FOUR PILLARS OF CAPITAL

A TIME FOR REFLECTION
2020

STONEHAGE FLEMING

NOW AND FOR FUTURE GENERATIONS

EXECUTIVE SUMMARY

This, our latest publication in the Four Pillars series, outlines the results of our findings from research carried out in May of 2020, surveying 183 contributors from families and advisers across the jurisdictions we operate in. Respondents to the 42-question survey represented four generations of wealth, the oldest being over 80 years old.

Senior colleagues from around the business share their thoughts on the results of our analysis in the four chapters that follow.

CHAPTER ONE: RISK

ARI TATOS
MANAGING PARTNER

- Although there has been a 14% increase in families discussing risk together, only 18% use a formal risk management process and 40% have neither a structured nor an informal process in place.
- Financial capital still dominates discussions around risk and families should consider broadening their conversations to consider intellectual, social and cultural capital factors.
- Two main risks emerge: family disputes – consistently the number one perceived risk to long-term wealth – and weak leadership, which has jumped from fourth to second place since our last research[1].

CHAPTER TWO: INVESTMENT AND SUSTAINABILITY

MONA SHAH
DIRECTOR, INVESTMENT STRATEGY & RESEARCH

- 83% of respondents already applying ESG principles to their investments said Covid did not alter their approach despite its devastating impact.
- This is not only due in part to families' increased awareness of sustainability issues, but is also influenced by lessons learned from previous economic shocks, which have taught us the effects of *not* investing sustainably.
- 25% of survey respondents registered an increased awareness of social capital and that they are thinking about how to apply it. This reflects the growing trend of families making commitments to improving environmental outcomes and reducing inequality through their investments.

CHAPTER THREE: PHILANTHROPY

JOHAN VAN ZYL
PARTNER & CHAIRMAN, SOUTH AFRICA

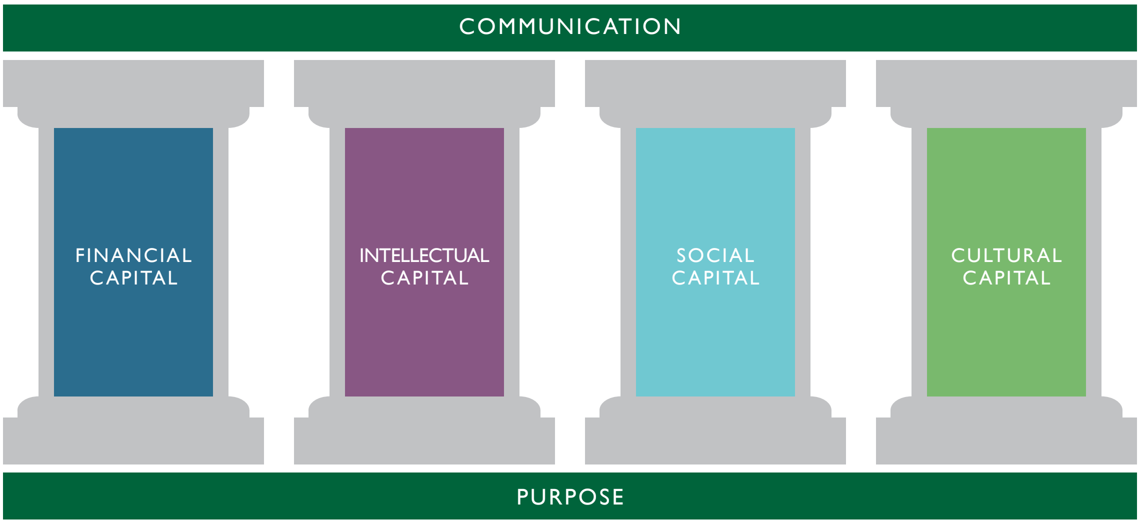
- Only a fifth of families who supported causes associated with the Covid pandemic had a formal process for doing so.
- With 31% of survey respondents contributing more to the community and wider society, philanthropy should not be overlooked as a vital succession-planning tool.
- While 43% of people indicated that Covid had not altered the way their family addresses their contribution to society, there might be no better time to unite a family behind a common purpose for wealth.

