in recent years and will continue to do so. Increasingly, business-owning families are confronted, for any of a number of reasons which will be explored later on in this document, with a need or an opportunity to sell part or all of their family business and they are relying on private equity transactions to achieve this. Family businesses themselves also find it increasingly necessary to look outside the family for managerial talent and have come to see partnership deals with private equity firms as a way to acquire managerial expertise and improve the governance and performance of their business(es). Such new developments present an opportunity for private equity firms to buy companies and restructure them, thus gaining a new clientele that suddenly has significant wealth to invest, with particular interest in venture capital opportunities.

1.1.4. Attitudes toward risk, investment allocation and tolerance of value fluctuations stem from underlying family views and experiences

The sophisticated investment, syndication and control procedures documented in the family offices interviewed stem from the underlying family views and experiences. They also lead to aggressive private equity allocations, albeit through novel mechanisms. Thus, family offices will increase in importance as key private equity investors and as a growing source of investment capital. While family offices tend to have particular characteristics (smart, patient and often more entrepreneurial and risk-taking with regard to investment decisions) that make them ideal private equity “customers”, it is very important for general partners to understand the dynamics of a family office when attracting such a client into an investment.

Clearly, there is a need to understand the mechanisms by which these factors and attitudes toward risk of the individuals involved affect investment allocation as well as to prioritize such mechanisms according to their level of influence. To shed further light on these developments, EVCA and IMD conducted an in-depth clinical study with a representative subset of major European family offices. The study illustrates how the relationship of family offices with private equity stems directly from the purpose of undertaking investments and the extent to which the family office and its activities are part of the personal endeavours of individual family members.

2. What is a Family Office?

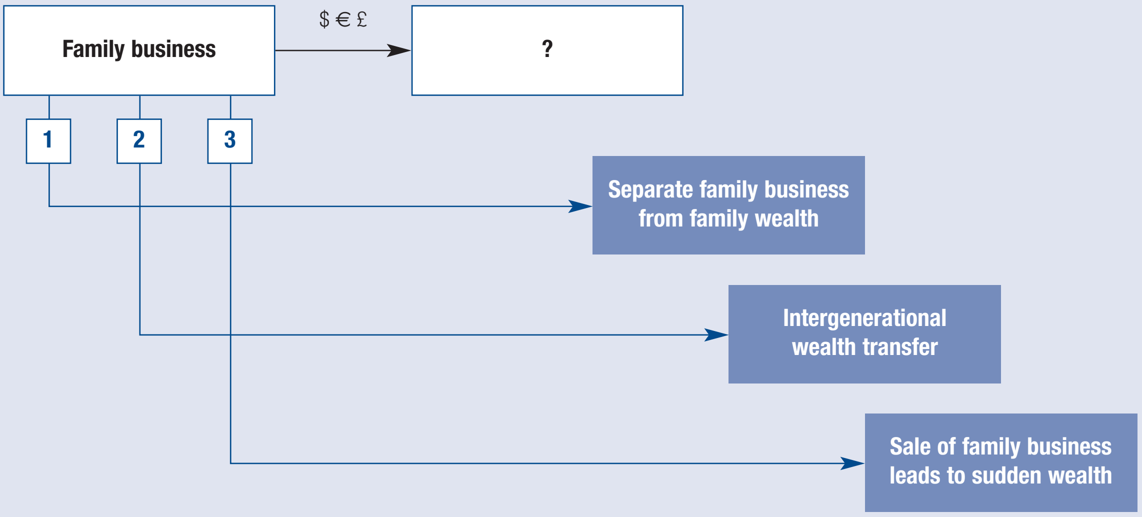
There is no specific definition of a family office. The common element of family offices, regardless of their organizational and operational form, is that they consolidate the day-to-day management and administration of the collective assets and business affairs of one or more families. The long-term goal of a family office is to preserve the wealth of the family(ies) for current and future generations. It must be noted that the primary goal of a family office is to provide for the family's upkeep, well-being and long-term financial planning, and it should therefore not be confused with a family foundation, which is intended primarily for charitable purposes.

2.1. Distinction between single and multi-family offices

Financial practitioners involved in providing services to family offices generally make a distinction between single and multi-family offices. A single family office (SFO) generally manages the wealth of members of a single family made up of individuals sharing a common ancestry or surname and assets inherited communally. By contrast, a multi-family office (MFO) manages the pooled wealth of members of different families and allocates funds to investments either in the aggregate or per family.

3. Why are Family Offices Established?

Figure 2: Factors leading to the establishment of a family office



Source: IMD/EVCA

3.1. Separation of family business assets from family wealth

A family office can represent a strategic decision by family members to create a formal distinction between the family wealth and the family business. By establishing a family office, family assets can be made from decisions related to the operation of the family business. Also, a separation can be carried out in the spirit of improving the transparency and corporate governance of the family business. Ownership of the family business can either be transferred to the family office or remain with members of the family. Generally, families prefer to keep ownership of the family business separate from the family office in order to protect the family assets from unfavourable business conditions that may affect the family business.

Several of the managers interviewed mentioned it was quite challenging for family members to understand the implications of this separation and why it was necessary to implement it. Managers additionally stressed that such delineation becomes even more important when there is a strong sentimental bond to the family business. This is for reasons such as protection from liability which could arise from operating the business and overexposure to certain industry segments and economic cycles. If the family still maintains a significant portion of its overall wealth in the original family business, the establishment of the family office formalizes the distinction between family wealth that is independent of the family business (i.e. realized profits or income) and the family business itself. This is not, however, a separation, but rather a clarification of the distribution of assets that family office managers must make in order to prudently invest the family's liquid wealth and create the governance and operating structures. Clarification becomes more important and more "sentimental", as one manager put it, in the case of the founder's generation or her/his children since they have had first-hand involvement in the family business.

