

The family balance sheet

Family Advisory and Philanthropy Services



Managing the family balance sheet

In this chapter, we offer you context on true family wealth, define the five forms of capital, outline ways of growing the qualitative capitals, and suggest a method for measuring that growth.

True wealth

Every family wealth preservation plan begins and ends with an acknowledgment that the most important assets a family has are its members.

For a business to be successful, a majority of management's time must be spent on asset growth rather than on liabilities. Families that understand this truth spend most of their time growing their assets, especially their qualitative assets. For example, they know that no matter how much they save in taxes, which are a cost or liability of doing business, those savings pale in comparison to the revenues lost through family members who are inadequately educated or do not trust each other.

What are a family's qualitative assets? They are the family's human, intellectual, social and spiritual capitals. These four capitals stand in addition to the family's quantitative assets: Its financial capital. Together, these five forms of capital comprise a family's true wealth.

The failure to acknowledge, measure, and nurture the human, intellectual, social, and spiritual capitals of a family is a principal cause for the failure of a family to preserve its wealth. The positive acknowledgment by the family that it has five forms of capital, and the accurate measurement of all five, give the family and its shareholders a proper accounting of the state of its business.

The five capitals

Here are brief descriptions of the five forms of capital. You may notice areas of overlap among the four qualitative capitals. Each also has its own focus. We have found the division into four qualitative capitals a useful tool to help families concentrate on areas that they might otherwise overlook.

1 Human capital

The human capital of a family consists of the individuals who make up the family. Their human capital includes their physical and emotional well-being as well as each individual family member's ability to find meaningful work and to establish a positive sense of personal identity.

2 Intellectual capital

The intellectual capital of a family is comprised of the knowledge gained through the life experiences of each family member. Some signs of intellectual capital include family members' academic successes, career successes, artistic successes and their understanding of their individual and family finances.

3 Social capital

Social capital refers to family members' relationships with each other and with their communities. No family exists without some social capital. Some key indicators of social capital include: the family's ability to make thoughtful, shared decisions together; to welcome new members into itself; and to give of itself—in time, talent and treasure—to the larger society of which it is a part. For many families, this includes their philanthropic, charitable endeavors, and civic contributions to the community.

4**Spiritual capital**

Spiritual capital comprises the family's ability to share and sustain an intention that transcends each member's individual interests. Sometimes that shared intention is described as a shared dream.

This capital is not necessarily equivalent to a family's spiritual beliefs or traditions, though such traditions may express and nurture spiritual capital.

Every family begins the journey of family wealth with some sort of shared intention, that is, with some form of spiritual capital. Other signs of spiritual capital include humility—the recognition that this journey is fraught with challenges and exceeds the strength of any one of us alone—and gratitude—toward those with whom we share the journey, those who came before and those who will come after us.

5**Financial capital**

The financial capital of a family may include cash, public securities, privately held company stock and interests in private partnerships.

While the focus of this chapter is the qualitative capitals, we should not underestimate the importance of financial capital. Financial capital greatly contributes to families' ability to cultivate their other forms of capital. It makes possible quality healthcare, education, philanthropy, and the time and opportunities to come together and talk about building and sustaining a shared dream. The opportunity to cultivate these qualitative assets—and not spend one's precious days laboring solely to make ends meet—is a great gift, which financial capital makes possible.

In turn, the qualitative capitals have a way of repaying that gift. With the growth of human, intellectual, social and spiritual capital comes a high probability of growing the family's financial capital.

Growing the qualitative capitals

Wealth preservation is a dynamic, not a static, process. To succeed, each generation of the family must be a first generation—a wealth-creating generation.

Any family whose true wealth—qualitative and quantitative—is simply maintaining value rather than growing is either in or in danger of entering a state of decay or entropy. A family, like every investor, must maximize its return on capital if it is to achieve the growth necessary for preservation over a long period of time. Here are some of the things a family can do to maximize the return on its human, intellectual, social and spiritual capital.

