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Why Most Families Lose Their Wealth by the Third Generation

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King Solomon warned, "An inheritance quickly gained at the beginning will not be blessed at the end."[1] Heirs given money typically have a strong inclination toward spending the money on possessions, pleasures, or other purposes without lasting significance. Psychologists specializing in "sudden wealth syndrome" acknowledge that heirs, like lottery winners, tend to blow their windfall.[2]

The availability of money may undermine the pursuit of higher purpose. Andrew Carnegie, the 19th-century steel magnate stated, "The parent who leaves his son enormous wealth generally deadens the talents and energies of the son, and tempts him to lead a less worthy life."[3]

When heirs receive money without prior coaching on the purpose of money, they will seldom take the time to understand the values that helped accumulate the value of the inheritance. Inheritors do not understand the blood, sweat and tears invested in accumulating the wealth.[4] Nor do heirs with money have much motivation to develop the bias toward diligence, delayed gratification, thrift, and other values needed to maintain healthy relationships with people who contribute to wealth accumulation.

There is frequently a lack of personally and socially beneficial purposes guiding the use of inherited wealth.[5] Jesse O'Neil, author of *The Golden Ghetto: The Psychology of Affluence*, documents how money transferred to heirs without a meaningful purpose often fosters "Affluenza." Heirs may lack the purposeful pursuits needed to cultivate self-esteem, self-worth, motivation, self-confidence, and personal identity. Moreover, the vacuum created by the lack of a healthy purpose leads to negative character qualities, such as the inability to delay gratification, unwillingness to tolerate frustration, feelings of failure, and a false sense of entitlement. As problems grow worse, heirs withdraw from others, avoid accountability, and develop progressively more serious social disorders. The presence of money catalyzes personality disorders. These disorders limit the ability to form vital relationships with other people and leave victims unable to find a comforting sense of purpose.

Parents may think that they can minimize the risk of affluenza by having an estate or financial plan with a clear purpose. Unfortunately, the purposes of an estate and financial plan (e.g., "transfer the business to my sons" or "generate an after-tax retirement income of $240,000") are usually too narrow to inspire and motivate heirs. Even if a plan is technically perfect, experienced advisers know that plans frequently do not get implemented because heirs and advisers do not have agreement on purpose. When the plans are implemented, they are too likely to transfer money to heirs who quit their jobs and then live purposeless retirements. Dr. Gerald D. Bell, of the University of North Carolina's Kenan-Flagler Business School, details how heirs can then drift into roles in which they play rather than work, pretending to be golf pros, skiers, artists, or writers but lacking the motivation to grow, preserve, or transfer wealth.[6]

Given the prevalence of heirs without purpose, it is no surprise that 75% of parents worry that heirs' lives may be adversely affected by wealth.[7] Estate planners who have watched inheritors over the decades will almost always agree that these fears are well-founded.

Around the world and across the centuries, heirs have lost wealth in a few short generations. In America, we say, "Shirt sleeves to shirt sleeves in three generations." In Asia, families speak of going from rice patty to rice patty in three generations. Europeans talk of the entrepreneur achieving enough success that he no longer needs to wear clogs but then watching grandchildren squander wealth, resulting in the family going from "Clogs to clogs in three generations."[8] Likewise, in Italy, families have been known to go "from barn stall to barn stall in three generations."[9]

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Frequently, the loss of wealth takes not three generations, but just three years. Zeeb and Cochell, in *Beating the Midas Curse*, tell of a family that squandered wealth accumulated over five decades in a mere twenty-four months.[10]

Studies in America provide contemporary evidence that families still lose their wealth following the time-tested pattern. 60% of families waste away their wealth by the end of the second generation. By the end of the third generation, 90% of families have little or nothing left of money received from grandparents. Ultimately, 95% of all traditional inheritance plans fail.[11]

Statistics collected from family businesses provide similar sobering facts. Only 30% of businesses make it to generation two and a mere 3% still generate profits in generation three.[12] Given the dismal success of family enterprises, it is no wonder that 65% of family wealth is lost by the 2nd generation and 90% by the third generation.[13] By the third generation, more than 90% of estate value is lost and, even worse, the generation three can usually articulate very little about the values that accumulated the wealth. Even in Australia, where there has been no estate tax[14], families lose their financial wealth and the values that accumulated the wealth by the third generation.

Even if financial wealth is not lost, the vision is frequently lost. Family members without an effective wealth transfer process typically have heirs working at cross purposes. Disruptive changes of leadership are common.[15] Studies show that values are not transferred to the next generation.[16] Conflicts regarding succession planning cause businesses to fail.[17] Planners involved with wealth planning can usually share countless sad stories about broken relationships. It is common for businesses to dissolve within months after the founder dies.[18]

When the family business founder fails to train the next generation of leaders to maintain relationships based on the founder's core values, trust deteriorates. Surviving heirs engage in power struggles to fill a leadership void if the business founder dies suddenly.[19] Too often lawyers wrangle for years and dissipate much of the estate value.

If a family does defy the odds and maintain a clear purpose long enough to accumulate significant wealth, they will face greater challenges. As Ralph Waldo Emerson reminds us, "It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have got it, it requires ten times as much wit to keep it."[20] Experience teaches that it is hard to accumulate wealth, harder to maintain it, and hardest to give it away prudently.

Are you providing guidance to your clients that will guard against a repeat of the above problems? Can your clients articulate clear plans for using inherited wealth to build healthy relationships? Do your clients have business succession plans in place for the seamless transfer of family business assets at the right time to the best people? If you struggle to answer these questions with clear and positive responses, you should look beyond common legal tools and help your clients think about the purposes of their wealth. This process can encourage family members to pass on proven spiritual and emotional values before they pass on the value of what they own. As a professional, you can find new joy and meaning in your calling while helping clients transfer both a relational inheritance and financial inheritance to their heirs. Following the example of Solomon, you can inspire future generations to leave a legacy of time-tested values.

Endnotes

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By: Tim Voorhees, JD, MBA

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