CHAPTER FOUR: PURPOSE

MATTHEW FLEMING
HEAD OF FAMILY GOVERNANCE & SUCCESSION

- At 51%, the percentage of families having an agreed purpose for wealth is up 13% in two years.
- This still leaves 49%, though, with no formal philosophy, leaving them without the critical building block purpose brings to any intergenerational planning strategy.
- These twin statistics demonstrate that conversations about purpose are difficult and may also suggest that families with no attachment to a family business are more likely to lack a common purpose.

THE FOUR PILLARS OF CAPITAL - DEFINITIONS



FINANCIAL CAPITAL

The tangible assets, business, properties, investments and intellectual property of a family which have quantifiable financial value.

INTELLECTUAL CAPITAL

The accumulated skill, knowledge, experience and wisdom a family can apply to the management of its wealth, its contribution to society, the individual fulfilment of its members and its collective wellbeing.

SOCIAL CAPITAL

The way in which a family relates to and engages with society and the communities in which it lives and operates. This includes the network of contacts which help a family to use its wealth and other assets to the benefit of society and/or the good of the family.

CULTURAL CAPITAL

That which brings a family together by identifying shared perspectives and themes in the way its members conduct their lives. This includes their approach to business, treatment of others, contribution to society, attitude to wealth and their values.

We would like to thank all those who contributed to this report. The results demonstrate the relevance the Four Pillars framework has to so many areas of family life, from leadership, dispute management and philanthropy to establishing a purpose.

The research enables us to better understand not only our clients and their concerns but also how we can shape our service offering to meet their needs.

FINANCIAL CAPITAL STILL DOMINATES DISCUSSIONS AROUND RISK

Families should broaden the scope to encompass wider risks

Our latest research reveals that while non-financial risks are on clients' minds, many continue to neither address them head on nor take formal steps to mitigate them.

Since the last Four Pillars of Capital report (*Four Pillars of Capital: The Next Chapter, Stonehage Fleming, 2018*), there has been a 14% increase in families discussing risk as a group. Although this is positive, the same percentage tells us they do not have a formal process for ascertaining and managing risks. And in total, 40% have neither a structured nor an informal process in place.

18% of people have a formal process for identifying and mitigating risk, but of the 82% who do not, only 27% say they would likely take steps to establish one as a result of the Covid pandemic.

18%

of people have a formal process for identifying and mitigating risk

It raises the question: what *would* it take to persuade people that a formal risk management process is a vital tool in preserving family wealth through the generations?

The statistics indicate that while there is a real appetite to discuss risks to family wealth, the range of discussion remains too narrow. The Covid crisis has prompted discussion around financial risk, but families – to a greater or lesser extent – are disregarding the wider, potentially more destructive non-financial risks. Furthermore, the fact financial risk is prioritised over other risks could indicate that those responsible for financial capital continue to dominate proceedings, raising questions about leadership.

For a matrix-based risk management framework to be fit for purpose it should consider the risks associated with all Four Pillars of Capital – intellectual, social, cultural and financial. This research shows us that non-financial risks are at least on clients' minds, if not yet being managed formally. The fact that respondents rate family disputes and leadership to be the first and second largest risks to long-term family wealth is a positive sign.

FAMILY DISPUTES

Since our 2018 survey, family disputes have maintained their position as the number one perceived risk to long-term wealth. Experience leads us to agree. Negative energy corrupts communication, lawyers are called and values are depleted or extinguished.

73%

consider it no more likely they will adopt formal risk management process following the covid pandemic

Nevertheless, it is difficult to think of a family we work with whose wealth has endured over three or more generations which has not survived a serious dispute. The reason is they have managed rather than ignored the risk.

A formal risk management and decision-making framework acknowledges that disputes happen and helps to head off problems before they arise. Agreeing a shared purpose, supported by strong governance, is the first step.

Written constitutions can include contingencies to cover, say, the possibility that a family member doesn't want to take on a role earmarked for them within a business. Families can be claustrophobic; people don't always feel like they fit in. By giving them breathing space to explore their own ambitions, though, families may better manage issues that could lead to a dispute.

LEADERSHIP

Fragile leadership is another non-financial risk on peoples' minds. Since our last *Four Pillars* report, 'lack of future family leadership and direction' has jumped from fourth to the second perceived risk to long-term family wealth.

Perhaps this should come as no surprise given the changing cultural landscape. 20 years ago, it wouldn't have occurred to people to question their family's leadership – even if they felt things were poorly managed. Today, as a society, we are more inclined to talk openly and express our desires for change.