Human capital

With respect to its human capital, a family can consider implementing the following ideas:

- Promote the physical capacities of each family member to achieve each member's maximum well-being. This includes providing the best possible medical care to every family member.
- Ensure that every family member's basic requirements for food, shelter and clothing are met, and for members who experience a life emergency, that those needs are met at a level adequate to allow them to regain the capacity for the pursuit of individual happiness.
- Emphasize the importance of the dignity of work to an individual's sense of self-worth and assist each family member in finding the work that most enhances that individual's pursuit of happiness. All such work is of equal value to the growth of the family's human capital, regardless of its financial reward.
- Encourage all family members, especially rising generation members, to develop a strong sense of personal identity separate from the family's financial success.
- Promote the family's geographic diversification. The world is becoming smaller every day. Families must participate in all corners of the world if they are to meet the challenges of a global world.
- Help each family member clarify individual values, identify signature strengths, uncover internal or external obstacles to flourishing at work or at home and advance the process of clarifying his or her dreams.

Intellectual capital

Here are some ways for a family to consider growing its intellectual capital:

- Stretch the intellectual capacity of each member to achieve each member's maximum level of learning, which includes learning how each family member learns best and meeting the needs of each family member's learning style.

- Provide a means for the collection and dissemination of the accumulated knowledge of all family members.
- Rapidly provide clear information on all family governance matters to all family members at the highest level of each person's ability to understand and seek feedback.
- Ensure that every family member understands, at the highest educational limit possible for that member, the workings of the family governance system and his or her role in it.
- Diversify its intellectual capital by encouraging its members to study the world's cultures and languages.

Social capital

Some steps families may wish to consider for growing social capital include:

- Hold well-designed family meetings that provide time to connect as family, conduct business and deal with difficult topics in productive ways.
- Encourage family members who have challenging relationships with each other to seek professional consultation to understand and if possible resolve their conflicts.
- Articulate a clear family governance system that encourages members to come to thoughtful decisions together.
- Provide incentives for the family's highest achievers to take representative and leadership roles within this governance system.
- Start early by providing rising generation family members opportunities to connect with the larger community through service in the family's business efforts or in its philanthropies.

Spiritual capital

Again, spiritual capital often finds expression in time-honored spiritual traditions. Families can also develop it in other forms. Some of these include:

- Tell the family's stories of success and failure, its good times and its hard times, making sure that rising generation family members have a chance to learn these stories and one day share them with their own children.
- Clarify the family's shared values and make sure that those values find expression in the family's business, philanthropy and gifts to family members.
- Approach important decisions with "seventh-generation thinking—thinking ahead 140 years."
- At the same time, promote humility, which recognizes that every family, no matter how wealthy or powerful, is part of a larger society. The family and its members must accept their limits. As the proverb holds, "Hasten slowly." The time to act is now, but with the recognition that none of us can predict—much less control—the future.
- Consider ending every family gathering with a brief gratitude exercise, in which members envision someone in the family they wish to thank and identify ways to offer those thanks.

Measuring the qualitative capitals

Most families measure success based on the heft of their individual and collective financial balance sheets. Each year, they add up their financial assets, subtract their financial liabilities and determine their family's net worth. Individual members and the whole family also likely prepare income statements showing the year's revenue minus expenses, and use that to determine that year's increase or decrease in the family's fortunes. This careful stewarding of balance sheets and income statements is critical to the management and preservation of the family's financial wealth.

Unfortunately, this exercise doesn't account for the family's qualitative balance sheets. Without an assessment of these four qualitative capitals, the family and individual balance sheets are incomplete and will not measure the extent to which a family is meeting its wealth preservation mission and goals.

To meet this need, our partner Wise Counsel Research developed a simple exercise called the Family Balance Sheet. The Family Balance Sheet uses a series of questions to evaluate the family's four qualitative capitals. We have reproduced a copy of these questions below. Each member of the family offers his or her responses, which can then be measured using a five-point scale, with 1 representing strong disagreement and 5 representing strong agreement. The responses then can be averaged for each capital, for each family member or across the whole family.