3.2. Intergenerational wealth transfer: a key driver for the establishment of a family office

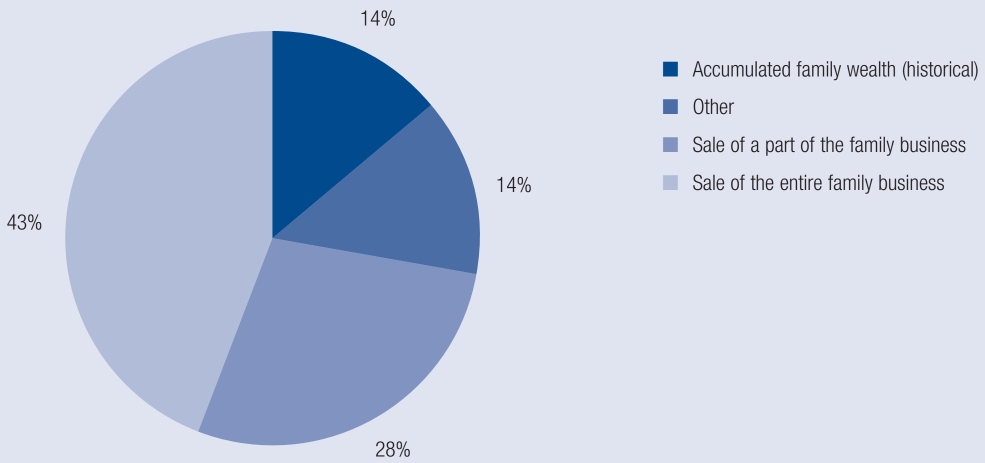
In general, family offices have historically been established as vehicles for the intra-family and intergenerational transfer of wealth, whether through liquid assets or through the ownership of a business. The most common historical trigger has been the retirement of the founder(s) of the family business in order to manage the wealth generated by the business. Moreover, family offices can be established by the heirs to such wealth in order to set up the structures necessary to manage inherited assets in common as opposed to liquidating them and dividing them up among themselves.

When generational transition occurs, the family office principals face two choices. They can either divide the assets and establish separate single-member family offices or they can turn the family office into a limited-member single family office. The latter, though much more formal in their implementation, are born out of a genuine interest of the inheriting siblings and first-cousins (to whom membership in this type of family office is generally limited) to have the family office serve as the “glue” that the family business formerly represented. This generation had direct contact with the family business in their formative period and thus understands the role it played within the family. The family office becomes a proxy for the family business and a platform for family interactions and continued involvement in common projects.

3.3. Sudden increase in liquid wealth after a transaction

The third source of funds, and most significant in our sample, is the sale of at least a portion of the family business, thereby leading to a sudden increase in overall available liquidity. To understand the importance of trade sales as a source of liquidity for family offices, all the reported assets of the family offices interviewed were aggregated based on their source. Out of a total of €30 billion reported as under management by our sample, 43% came from the total sale of a family business and 28% from the sale of part of a family business. In comparison, only 14% of assets came from historical family wealth. As will be seen later, such rapid acquisition of wealth coupled with the involvement in the pre-existing family business has consequences for the investment behaviour of family members since they tend to be more “business-savvy” and “involved” than investors whose source of assets is historically accumulated wealth.

Figure 3: What is the origin of the family offices' wealth in our sample?



Source: IMD/EVCA

3.4. In most cases, a family office was established to improve family governance

Regardless of which combination of factors led to the establishment of the family office, a common driver consistently mentioned was an interest of either the original business founder and/or the heirs to establish a management and governance structure that would avoid conflict. As one participant commented, “Tall fences make good neighbours”.

4. Types of Family Offices

4.1. The organizational model for family offices is in a state of flux

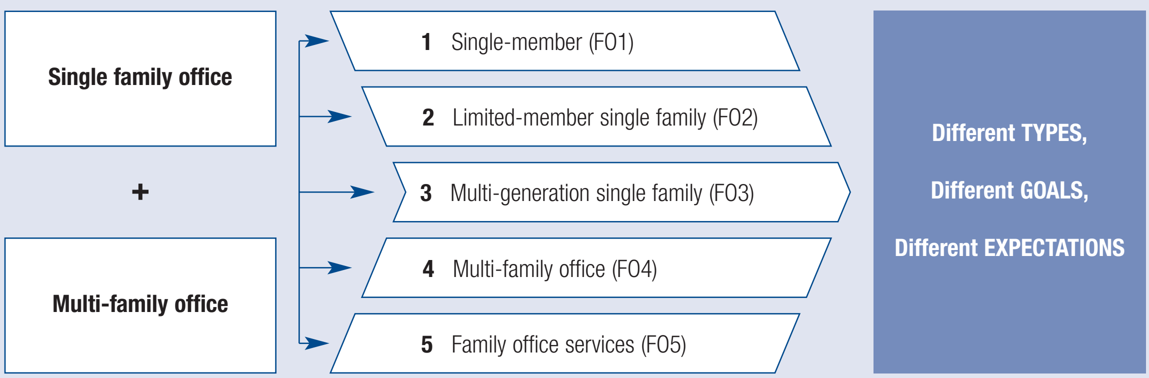
The current view among practitioners is that single family offices (SFO) are in a transitional period. Families are increasingly embracing the multi-family office model (MFO), as SFOs are increasingly opening their services to other families, thus becoming MFOs. However, the fieldwork for this study strongly suggests that such a view is an oversimplification, and some of those statements simply do not correspond to our findings. None of the SFOs interviewed had any interest or desire to open themselves to other families and establish an MFO. According to this study, family offices serving a single family are not disappearing but, quite the contrary, are increasing in number. This is particularly the case for those which are used to working closely with other family members as they prefer to set up their own independent operation that is more in tune with their needs, interests and goals. While, broadly speaking, a family office is an office serving one family, and by analogy, a multi-family office serves many families, a shared genealogical lineage is a rather crude and uninformative delineator for categorizing family offices. It is much more informative to understand the structure and genesis of a family office as a function of the distance from the founding principal, the size of the clientele and the involvement of family members in the office. The further the generational distance from the founder, the less cohesion between family members and the more likely the family office will be reorganized.

