INSIDE

Family Business

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Is your family business
in good financial health?

Now you see it — now you don't
Make part of your 2007 tax bill disappear

Thriving on competition
How to turn sibling rivalry to your advantage

Developing company mission
and vision statements — with *zest!*

Is your family business in good financial health?

Caught up in the passion of building, operating and growing a family business, entrepreneurs may not take the time to really learn about their firms' financial well-being. Yet understanding and monitoring company financials is essential to achieving long-term success and profitability.

WORRISOME SYMPTOMS

If your business is in trouble, it may not show on the surface for quite a while. You may have a prime address, impressive lobby, bustling operation and highly accomplished staff — but still be headed for a financial breakdown.

In fact, the first danger signs may surface in your personal well-being. If you find your stomach in knots, feel run down and can't sleep, you may be worrying about your family business's starved cash flow, crippling expenses, hemorrhaging revenues, or feverishly high debt and financing costs relative to investment return.

Your company might need treatment for aching staffing costs, injured productivity, paralyzed inventory mobility, nagging receivables problems or an unhealthy dependence on a few large customers. Other causes for concern could be confused goals and objectives, missed opportunities to reinvest in growing your business, and heavy tax liabilities causing you to struggle to keep up with payments. To prevent a breakdown, it's critical that you take quick action. That means giving your firm's financial health a thorough checkup, and doing what's needed to revitalize your operations.

ROBUST FINANCIAL INDICATORS

Even a company boasting increasing sales and turning a profit may be struggling to manage high expenses and debt and maintain a positive cash flow. Following are key financial health indicators to calculate and track in keeping your business healthy or managing it back to health:

Revenues. This money, generated from your company's sale of products and services, appears as the top line of your income statement. The revenue figure is key to your business's ability to turn a profit and can indicate your profit potential if you're just starting up and seeking to attract investors.

Operating expenses. High operating expenses are a common and potentially serious financial health problem for businesses. Carefully monitor and limit them to a reasonable percentage of revenue through efficient staffing and minimizing costs where possible. Operating expenses break down into three categories:

1. **Compensation.** This is typically one of a business's largest costs and includes employees' salaries and commissions, plus travel expenses. Watch your staffing needs relative to your sales, and make adjustments as appropriate.

2. **Marketing expenses.** These may include a range of promotional activities, the greatest of which often is advertising. Review your company's sales levels relative to marketing costs to assess effectiveness and value.

3. **Research and development (R&D).** This includes the creation of new or enhanced products, processes and services. To evaluate your company's R&D investment, periodically revisit the budget and review progress made against business goals.

Profit and profit margin. Gross profit equals revenues minus the direct costs associated with producing your products (cost of goods sold). As a general rule, you should have half or more of your sales volume left

after subtracting your direct costs. Gross profit margin equals gross profit divided by sales revenue.

To calculate your net profit margin, subtract total operating expenses from your gross profit, and divide that number by your sales revenue. Look to industry benchmarks, and strive to outperform your competitors.

Working capital. This is your current assets minus your current liabilities — in other words, the funds you have access to today to sustain your operations. Generally, you should seek to have at least one and a half to two times the amount of current assets to liabilities.

Reviewing your family firm's financials should serve as a routine diagnostic test of its health. Make sure you have the necessary financial management software to analyze the numbers and related trends monthly, quarterly and annually.

A HEALTHY ROUTINE

Routine financial checkups will help you determine where to stay the course with your operations and pinpoint where to make changes. For instance, you may find that you need to cut back on operating expenses, improve inventory management, ramp up sales or boost receivables collections. Or perhaps it's time for you to adjust your prices to better compete or offset rising operating costs.

If you're maintaining your company's financial health, you should spot any potential problems in plenty of time to deal with them. And if you find your business plan is lacking and your financial goals are unclear, sit down and devise strategies to aid your recovery.

> HOW TO FIND YOUR COMPANY'S BREAK-EVEN POINT FOR TURNING A PROFIT

To help understand when your business is beginning to turn a real profit and also aid in making cost-effective financial decisions, you can perform a break-even analysis of your business's cash flow situation.

Relatively simple to perform, the break-even sales computation is:

(Operating expenses + annual debt service)/gross profit margin = break-even sales.

Note that operating expenses, in this calculation, exclude depreciation, and annual debt service equates to total monthly debt payments for the year.

You also can use break-even analysis to calculate the other variables in the equation, such as:

(Operating expenses + annual debt service)/sales = break-even gross profit margin, or

(Gross profit margin x sales) – annual debt service = break-even operating expenses.

For example, say MakeBelieveCo has operating expenses of $300,000, debt service of $60,000 and a gross profit margin of 25%. Calculate the three break-even analysis computations as follows:

Break-even sales: ($300,000 + $60,000)/.25 = $1,440,000

Break-even gross profit margin: ($300,000 + $60,000)/$1,440,000 = 25%

Break-even operating expenses: (.25 x $1,440,000) – $60,000 = $300,000

In this case, with MakeBelieveCo's break-even sales approaching the $1.5 million mark at a 25% gross profit margin, the company appears to be progressing toward a financially healthy future.