As a snapshot, the Family Balance Sheet offers insights into which capitals the family has developed well or not, where the strengths of the families lie and where are the areas of opportunity for growth. A family can also use the Family Balance Sheet in an iterative way. By filling it out every year or every two or three years, the family can track the growth of its qualitative capitals.

If you are interested in trying out the Family Balance Sheet, you can copy the pages that follow and share them with your family members.

Human capital

Human capital refers to each family member's physical and mental well-being and ability to pursue his or her own happiness and fulfillment.

	Strongly disagree	Some what disagree	Neutral	Some what agree	Strongly agree
My family supports the individual development of each member.	1	2	3	4	5
My family members enjoy physical and mental health.	1	2	3	4	5
My family members have their basic requirements met (food, shelter, clothing).	1	2	3	4	5
My family members each have a strong sense of personal identity.	1	2	3	4	5
My family members enjoy meaningful work.	1	2	3	4	5
My family members have meaningful relationships with others.	1	2	3	4	5
My family members feel at home in places around the world.	1	2	3	4	5

Total points per column _____

Total points for human capital _____

Intellectual capital

Intellectual capital refers to family members' intellectual development and their understanding of their personal and family wealth.

	Strongly disagree	Some what disagree	Neutral	Some what agree	Strongly agree
My family values lifelong learning.	1	2	3	4	5
My family members share their experiences and knowledge with each other.	1	2	3	4	5
My family members know and respect our individual and shared values.	1	2	3	4	5
My family members know and respect our individual and shared dreams.	1	2	3	4	5
My family members understand their personal finances.	1	2	3	4	5
My family members understand our family financial wealth, its structures, and the roles and responsibilities within those structures.	1	2	3	4	5
My family members are able to manage and evaluate outside advisors.	1	2	3	4	5

Total points per column

Total points for intellectual capital

Social capital

Social capital refers to family members' relationships with each other, with others important to them and with their communities.

	Strongly disagree	Some what disagree	Neutral	Some what agree	Strongly agree
My family members affirm each other and enjoy spending time together.	1	2	3	4	5
My family members communicate with each other about important topics.	1	2	3	4	5
My family members are able to have difficult conversations.	1	2	3	4	5
My family members are able to collaborate to make shared decisions.	1	2	3	4	5
My family enjoys strong relationships between trustees and beneficiaries.	1	2	3	4	5
My family is welcoming to spouses and rising generation members.	1	2	3	4	5
My family has capable, engaged family leadership with a leadership succession plan.	1	2	3	4	5
My family is strongly connected to its community or communities through business, philanthropy, etc.	1	2	3	4	5

Total points per column

Total points for social capital

Spiritual capital

Spiritual capital refers to the family's ability to share and sustain an intention that transcends each member's individual interests. Sometimes it is described as a shared dream.

	Strongly disagree	Some what disagree	Neutral	Some what agree	Strongly agree
My family shares traditions and beliefs.	1	2	3	4	5
My family members demonstrate humility in word and deed.	1	2	3	4	5
My family members regularly express gratitude to others.	1	2	3	4	5
My family has clarified its shared values and applies those values to business, philanthropy and giving.	1	2	3	4	5
My family members practice "seventh-generation thinking."	1	2	3	4	5
My family members share stories about the past and present.	1	2	3	4	5
My family members find strength in a shared sense of identity as a family.	1	2	3	4	5

Total points per column _____

Total points for spiritual capital _____

Qualitative capital summary

Take your total points from the previous four pages:

Total points for **human capital** _____

Total points for **intellectual capital** _____

Total points for **social capital** _____

Total points for **spiritual capital** _____

Total points for all capital _____

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2019-174007

Exp.: 07/31/2020, IS1903345