Practical experience tells us that some are often perceived to be more instinctive than others about the non-financial aspects of family life. The recognition of the increasing importance of the non-financial pillars of capital will prompt families to move cultural, social and intellectual capital further up the agenda such that they consider a broader, team-led approach to leadership. Those families doing the most effective job of risk management have already recognised this.

Although we notice a trend towards families becoming increasingly democratic, 73% consider it no more likely they will adopt a formal risk management process following the covid pandemic. Not only does this suggest that leadership models have further to evolve but it also further confirms that families are managing a significantly narrower risk set than they should be.

The process of review should be ongoing as new risks emerge all the time. For a family to assume they have all risks covered from year to year leaves any legacy vulnerable. The good news is there is a significant proportion of people ready to make that change and review their processes. The others require a bit more time and counsel around the broader risk landscape as it evolves. Both of which we are here to help with.

ARI TATOS
Managing Partner
Switzerland

FAMILIES DEMONSTRATE COMMITMENT TO IMPROVING ENVIRONMENTAL OUTCOMES AND REDUCING INEQUALITY

Before, Sustainable Investing was accelerating. Now it's becoming mainstream

The Covid-19 pandemic has brought into sharp focus the immediate economic realities for governments and businesses alike. This might have led wealthy families to prioritise investment returns (financial capital) over considerations for the planet and society as a whole (social capital).

In actual fact, our research shows that 83% of survey respondents who apply ESG principles to their investments have not altered their approach despite the devastating impact of Covid-19. We also know from this and prior research that a significant proportion of our clients want to reflect their values in their portfolios.

83%

of respondents that apply ESG principles to their investments have not altered their approach despite impact of Covid-19

The reasons for this commitment to ESG investing are broadly to do with education, lessons learned from previous economic shocks and a greater awareness of what not investing sustainably will do to our planet, its people and its wildlife.

The coronavirus pandemic has many similarities with the global financial crisis (GFC) of 2008. Then, as with the Covid pandemic, governments responded with extreme economic and fiscal stimulus measures. Often, austerity programmes followed, which saw dramatic cuts in public spending. In the 12 years since, there have been increasing concerns about the growing inequalities in society including around job security, health and education.

Today, experts warn that the coronavirus will set back the efforts made by governments and investors to redress the balance in creating a fairer more sustainable world. A July 2020 UN report found that Covid-19 is reversing decades of progress on poverty, healthcare and education. The global effort to achieve the 17 UN Sustainable Development Goals by 2030 was already behind by the end of 2019. Now, the pandemic has let loose an unprecedented, largely unforeseeable, crisis – with the world's poorest and most at risk the worst affected.

This crisis, though, is different to the GFC. Firstly, people don't view the Covid-19 crisis as a bailing-out of bankers (to the tune of trillions of taxpayers' cash) for a problem created by bankers themselves. The Covid pandemic – to a greater or lesser extent – is viewed as no one's fault and everyone's problem. The result is that people are more inclined to want to help tackle the problems highlighted by the virus – like increased social inequality – as well as the immediate effects of the virus itself.

25% of survey respondents registered an increased awareness of how they might deploy their social capital and are either already doing so or are considering their options. It is easy to see how those comparing the situation today to the GFC might feel differently as to how they might be able to help.

The 83% of people sticking with ESG principles for their investments despite the impact of Covid tells us that having a voice on, say, social inequality via investment, while previously considered 'niche' is now becoming mainstream. Where once, taking a stand on climate change or world poverty was thought to be the preserve only of left wing radicals, it is now on everybody's agenda – top of the agenda, indeed, in many board rooms around the globe.

Wealthy families are part of this. They are starting to embrace the idea of a global community and being more mindful of the resources that they use, and how they can use their capital for good, to influence the way companies behave.

Our survey was distributed in May 2020, just after the peak of the pandemic. Respondents had been able to observe the panic that people were feeling. Most had also experienced lockdown and were answering the survey from a more thoughtful place, with an eye firmly on the future.

Some commented that the next generation of their families is "more interested in social impact investments" and that there is a "general trend towards increasing exposure to sustainable strategies and ensuring that investment managers incorporate ESG strategies" into their processes.

While we have heard from clients and recorded similar comments in previous *Four Pillars* surveys, investing sustainably has itself become established. The pandemic has accelerated its course and 'ESG investing' is simply becoming 'investing'. It is a new normal.