4.2. Family offices can be divided in five categories rather than two

4.2.1. Founder involvement in the office is a key differentiating factor

Our taxonomy further categorizes single and multi-family offices based on one of our key findings: the level of involvement of the original founder in the family office is more indicative of investment appetite, risk tolerance and interest in financial matters than the amount of wealth managed or the number of families served by the office. According to our taxonomy, the desired level of involvement of the principal owner(s) and the goals that the principals plan to accomplish through the family office determine the most appropriate choice from among the five models presented.

Figure 4: The five types of family offices



Source: IMD/EVCA

4.3. Single-member family office

The first type of family office identified is the single-member family office, FO1 in the diagram. Such an office is created to serve the needs of a single individual, generally the original entrepreneur and owner/manager of the family business. The key differentiating factor in these offices is that they serve a single individual and not an extended family. An FO1 is not only established for reasons of intergenerational wealth transfer, it can also be part of a strategic division. In some cases, such a family office was established when wealth was being transferred from the founder to his/her children and they, as heirs, preferred to set up offices independent of each other and pursue their own interests. An FO1 can also be created by "pruning" members from the family office, as was the case in one of our interviews: one sibling bought out the shares in the family office and family business of the other siblings, thereby leaving the family office subservient to a single individual.

4.4. Limited-member single family office

It is clear that the structural continuity of a family office is not guaranteed, especially at times of generational transitions. Instead, it is subject to the interests, goals and involvement of the heirs in question. There were several cases in the sample in which family members served by a single family office "cashed-out" from it and then either established their own FO1 or pooled together with other members to establish a limited-member single family office (FO2 in the diagram). The important difference is that in an FO2, more attention is paid to issues related to governance, making it increasingly necessary for family members to use formal channels and reviews when communicating information to each other. However, because there is still little generational distance between the current members of the family office and the original principal (the source of the wealth), the family members remain quite entrepreneurial and business-savvy and, therefore, tend to be more involved in the family office than would generally be the case for family members of later generations.

4.5. Multi-generation single family office

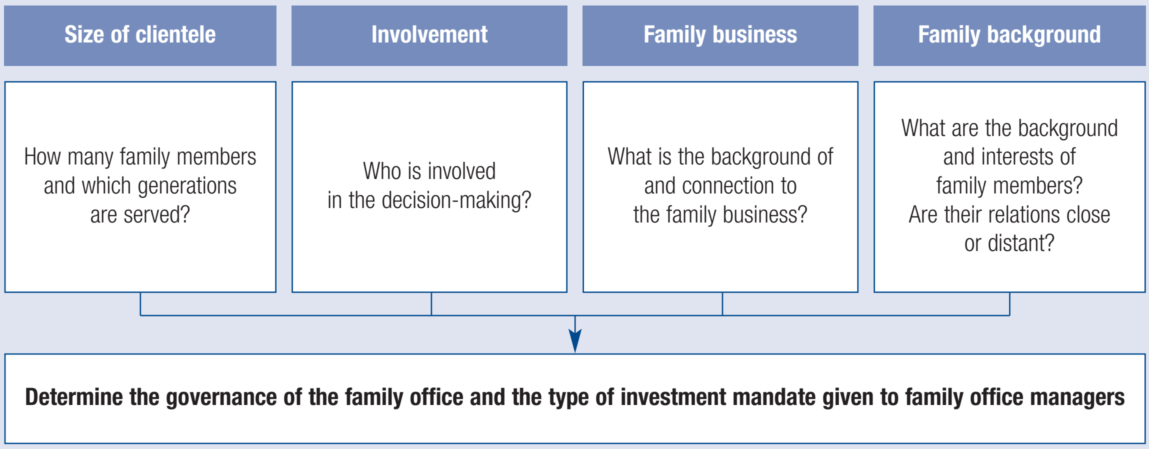
The third model is the multi-generation single family office (FO3) which, in the words of one of the interviewees serving such a clientele, was characterized "as a single family private bank, really". The distinguishing factor compared to the previous two categories is the increasing distance between the founding principal and the office's clientele. Further members served by an office of this type tend to be much less familiar with the family business. As a result of the relatively higher number of clients, much more attention tends to be paid to the formalization of decision-making and governance. The increase in clientele also means that there is a large discrepancy in terms of the stage in life of the members and, in turn, of their investment needs and horizons. Therefore, capital allocation has to be rearranged so that it will provide current income for older generations and a long-term investment horizon for the younger ones. Of course this means that there is a dichotomy: on the one side, there is a need for liquid, "safe" investments to provide for current needs, and on the other a need to undertake long-term, high upside, but high risk investments for future generations.

4.6. Multi-family office and family office services

Based on the comments from interviewees, two other types of family office complete the taxonomy presented here: multi-family offices, as described earlier, and family office services provided by private banks.

