

# Inside Family Business



## Where's the beef?

Entice employees with your benefits package

## Sharing the wealth

When to transfer family business ownership

Does your successor have what it takes to succeed?

## No more guessing games

How to improve management decision-making

March/April 2007

# Where's the beef?

## Entice employees with your benefits package

**W**hen it comes to employee benefits, one big question family business employers may struggle to answer is, "Where's the beef?" The question doesn't necessarily refer to salary, but to the overall value of company benefits. If you can't offer applicants and employees benefits they value, you'll struggle to recruit and retain them. This is especially true for nonfamily employees.

The average turnover cost for a typical position ranges from nearly 50% to slightly more than 60% of an employee's annual salary, according to a 2005 Watson Wyatt Human Capital Index® report. Clearly, you want to hire the right people and avoid having to quickly replace them. So, what benefits should you offer that employees can really sink their teeth into?

### The basic platter

For starters, let's look at what's considered status quo. By law, employers are generally required to provide workers' compensation insurance; withhold income, Social Security and Medicare taxes; and provide time off to vote and to fulfill civic obligations such as jury duty and military service. Additional requirements may apply, depending on the state.

Employers typically offer a standard benefits package, which usually includes:

- Health insurance, often with dental and vision plan options,
- Disability insurance,
- Life insurance,
- A retirement plan,
- Paid vacation, national holidays and sick leave, and
- Paid or unpaid time off for religious holidays and bereavement.

These benefits are considered staples to attract potential employees, and retain them

once they're hired. Health benefits are particularly important, because they can be difficult and costly for employees to obtain on their own, especially if the employees are older or have existing health conditions.

But basic benefits are like a salad, bread and baked potato: They'll satisfy employees' basic needs, but won't necessarily excite them. To compete for the best and brightest candidates, many companies are upping the ante — and adding a nice, big juicy steak to their benefits platter.

### Adding more sizzle

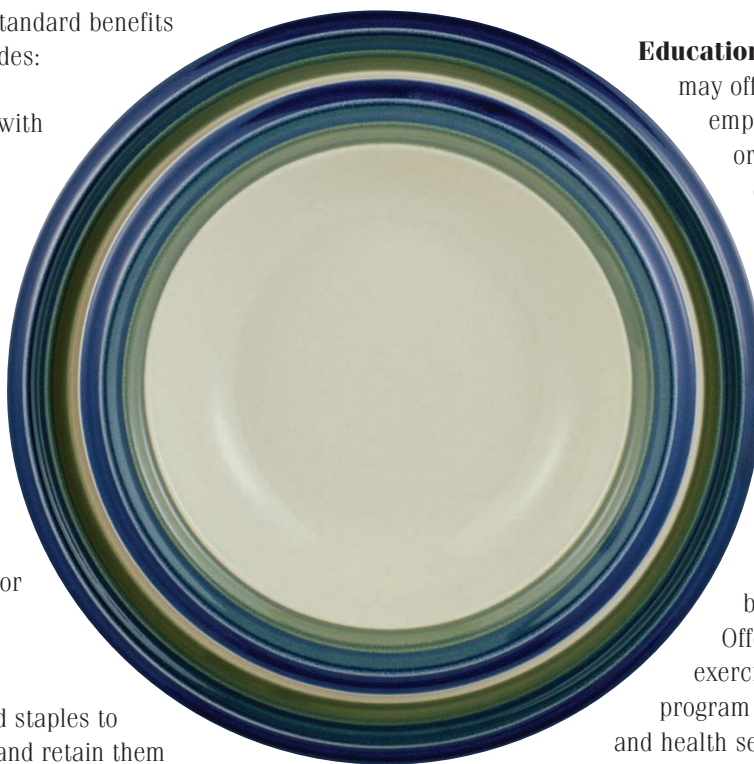
Some added benefits employers are throwing in to attract and retain employees include:

**Child care assistance.** Today's economy often requires both mother and father to work to support a family. Any assistance employers can provide is highly appreciated.

If your family business employs many working parents of small children, you may find it beneficial to offer day-care facilities onsite or nearby. If your company is smaller, consider teaming up with a local day-care provider to offer a subsidized program for employees.

**Education assistance.** Employers may offer to pay for part or all of employees' continued education or training, as it relates to current jobs or future job potential. This includes tuition, books and any required supplies.

**Health and wellness solutions.** Helping employees attain and maintain wellness not only boosts their productivity, but also can reduce your family business's insurance costs. Offerings include on-site exercise facilities or a subsidized program with a local health club, and health seminars for employees.



Working long hours in today's 24-7 business environment, employees are at increased risk of stress, fatigue, burnout and accidental injuries. Consider providing a room on your premises where they can relax and refresh themselves.