Now you see it — now you don't

Make part of your 2007 tax bill disappear

There's really no magic to year end tax saving strategies, but timing is everything. Start reviewing your potential deductions and income now, so you can create and implement a plan to reduce your 2007 tax bill. Come next April, you'll be glad you did.

AMAZING SHRINKING TAX LIABILITY

Tax planning tips that may come in handy for both your personal return and your family business tax obligations include:

Making smart charitable contributions. Use appreciated securities for significant charitable contributions you make before year end. This will let you deduct the current market value and avoid paying capital gains tax.

Charitable contributions typically are 100% deductible. But they must stay within adjusted gross income (AGI) limits, which range from 20% to 50% of your AGI, depending on what you donate and whether the recipient is a private charity or an operating or nonoperating foundation. Donations in excess of the limits may be carried forward for up to five years.

C corporations can deduct contributions up to 10% of their taxable income. Partnerships, limited liability companies and S corporations must pass through the deduction to the owners and partners, who can take it on their personal returns.

Remember your retirement plan. For 2007, you can contribute up to $15,500 to a 401(k) plan or its equivalent — and an additional $5,000 if you're 50 or older by Dec. 31. If your plan offers a Roth 401(k), consider which type of 401(k) is better for you based on your age, current and projected future tax brackets, and cash flow needs.

If you're establishing a new plan, remember the deadlines. 401(k) and profit sharing plans, for instance, must be established before year end, and Savings Incentive Match Plans for Employees (SIMPLEs) must be set up before Oct. 1, while Simplified Employee Pension (SEP) plans have until the extended due date of your timely filed tax return. IRAs, on the other hand, can be created and funded after the close of the tax year, but only up to the April 15, 2008, deadline. The earlier you contribute, though, the sooner you can start benefiting from tax-deferred growth.

Use the Section 179 expensing election. Take advantage of the Sec. 179 expensing election by scheduling any asset purchases now. The maximum Sec. 179 deduction, as increased by the Small Business and Work Opportunity Tax Act of 2007, is $125,000, although it is reduced if the cost of all property — new and used equipment, including off-the-shelf software — you place in service during the year exceeds $500,000. The advantage is that you don't have to depreciate these assets over several years.

Review your expected year end profits before you deduct asset expenses. If your capital expenditures exceed your profits, you may want to expense some of the capital assets placed in service during the year and depreciate the remainder, possibly creating a loss. You can then carry the loss forward to offset future expected income, or carry it back to recover previously paid taxes.

Don't rule out the manufacturers' deduction. Manufacturers are eligible for a deduction of up to 6% of certain income. And the IRS definition of "manufacturer" includes not just traditional manufacturing operations, but also construction, architectural, engineering and computer software production companies. Check with your tax advisor about whether your business qualifies.

Create a Health Savings Account (HSA). An HSA lets you allocate pretax dollars to be used to pay for medical expenses, either currently or in the

future. Note that HSAs are *not* the same as the previously established Medical Savings Accounts (MSAs). If you have a high-deductible health insurance plan, an HSA could be a viable option.

Avoid the alternative minimum tax (AMT). The AMT is a parallel tax system with two tax rates (26% and 28%). Many of the deductions allowed in calculating regular tax liability aren't allowed for the AMT. Know what can increase your AMT liability. For example, you can trigger the AMT with some municipal bonds or large unreimbursed employee business expenses. If the AMT is higher than your regular tax, you pay the additional amount.

If you'll be subject to the AMT this year, try to defer expenses you can't deduct for AMT purposes, such as state and local income taxes and unreimbursed employee business expenses. Also, defer expenses that are deductible for AMT purposes but will provide a smaller benefit because of the lower tax rate, such as charitable contributions.

Offset capital gains with losses before year end. A long-term loss can offset short-term gains and save you more tax. To keep an investment and still create a tax loss, avoid "wash sales" — selling a security, then buying a "substantially similar" security within 30 days. Instead, after you sell, wait until you are not within the 30 day period, and then purchase the same security. Alternatively, you may first buy more shares and then wait 31 days before selling your original shares.

Shift income and expenses. If your family business operates on a cash basis, you can defer taxes by pushing income into next year and bringing expenses into this year. For example, if you have a sizable bill that's due in January, paying it before Dec. 31 lets you take advantage of the deduction this year. Or, you can delay payment to reduce next year's income.

THE MAGIC OF EARLY PLANNING

Whether these strategies are right for you and your family business depends on your tax situation and state of incorporation. Consult your tax advisor — but don't delay. The trick to the disappearing tax bill is early planning.

Thriving on competition

How to turn sibling rivalry to your advantage

Pummeling each other, pulling pigtails and playing pranks are generally seen as normal, playful signs of affection between young siblings. But what happens if these childish antics escalate into more serious fighting when your grown children are working together in the family business?

Sibling rivals can push each other to perform their best, but if competition goes too far, it can become disruptive and force you, as the parent and owner, to step in and mediate. You may then be accused of unfairly siding with one child over another. But if you understand the sources of rivalry and learn how to manage it, you can use sibling one-upmanship to your company's advantage.