This is reflected in the decisions families have been making in their personal lives. Trends have accelerated here too, be it responsible travel, electric vehicle usage, managing your body weight for health, better hygiene and healthcare and so on.

The pandemic has given everybody the opportunity to step out of their daily lives and take stock of what they do, how they do it and what resources they use and how they want to step forward into the future.

For businesses, a sudden redefinition of vision accompanied by a redeployment of time, energy, and resources may be very well meaning, but it won't guarantee businesses a free pass into the ESG club. Investors will have to stick to their investment principles to filter out any tokenism. There is no substitute for proper due diligence and investors will need to go through the investment process and portfolio holdings line by line. There is no other way to be confident that companies are genuinely doing the right thing with their investors' capital.

For families, agreeing a social capital strategy will also form the basis of any conversations with their investment teams. By agreeing upfront a purpose for their family's wealth, leaders should be able to manage the flow of that purpose through everything a family does.

MONA SHAH
Director - Investment Strategy & Research
United Kingdom

FEW EMPLOY A PHILANTHROPIC STRATEGY DESPITE RECENT GROUNDSWELL IN INTEREST

Philanthropy plays an important role in defining purpose

Years of working with clients and families has taught us that defining a philanthropic strategy is one of the best ways for a family to outline a purpose for their wealth. Yet, while our 2018 research paper (*Four Pillars of Capital - the Next Chapter*) highlighted the increasing importance families are putting on philanthropy, most are still not implementing one.

Our most recent research, (*Four Pillars of Capital - A Time for Reflection, 2020*), shows that despite the groundswell of interest in supporting causes associated with the Covid-19 pandemic, of those who have, only 20% of families have a formal process for doing so.

despite the groundswell of interest supporting Covid-19 associated causes, of those who have,

20%

of families have a formal process for doing so

So, why are so many families still neglecting philanthropy as a strategic planning tool?

While 31% of survey respondents said they are actively contributing more to the community and wider society, overall the picture shows that philanthropy is often ad hoc and not considered as part of a central strategy. "Making a contribution to the community is certainly on our philosophical check-list but has to date been undertaken at an individual rather than group level," commented one respondent.

Perhaps the reason for not formalising philanthropy is to do with the perception that many families believe they are too 'small' for it to be of relevance to them. Certainly, when you think of philanthropy in the 2020s, you tend to think of the vast charitable foundations like the Bill and Melinda Gates Foundation, focused on tackling the great global challenges of our time. However, philanthropy takes many forms, including local giving.

The pandemic has been effective in turning many of our clients' attention to the inequalities closer to home, prompting an uptick in local giving initiatives. Throughout our global office network, clients have come to us for help in setting up charitable trusts. There is every reason for these initiatives to form part of a formal strategy.

43%

of survey respondents said that the Covid-19 pandemic had not altered the way their family thinks about or acts when it comes to contributing to the community and wider society

In South Africa, the pandemic has prompted much philanthropic activity. What is notable across the board is that those families with a plan already in place were at a huge advantage. In order to be agile and have the desired impact as quickly as possible, an existing philanthropy strategy proved to be essential.

It is not only this ability to move quickly and deftly when a crisis strikes that makes a strategy so important. It is also an effective succession-planning tool. Our Four Pillars research series has emphasised that all pillars of capital – financial, intellectual, cultural and social – stand on the foundation stone of purpose. Defining that purpose is the starting point of any succession plan. It is also, however, one of the things families find most difficult.

Speaking at the last Stonehage Fleming Next Generation course in the UK, Myriam Vander Elst, talked about how philanthropy had helped her find purpose, following the sale of a family business. Today, Myriam is Managing Director of Epic Foundation, a global non-profit start-up that fights to change the lives of disadvantaged youth. She spoke of philanthropy as a powerful tool in bringing families together. "It gives people a common purpose that can be built around the values of the family - transcending business interests."

This is mirrored by our own experience of working with families. By putting philanthropy at the centre of any discussion about purpose, a family automatically engages a broader cohort of people – not only the next generation, but also those family members who are not necessarily financially oriented and who may have been overlooked for leadership roles in the past. In this way, defining a philanthropy strategy can unlock new potential within a family, enabling different perspectives to be considered and engaging people focused on the other three pillars of capital.

