Want to Promote Family Entrepreneurship? Consider a Family Bank

A key objective among many single-family offices serving Super Rich families (those with a net worth of at least $500 million) is to enable future generations of family members to build their own wealth and create their own entrepreneurial legacies.

With that in mind, the Super Rich are embracing ways to develop the business acumen of inheritor family members—as well as ways to support them in forming new ventures of their own.

One way the Super Rich are making that happen is through family banks. And increasingly, families that aren’t as wealthy as the Super Rich are using these banks as well.

A way to generate family wealth—and family financial intelligence

A family bank is a formal legal entity a family sets up, with rules that govern how family members can access funds to start or support business ventures as well as how those family members are expected to pay back that money.

Family banks are designed to bring a level of structure, professionalism and accountability when providing money to family members to fund initiatives. As such, they can help instill financial intelligence, financial responsibility and financial values in family members—while also helping to avoid accusations of favoritism in families with multiple children.

Certainly, family banks have one clear and overarching goal: creating new wealth. According to data from the Family Office Association, a full 95 percent of the single-family offices that have established family banks (as well as those that employ a defined process without a formal family bank structure) say “new wealth creation” is a top reason for having a family bank.

The concept of the modern family bank dates back to the founder of the Rothschild dynasty, Mayer Anschel Rothschild. To protect his heirs from the problems created by inheriting significant personal fortunes, he decided the Rothschild fortune was to be used for the education of heirs as well as investment—including new ventures. Rothschild inheritors were expected to grow the family fortune by making their own way in business, backed by the family’s resources.

Today, family banks are structured and used in a few ways:

- One use of the family bank is to provide short-term loans to family members who have experienced a personal setback. The monies are intended to help them get back on their feet.
- Another is to loan money to family members for business ventures that can potentially generate additional family wealth.
CONSIDER A FAMILY BANK

Fostering growth from new family businesses

Increasingly, family banks created by the Super Rich are focusing on promoting and supporting entrepreneurship among family members who inherit wealth. The funds provided by a family bank are intra-family loans, equity investments in the new entrepreneurial ventures or both. For example, a patriarch might loan his daughter money through the bank so she can start a consulting business. The daughter agrees to repayment terms at a preferred rate.

Additionally, many family banks are designed to foster the creativity and capabilities of the next and future generations—in essence, to build human capital along with financial capital. Therefore, some family banks incorporate formal and informal entrepreneurial education and mentoring support.

Accountability is paramount with family banks. They are not just pools of money that family members can draw on as they see fit. Obtaining funds from a family bank is very much akin to getting funding from a venture capital firm or commercial bank: The transaction must meet established criteria and be well-documented.

Solutions for the not-so-Super Rich

All this said, family banks are not the exclusive domain of the extremely wealthy. Families with considerably less wealth can also use a family bank as a lending and investment vehicle to support the commercial activities of their heirs.

Whereas the exceptionally wealthy move assets around to fund their family banks, those less wealthy are not always in such a financial position. Instead, they may need to build a pool of money that family members can use. For example, a family could use the tax-free buildup from certain types of life insurance to amass wealth that family members can then use to fund their own entrepreneurial ventures.

Family banks are one tool that many wealthy families use to foster a culture of entrepreneurship and financial responsibility among children and grandchildren—as well as create new wealth for the family coffers. You may wish to explore whether a formal family bank or family bank-style arrangement meets your particular goals and family dynamics.

Expertise for family banks

Family banks created by the same Super Rich families that set up single-family offices regularly make use of experts to assist and advise them—including wealth managers, lawyers and accountants. Generally, these families look for experts with a few key characteristics:

- **Insights and experience with wealthy inheritors.** Familiarity with family dynamics and an understanding of the perspectives, needs and wants of the next-generation wealthy are essential to ensuring accountability and a meaningful return on investments.

- **Expertise in and experience with entrepreneurship.** The ability to provide tactical guidance in making investments in private enterprises and helping them grow is critical in supporting inheritors.

- **Tax mitigation expertise and experience.** The exceptionally wealthy make considerable use of tax specialists to minimize income and estate liabilities. With new ventures, there can be substantial opportunities to reduce current and future taxes.

- **Independent and conflict-free.** Advisors need to be independent without a stake in the process, save for helping the inheritors and the companies.

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