5. What Determines the Office Structure and Investment Allocation?

Figure 5: Factors influencing investment allocation



Source: IMD/EVCA

5.1. Size of the clientele

The size of the clientele was the primary determinant of the office structure and its operation, as well as of any investment decisions. Two factors need to be taken into account: the number of family members and the "generational spread", i.e. the distance between the newest generation of family members served by the office and the founder's generation. If two family offices serve an equal number of family members, but in one they are all in the first generation, whereas in the second office they are from the first, second and third generations, the second is considered to have a larger clientele because it has a greater generational spread. There is a higher number of investment profiles to be served, thus leading to a greater complexity in the overall asset allocation.

5.1.1. Smaller offices tend to be more flexible and nimble

Family offices serving a smaller number of family members tend to be the key decision-maker in the management of the whole of family members' assets, taking a more entrepreneurial and less risk-averse approach to investment. Such offices tend to have leaner decision-making processes since family members tend to be increasingly financially literate and more likely to be involved in decisions.

5.1.2. Larger offices tend to be less so…

Offices that serve a higher number of family members, or have a greater generational spread, tend to be more of an intermediary between family members and external providers due to the fact that asset management has more likely been outsourced. There is much less tolerance of risk and entrepreneurial spirit. Such offices tend to be more complex in their operations as they have more complicated recording, voting and reporting requirements. Family members tend to have less financial literacy (or interest) and prefer to delegate decisions to others. In turn, managers have to cater to a divergent community of investment profiles.

The higher the number of family members, and/or the broader the generational spread of the clientele, the more specific the internal rules and requirements and the provisions for information flow. The more generations served, the more individualized attention has to be paid to each individual family member's circumstances as they are all in different phases of their life cycle and thus have different investment horizons, risk profiles and liquidity concerns.

Figure 6: Fewer family members versus more family members

The smaller the number of family members…	The higher the number of family members…
• The leaner the decision-making process • The more financially literate • The more entrepreneurial, risk taking • The more involved and hands-on in the family office Family office is the key decision-maker in the management of the family members' assets	• The more complex the running of the office • The greater the variety in family members' individual investment profiles • The less financially literate • The more likely decisions will be delegated to others Family office is an intermediary between family and asset managers

\+ **Entrepreneurial spirit and tolerance for risk** -

Source: IMD/EVCA

5.2. Who is involved and to what extent influences structure and investment allocation

The governance and operations of the family office are determined by the family members' desired level of family involvement in the office, as well as their relationship with the office's management team. Family members must decide upon matters such as who is going to be involved in operational and strategic decisions, in day-to-day administration, and how much discretion is given to the managers of the family office. The type of involvement opportunities that are possible within a given family office are generally set out in the founding charter of the family office and represent a consensus position.

5.2.1. Three forms of family involvement

Involvement in the governance of the family office

The involvement in the governance of the family office refers to the voting rights allocated to each family member for taking long-term strategic decisions at board level. All the families surveyed mentioned that they have some sort of document providing a legal basis for the family office, with varying levels of sophistication, which sets out and allocates these voting rights.

5. What Determines the Office Structure and Investment Allocation?

Family members in the role of family office managers

Family member involvement as managers of the family office occurs when family members take on specific roles within the family office for which they are professionally qualified, and their employment is based on market principles. Day-to-day involvement can also be part of some families' efforts to educate future generations and inculcate business sense and family values.

Family members involved as management stakeholders in direct equity investments

Family members can be involved in the direct investments of the family, including the family business. Again, as with employment in the family office, family members participating in the management of the offices' direct equity investments can also be part of an overall professional development programme or it may concern the full-time occupation of the family member(s) involved.

5.2.2. The mandate given to managers determines their latitude in investment decisions

The relationship between the manager of the family office and the family members is paramount in the investment decision-making process of the family office. The manager serves as a gatekeeper and information filter to the family members. While the majority of family office managers interviewed are not family members, they do have, in the words of one participant, "total loyalty to the family". The links between family members and family office staff are quite strong: in a number of family offices interviewed, most staff members were either recruited directly from the original family business or were long-term business advisers to the family. In smaller family offices (serving the founder and the second generation), there is less formalization of the relationship between the family and the manager and among family members themselves, and much of the decision-making is consensual. In larger family offices, there tends to be greater formalization of the decision-making process.

6. Family Dynamics, the Business and the Office

6.1. The family business is a platform for family interaction

Respondents generally emphasized the important role the family business plays (or played) in strengthening the relationship between family members and their cohesion as a family. Thus, it is clear that a family business influences the intensity and degree of intra-family relations. Several managers referred to the family business as “the glue” that holds several branches and generations of the family together. In such cases, the family business is part of the family’s history and tradition and it may be difficult to see it objectively as part of an equity investment portfolio.

6.2. The family office can also be a platform for family relations

Family member involvement can in itself be a goal when establishing a family office. Generally, more entrepreneurial individuals prefer to be more involved either in running the office or in the investments undertaken, and in several of our cases the family office had become a new “family business” for family members to run. In cases where the original family business was no longer there to serve as the “glue”, our sample exhibited two possible outcomes in which the total wealth is divided across family members. In some cases, family members each take their share of the wealth and make decisions on how to manage it either individually or in groups of family members. In several other instances, a small, like-minded group of members buys out the other family members’ stake, thereby consolidating ownership of the family wealth. They then proceed to establish a single-member family office (FO1).

In the two scenarios described above, the desires and interests in terms of level of control over family wealth and involvement in its management were different across family members. In short, some wanted to be hands-on or more risk taking, others did not. Therefore, the best outcome to meet everyone’s needs was to split the wealth. Each member’s desire for independence and fulfilment of entrepreneurial drive outweighed the benefits of staying together. For those members, the family office can be a surrogate for the role previously played by the family business as a platform for family relations.