43% of survey respondents said that the Covid-19 pandemic had not altered the way their family thinks about or acts when it comes to contributing to the community and wider society, although they say they have always been aware of their social capital. This seems strange given how much people have learned about each other and how others live since the pandemic broke out. Now is the time to harness the practical wisdom garnered over the last year or so to seriously consider the part that a philanthropy strategy can play in uniting a family and helping them find a purpose for their wealth.

JOHAN VAN ZYL

Partner & Chairman - South Africa

FAMILIES USING AGREED PURPOSE FOR WEALTH UP 13% IN TWO YEARS

Four Pillars framework helps agree a shared philosophy

When it comes to families establishing a purpose for their wealth, things, it seems, are moving in the right direction. While our 2018 research showed that only 38% of wealthy families had a shared agreement on purpose[1], according to our latest findings, that number is now 51%.

That still leaves just under half of families with no formal philosophy or purpose – something we as a firm consider the most critical building block of any intergenerational planning strategy. However, with 24% of families "rethinking" it and 25% saying it has been "critical" to them during Covid, purpose is very much on the agenda. One respondent noted that discussions had "highlighted that having a purpose pre-agreed would make the decision-making process in the family simpler and less subjective."

51%

of wealthy families had a shared agreement on purpose

Interpreting the statistics lies in understanding who makes up that half of respondents with no formal purpose. It certainly confirms that vital conversations about purpose are neither easy to start nor to finish. However, it is also fair to assume that the half of respondents with no formal purpose are families with no attachment to a family business.

A family business – typically with deeply ingrained cultural values – often provides a family with a ready-made purpose. When a business is sold, that strong sense of purpose is removed, leaving something of a vacuum. Although difficult, establishing a new purpose and framework for collective decision-making is not impossible.

As advisers, it is important never to impose a preconceived purpose on a family but to ask the right questions, guide discussions and facilitate an environment where they themselves come up with what is most important to them.

A purpose can often be quite general – more of a vision that provides individual family members with a degree of latitude in how they interpret it. Some families, for instance, may make it their aim to 'improve sustainability outcomes for their local communities' – a purpose which is quite deliberately interpretable in many ways.

24%

prompted to rethink their existing philosophy, one reason has been the marked differences between people's experiences of the crisis

Other – perhaps more streamlined – families might wish to outline a more specific purpose. In this case, it can be helpful to identify a passion all members get behind, be it humanitarian, academic, ideological, social or aesthetic.

Glyndebourne – an opera house in the heart of the English countryside – is a good example. It was born of the shared passion for music of John Christie and his love, soprano Audrey Mildmay. Although today it is one of the finest and most celebrated opera houses in the world, it all started as a personal project for a family to celebrate their passion for opera.

However you establish your purpose for wealth, it is essential that every pillar of capital is properly serviced to ensure both its own continuity and the continuity of the wealth itself. The success of something specific like Glyndebourne could not have been achieved without the Christie family's attention to all four pillars of capital. Their musical expertise (intellectual), their responsible operational and employment policies (social) and their strong values (cultural) have all played a part in sustaining the festival across the generations. And without the financial capital, the concept would not have existed at all, much less evolve and thrive over the years.

For the families we work with the Covid pandemic has undoubtedly played a role in helping them appreciate the role of purpose in their governance structure. For the 24% prompted to rethink their existing philosophy, one reason has been the marked differences between people's experiences of the crisis. Wealthy families have become more conscious of the already growing scrutiny of their behaviour and are more aware that they are responsible for what their behaviour may 'look' like.

The inclination to focus on purpose and keep it top of mind is set to continue. The fact that the three non-financial pillars of capital have been gaining greater prominence in family governance over the last ten years is a trend we as a firm have been watching for some time. Indeed, our first Four Pillars paper[2] noted that "families who concentrate solely on managing their financial capital, and do not develop a holistic long-term strategy that encompasses the other pillars of capital, will struggle to break free from the mould of 'clogs-to-clogs in three generations'." The covid pandemic has redoubled our efforts to renew that message to all our client families.

MATTHEW FLEMING

Partner & Head of Family Governance & Succession

United Kingdom

Notes:

1 Four Pillars of Capital the Next Chapter: Practical Leadership for Changing Times, 2018

2 Four Pillars of Capital for the Twenty First Century, 2017

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