UNDERSTANDING HOW IT STARTS

To harness the energy of sibling rivalry, first understand the factors that naturally shape your children's personalities, relationships and business philosophies. These range from their basic genetic makeup and gender, to their life experiences and the family environment when they were growing up. Birth order can be significant in explaining the dynamics at work among siblings:

Eldest child. The firstborn basks in the family spotlight — until the next baby comes along. This child may naturally feel a little jealous of younger siblings. He or she may aim to please parents through obedience and assuming responsibility. But there's also a danger of becoming authoritarian, overly protective and almost parental toward the rest of the brood.

Middle children. These children may feel somewhat overlooked by their parents. They may try hard to stand out, and compete to win their parents' affection. To call more attention to themselves, they may focus on developing different abilities or, on the other hand, rebel.

Youngest child. The baby of the family is often the most pampered and may grow to depend on family members' ministrations. He or she may end up suffering from low self-esteem or, at the other extreme, may learn how to exploit the "baby" position for all it's worth.

If your children haven't grown out of their rivalry before going to work for the family business, they may continually try to outdo and even sabotage each other to win your favor.

Or, they may develop clashing business philosophies, with one having a more conservative orientation toward business growth, and the other leaning toward the entrepreneurial side. They may also have different comfort levels for taking investment risks or maintaining financial stability.

HARNESSING COMPETITIVE ENERGY

Now that you know where rivalry begins, here's how to help your children use their competitive energy for the greater good of your business and family:

Treat all employees equally. Develop and implement policies and procedures for qualifying, hiring and promoting your children just as you would other employees. And if, for estate and income tax reasons, your children as a group are more highly compensated than nonfamily employees, educate them as to why this is the case, stressing that the higher compensation is not based on performance.

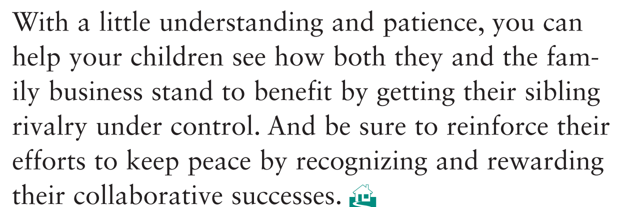
Make your expectations clear. Define and communicate the roles you expect your children to play in working with siblings and meeting business goals. From the time they join your staff, tell your children exactly what their responsibilities are, what constitutes professional behavior with other employees, and what goals they need to attain.

Approach conflict methodically. When a conflict arises, require siblings to respectfully listen to each other's perspectives on the problem, weigh the pros and cons of potential solutions, and choose the one that best benefits the business and family. To help objectively mediate, consult an independent family business advisor, or, if your business has one, an advisory board.

Help siblings use their unique skills. One way to keep your children at odds is to constantly compare their respective strengths and weaknesses. Instead, call attention to what each one can contribute. Help them identify and use their unique skills to build a more powerful and productive work team.

BUILDING COLLABORATION

With a little understanding and patience, you can help your children see how both they and the family business stand to benefit by getting their sibling rivalry under control. And be sure to reinforce their efforts to keep peace by recognizing and rewarding their collaborative successes.



> DEVELOPING COMPANY MISSION AND VISION STATEMENTS — WITH *ZEST!*

The task of developing mission and vision statements can easily fall by the wayside for family businesses. Owners may struggle, not quite understanding the difference between the two types of statements or how they relate. For their part, employees may find finished statements too lofty or vague to practically apply.

Your mission and vision statements should summarize at a high level what you want your business to achieve and how you're going to make it happen. By following a few commonsense steps, you can create statements that will become valuable tools for your company's success.

WHAT'S YOUR GOAL?

Without a mission and vision, family business management and employees can become confused about priorities, growing frustrated and apathetic over time. That's a sure recipe for failure in today's competitive business environment. Well-written mission and vision statements can provide a strategic focus. They can help guide and unify your firm to pursue the right activities and allocate the necessary resources to make your plans become a reality.

When creating mission and vision statements, begin with the vision. Carefully reflect on your unique aspirations for your company's values, business growth and profit goals.

The mission statement is your means of attaining your vision. It lays out in general terms what you will deliver, to whom you'll deliver it and how you aim to do so. Consider the following example:

To achieve "Y," your vision, ...	You must fulfill "X," your mission.
What you ideally want your company to become:	How your company will realistically make it happen:
PizzapieCo seeks to delight its customers and become the No. 1 deep-dish pizza delivery chain in the Pepperoniopolis metro area.	PizzapieCo is committed to delivering the zestiest deep-dish pizza, with its secret recipe containing choice ingredients passed down through family generations, to the customers of the Pepperoniopolis metro area within an hour of receiving an order.

Compelling and inspirational statements will motivate your employees to embrace your company mission and vision. Make your statements challenging but obtainable, so everyone can work together to bring them to reality. And above all, keep them clear, concise and understandable.

READY FOR CHANGE?

Family business growth is about adaptation and evolution. Remember that your mission and vision statements are not written in stone. To keep them effective, periodically reassess and update them as your business grows and its needs and goals change.

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