6.2.1. And a platform for the entrepreneurial spirit of the family

The establishment of a family office can also provide the framework necessary to unleash a family’s entrepreneurial spirit, providing renewed dynamism to intra-family relations and thus forging stronger bonds, particularly in cases where the original family business has reached a significant level of maturity. One of the family offices interviewed sold off a minority portion of their family business for several billion Euros specifically because they felt that running the family business was becoming “burdensome and did not give us the managerial autonomy we cherished”. They undertook investments as a family for “fun” in order to realize their “entrepreneurial will as a family”. They proceeded to devote their time to what they refer to as a “family project”: a travel and leisure investment worth several hundred million Euros. In several other instances, there was a deliberate divestment from the original family business in order to pursue other opportunities that were deemed to be more “fun”.

6.3. Family background

Connection and experience with a family business has a bearing on the investment profile of family members and, therefore, on that of the family office. The fresher the experience or involvement of family members in the business, as would be the case if they still hold significant portions of it, participate in its corporate governance, and/or are part of the day-to-day management team, the more involved they are in the family office. Several of the managers interviewed pointed out that a connection to the family business gave family members "business sense" and "awareness" of business matters, contributing to a greater likelihood that family members individually or collectively would want to start their own business. However, in situations where the business is a distant memory, there tended to be less interest from family members in involvement in the family office and more demand for lifestyle management. In fact, one of the family office managers quipped "To my family, money is a burden." As a result, the structure that the family chose basically handed all decision-making powers to the manager, since they wanted as little involvement as possible.

7. Family Offices as Investors

The factors leading to the establishment of family office (as described in Figure 2) determine the origin of the funds that the family office manages and are thus critical in determining the future investment allocation behaviour of the family office. As illustrated in Figure 7, the investment behaviour and tolerance of fluctuations in portfolio risk and variance change according to the generation involved.

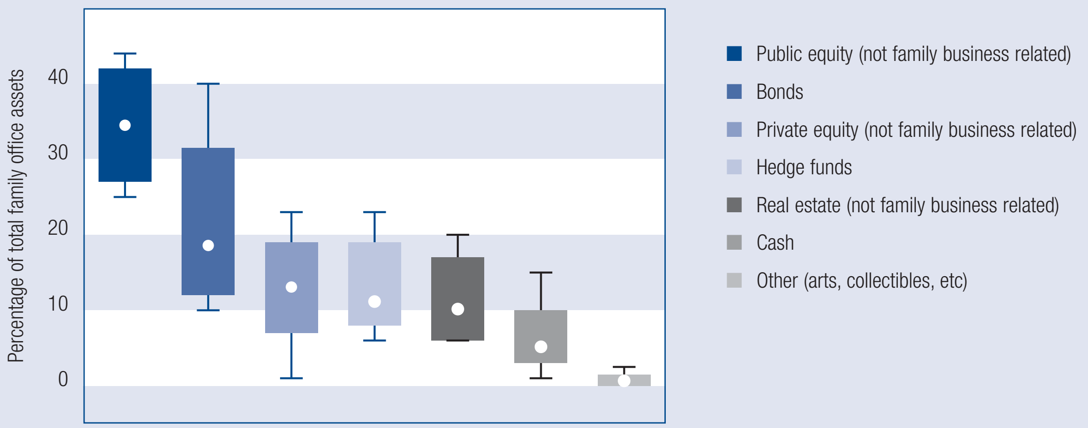
Figure 7: Summary of investment characteristics of family offices interviewed

	Low	Medium	High
Size	High number of family members	1st, 2nd generation	Founder only
Bonds, stocks, real estate	> 90% of assets	60%-80%, reduction with time	50%-75%, depending on volume of wealth
Private equity & venture capital	Limited < 10%	15%-20%, increase with time	Up to 50%, depending on link to family business
Strategy	Allocation according to individual risk profile of family members	Increase in private equity as knowledge base increases	Invest because it is fun, more likely to co-invest or invest directly

Source: IMD/EVCA

The current allocation of family offices can be quite varied as illustrated in Figure 8. This box plot shows the family office that allocates the highest proportion of its portfolio to a single asset class and the one that allocates the least. The dot indicates the average allocation and the area of the box represents the range of values for the family offices in between. It becomes clear that some family offices allocate very little to private equity investments while others allocate a higher portion of their total assets.

Figure 8: Current asset allocation of the family offices



Source: IMD/EVCA

7. Family Offices as Investors

7.1. For managers, connection to the family business influences allocation… or at least it should

Several of the managers interviewed pointed out that the amount of the family's overall wealth that is still tied to the family business is often the manager's (but not necessarily the family's) key deciding factor in terms of investment allocation. Family offices that are the product of either factor two or three, i.e. intergenerational wealth transfer or sale of family business, or both as listed above, tend to manage a larger overall proportion of liquid wealth than families that still have a significant portion of their overall wealth in the family business. One manager commented that s/he takes "a helicopter view" of the situation: "I have to take into account both the family business and the liquid family wealth when deciding on an asset allocation strategy since the family business is really a direct equity investment." S/he continued, echoing an observation made by other managers: "The family tends to only look at the liquid wealth side of the equation and doesn't really see that the family business is part of the overall portfolio, since to them it's always been there." In a similar vein, another manager mentioned that "the family business has to be counted in what I call the "risk-budget" of the family. What I mean by that is that good asset allocation has so much going into stocks, so much into bonds, so much into private equity, there is a risk budget. I have to take into account the risks inherent in private equity holdings, as well as the business risks of the family business when doing my overall allocation." Managers generally commented that getting family members to see the family business from this different point of view was one of their top priorities and, at times, a major source of frustration.

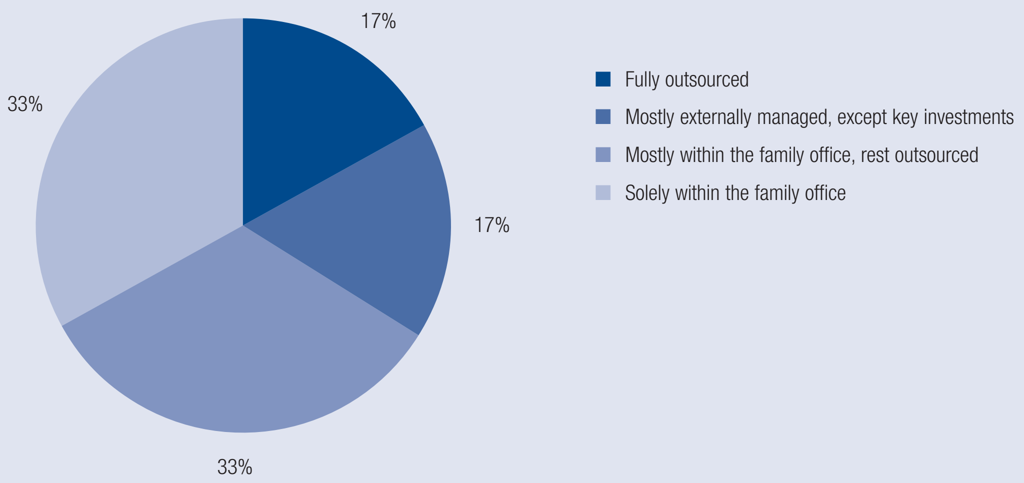
7.2. For family members, the family business brings early investment opportunities

Investment decisions and allocations are quite dependent upon where in its life cycle the family office finds itself. When choosing investment opportunities in the early stages of the family office, respondents pursued two types of investments. First were real estate investments, as they were immediately recognized as a good mechanism for capital preservation. Generally, such investments tend to be in domestic markets, but several families reported larger, global commitments to real estate, either directly through real estate investment funds or through ad-hoc investment clubs with other families. The second type of investments is undertaken in the industry of the original family business or related industries. Regardless of the underlying business risk of such industries, they were seen as less risky than other competing alternatives. In their view, familiarity with those industries compensated the inherent business risk.

7.3. Family offices are close to their investments

The family offices surveyed tend to prefer to keep their active investments "in-house", while outsourcing passive, conventional investments and cash management. For most interviewees, being involved in the family office and investment decisions is, to a great extent, part of a desire to remain professionally engaged.

Figure 9: Who manages the financial assets in a family office?

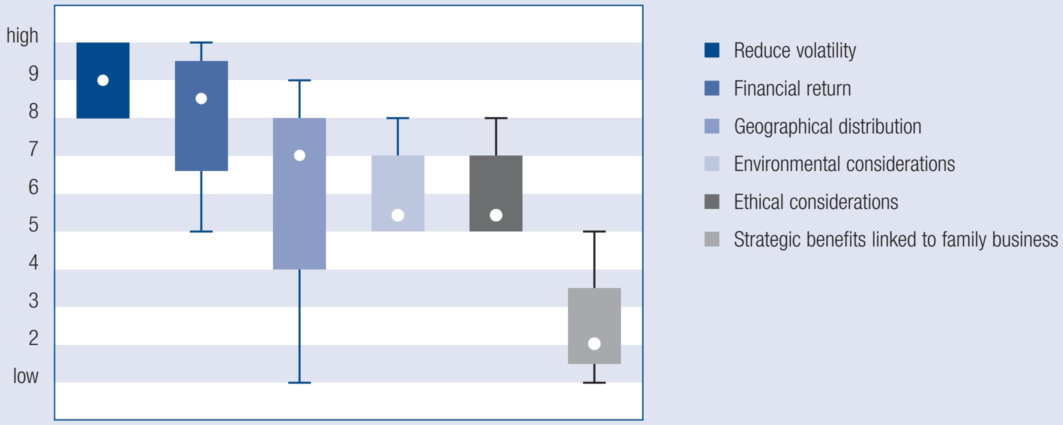


Source: IMD/EVCA

7.4. And it is not just about returns

Figure 10 is a box plot summary of self-assessment scores of the main drivers of investment decisions. For almost all families, the most important aspect overall is to reduce volatility, with financial returns taking a back seat. There is greater variance in the importance given to geographical distribution, particularly because families involved in real estate investments see less importance in doing so. For others, the need for geographical distribution was paramount as a strategy to reduce overall volatility. Another interesting point is the relatively high importance given to environmental and ethical considerations in the allocation of family investments. This is a signal that it is important for families to act in accordance with their beliefs.

Figure 10: Main drivers of investment decisions



Source: IMD/EVCA

8. Private Equity Investment Preferences

8.1. Family offices are quite knowledgeable about and keen on private equity investments

Private equity investments by family offices include direct investments in companies, including the family business(es), other direct equity investments, as well as co-investments. Single-member family offices (FO1) tend to be the most involved in private equity investments, followed by limited-member single family offices (FO2). Overall, it was clear that managers and family members involved in these types of family offices were extremely knowledgeable about private equity investments, which is quite the opposite of the reported view of financial professionals.

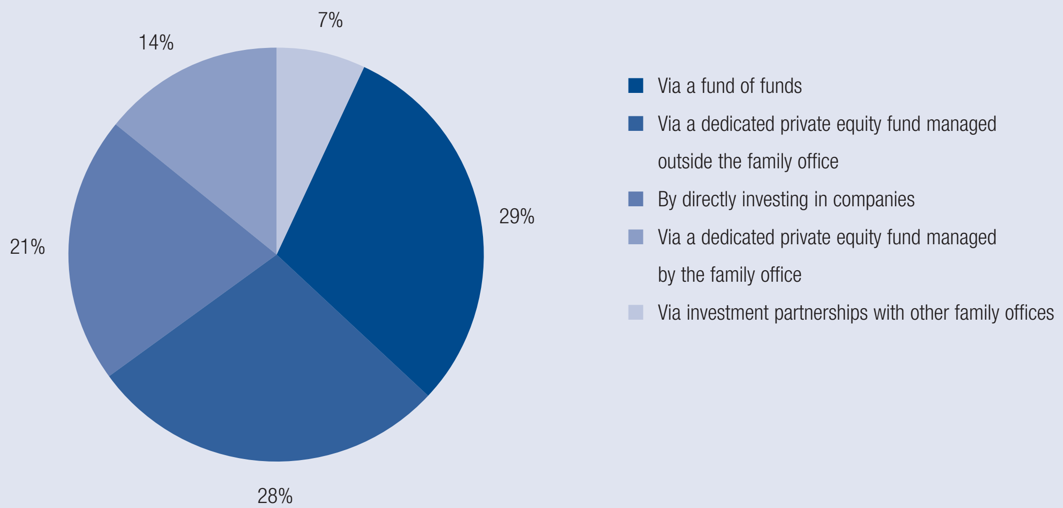
8.2. But do not feel understood by the industry

Interviewees across all categories of family offices consistently reported that outside investment advisers tended to use the size of the family office as a gauge for interest in alternative investments or the ability to undertake them. All single family offices interviewed mentioned that they found it hard to access the top funds, even if they were able to commit the significant minimum investment. This indicates that the working assumption of at least some members of the investment community is that if an office represents one or more families, it either has more resources to invest or the necessary entrepreneurial interest and/or professional sophistication to engage in alternative investments, including private equity.

8.3. And a significant portion prefers to go its own way

As Figure 11 shows, one third of the family offices interviewed preferred to enter the private equity asset class directly rather than to rely on outside intermediaries.

Figure 11: Preferred method of entering the private equity asset class



Source: IMD/EVCA

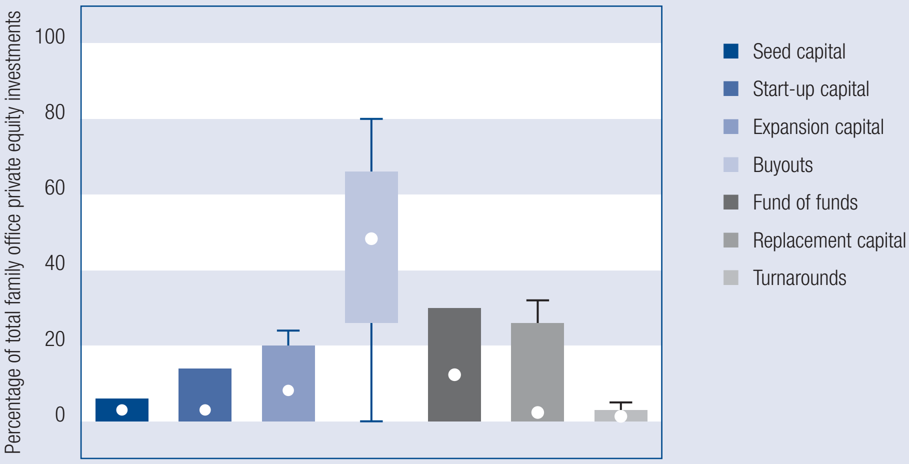
8.3.1. Access to top funds is crucial when investing in private equity

Respondents involved in private equity investments consistently identified the importance of getting into the top funds in order to make acceptable returns. In the words of one manager, “Be there [in private equity] only if you can align yourself with the Sequoias of the world... if not, forget it. 75% of private equity and venture capital money is wasted.” Consistently, they find that the market is overcrowded, thereby highlighting the common perception that there is excess liquidity in the industry.

8.3.2. But there is a strong preference for buyout funds

Compared to other types of private equity investments, family offices (FO1 and FO2 in particular) have a strong preference for buyout funds and dedicate a significant part of their total private equity allocation to them.

Figure 12: Allocation of family offices to private equity by investment stage (of family offices reporting private equity investments)

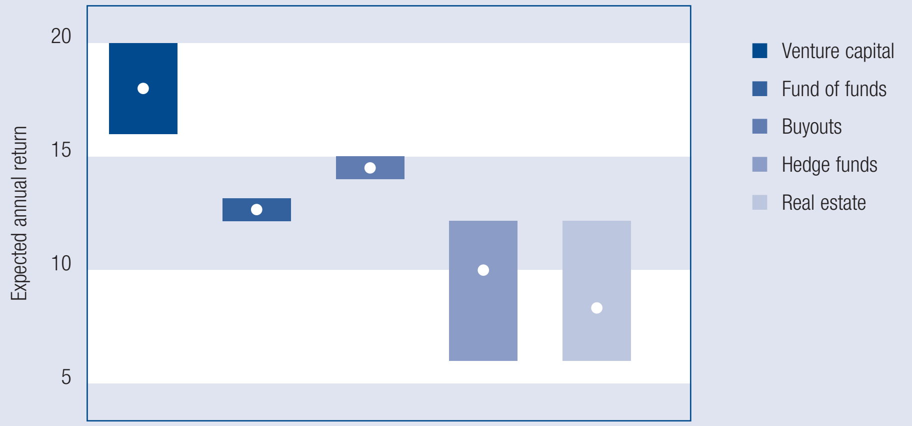


Source: IMD/EVCA

8.3.3. Because of the opportunities they seize

The main argument managers gave for investing in buyouts was that they can absorb large amounts of capital, and that European funds in particular have generated very good returns. Figure 13 shows that overall, family offices expect higher returns from buyout funds than from either fund of funds or hedge funds. Real estate return expectations are actually quite low, but are valued for the security that a physical asset provides.

Figure 13: Return expectations (of investments undertaken or being considered)



Source: IMD/EVCA

Besides returns, managers also noted that they as principals (as well as family members) can get much more involved in the business aspect of an investment. Again, this satisfies the previously mentioned interest in entrepreneurial investments.

8.3.4. And because venture capital funds are difficult to enter…

A further reason given for the preponderance of buyout fund investments is the difficulty of getting into the US venture capital market and the perceived limited appeal of European venture capital funds. Interestingly, respondents, all of which are based in Europe, did not feel that they were at a disadvantage in gaining access to North American funds compared with their counterparts across the Atlantic. The situation is that overall family office access to such funds tends to be difficult, especially for family offices which have only recently been established.

8.4. Direct equity investments

The extent to which a family office undertakes direct equity investments depends on the level of involvement chosen during the creation of the family office. Overall, such investments are inversely related to the size of the clientele: smaller offices and those serving the first generation are in general the most likely to engage in direct equity investments. In other words, the larger the office, the more restricted this type of investment. In our sample, family offices serving second and/or later generations do not, as a matter of principle, undertake direct private equity investments in which a family member (as opposed to the family office) has managerial involvement. One of the managers said that his family office, which serves the founding and second generation (he is also a family member), only passively approaches private equity and avoids direct investments. Basically, if family members want to make such investments, they have to do it on their own account, independently of the family.

9. What Drives a Family Office's Entrepreneurial Spirit?

Building on the findings mentioned in the previous section, three key determinants, or signals, of the entrepreneurial drive of a family office can be identified. This in turn shapes the investment allocations across our sample.

9.1. Portion of wealth tied to the family business

If a significant portion of the family office's overall wealth is tied to the family business, then the share of private equity investment declines in favour of more traditional investments. In cases where there is no longer a connection to the family business, but it is still in the "recent memory" of family members, i.e. they were personally involved at some point, the family offices exhibit a greater entrepreneurial culture and drive and thus are likely to undertake private equity investments.

9.2. Generational distance from founder

The second determinant, generational distance from the founder, works in a similar way. The greater the distance, the less entrepreneurial the culture (focus on preserving the current lifestyle rather than active involvement in financial management), while the shorter the distance, the greater the entrepreneurial drive.

9.3. Size of the family office

The last determinant is the size of the clientele. In fact, the evidence gathered supports the view that the creation of a family office separate from that of other family members and controlled by a single family member is an expression of the founder's wish to follow his/her entrepreneurial spirit and hands-on involvement. Managers of such family offices pointed out that the family office is a tool for its family founder to pursue his/her business interests as, in the words of one manager, "It's the principal's money and s/he can do what they want and answer to no one." By contrast, larger offices tend to have less room for such entrepreneurial individuals and are more administrative in nature, which is why in several cases individuals decided to leave such arrangements and establish their own family office.

10. Concluding Remarks

Based upon the findings reported above, we believe that family offices will increase the proportion of their total allocation to private equity. Firstly, while their exposure to these asset classes is quite small when they are first created, as family offices gain knowledge and expertise they generally increase the allocation to private equity investments. Secondly, the strong rise in the number of family offices established in recent years is only the start of a trend. In the coming years, an ever larger number of family businesses will be sold off because of a lack of successors, leading to the creation of more family offices. Thirdly, we believe that family offices will rise in prominence and appeal as limited partners. The wealth managed by a family office is private, and thus subject to minimal regulation, which contrasts with the increasing regulations applicable to banks, pension funds and other limited partners. However, in order to be able to capitalize on these developments, it is important for both the families involved and those seeking to provide investment opportunities, that the family office models used correspond much more closely with the interest and goals of family members rather than to rely on outdated models.

Lastly, our research suggests a shift away from the traditional matriarch/patriarch view of the family office, which serves as a trustee appointed to ensure the welfare of family members, to a more entrepreneurial and participatory one. Respondents identified two reasons for such a move. Firstly, there is a shift in the concept of “retirement” among family business founders, so the patriarch or matriarch, and less interest in (or social acceptance of) being one of the “idle rich”. The rising demographic phenomenon of active retirement, which incorporates active participation in business life, is also evident in family offices. Investment opportunities seized through the family office are fun and part of personal goals, and expanding the family business is necessary to gain the financial means and freedom to pursue individual or family dreams and objectives. Secondly, the future generations tend to be significantly more business-savvy, either through their early experience of the family business or their educational and/or professional background. Involvement in investment decisions is a good thing as more than half of the respondents mentioned: family members are involved in investing “because it’s fun!”

11. About our Sample

For this study, 12 single family offices located across Europe were interviewed between November 2005 and October 2006 about their history and investment allocation process. The offices interviewed were established, working family offices which were independent of a family business and/or other entities. The offices interviewed currently manage more than €500 million of assets each. All family offices included had at least €1.5 billion of total assets under management (not including any ownership in the family business). Collectively, the participants in this study represent a total of €30 billion of assets directly under management [4].

[4] We wish to state that in our explanations, we have been purposefully parsimonious with regard to the amount of information we provide on the family offices that took part in the study. We find it necessary to sometimes err on the side of caution rather than to disclose information that could, even remotely, be used to determine the identity of a respondent or of the family in question.

12. List of Abbreviations

EVCA	European Private Equity and Venture Capital Association
FO	family office
FO1	single-member family office
FO2	limited-member single family office
FO3	multi-generation single family office
FO4	multi-family office (MFO)
FO5	family office services
IMD	International Institute for Management Development
SFO	single family office

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