Furnish it with comfy couches, chaise lounges and big cushions, and perhaps a couple of massage chairs. You might paint the walls a soothing shade, hang some pictures of beautiful scenery and play soft classical music in the background.

**Product and service discounts.** Another cost-effective employee benefit is discounts on your company's products or services. You also may find local vendors willing to negotiate discounted arrangements for your employees. For instance, you might approach a local bank, financial planning or legal firm, clothing store, dry cleaner, restaurant, hotel or cinema.

**Commuting assistance.** Commuting costs can run high for employees who have to travel long distances or live in major metropolitan areas. Consider subsidizing the cost, for instance, by offering free monthly passes for public transit or parking garage spaces.

**Flexible work arrangements.** Balancing work and personal life is a challenge for many employees these days — whether they're trying to attend school or manage a long commute. They may also have to care for young children, elderly parents or both. To help employees achieve better balance, some employers are offering modified work schedules.

For instance, you might let workers start and leave earlier, or later, to avoid rush-hour traffic jams or accommodate dropping off and picking up children at day-care or school. Other flexible arrangements include having employees work four 10-hour days with the fifth day off, or work from home and come to the office only for training and staff meetings. The potential benefits to your family business include improved worker morale, productivity and retention.

## Equal portions for all

These are just suggestions to get you started. To make your benefits package more appealing, consider your employees' specific needs. Each year, distribute a written benefits summary to employees, including the dollar value. This will help employees realize and appreciate what they're saving.

## Garnish for your benefits

Opportunities for improving your family business's benefits are limited only by your imagination. Some creative options employers are offering these days include:

**Concierge service.** For busy employees who find it difficult to tend to essential personal errands and home maintenance issues, some companies are appointing an individual or team to handle these chores.

**Dog-friendly workplace.** This allows employees to bring their canine friends to work, easing worries about feeding and walking their pooches when they have a long commute or expect to work late.


**Special pampering.** Massages, spa days and even vacation cruises are a great way to reward hardworking employees.



Take care not to unfairly exclude any employees from receiving benefits. If individuals feel they've been treated unfairly, you could end up with a morale problem or, worse, a discrimination suit. This especially applies when a benefit offers tax advantages.

## Benefits outweigh the costs

Beefing up your family business's benefits obviously requires you to bear some upfront costs. In the long run, however, you stand to improve your ability to recruit and retain top talent, and increase employees' morale and productivity. You also may realize valuable tax savings.

How can you structure a program that will help both your employees and your family business? Sit down with your accounting and legal advisors and a benefits consultant to evaluate potential options and perform a cost-benefit analysis. 

# Sharing the wealth

## When to transfer family business ownership

**Y***ou started your company in a corner of your basement 30 years ago. Now, you wonder how to cost-effectively transfer shares to your children. Perhaps the hardest question is when to make the business theirs.*

### Now or later?

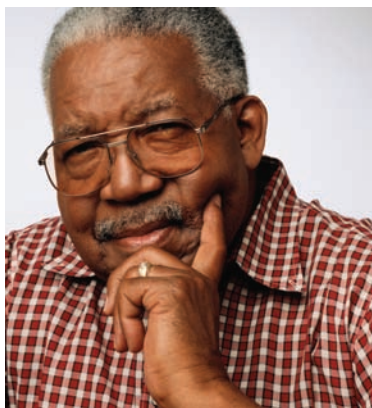
To transfer the greatest wealth to your family, first decide whether to give shares immediately or at your death. In addition to annual exclusion amounts, you can bestow up to \$1 million — the lifetime gift tax exemption amount — during your life without having to pay gift tax.

But the amount you give reduces the \$2 million you can transfer estate-tax-free at death. Plus, any taxable gifts you've made within three years of your death are effectively brought back into your estate.

How to decide? Consider not only the potential future estate tax savings, but also family income tax savings. Also, remember the possible cash flow issues of having some of the company ownership, and attendant income and distributions, attributable to others. Here's how one business owner worked through the process and made a decision.

### What's the best plan?

John is 75 and his business, Sharp Hardware, is worth \$4.5 million. John is the sole shareholder. Two of his three children work with him; the other is a teacher in the local elementary school. He has approximately \$2.5 million in other assets, and, since his wife's death last year, has been keen to do some estate planning.



John knows that, if he were to pass away today, the estate tax liability would be in the neighborhood of \$2.25 million, plus any state estate tax. And if the company's value continues to increase over the years and John does no planning before he dies, the

estate tax burden will likely grow, too. (Keep in mind that the estate tax exemption increases to \$3.5 million in 2009 before disappearing in 2010 when the estate tax is repealed. It's scheduled to return with the estate tax in 2011 but at a smaller level, \$1 million.)

***Any taxable gifts you've made within three years of your death are effectively brought back into your estate.***

Above all, John wants his company to survive him. He also wants to minimize the income and estate tax ramifications his children will face at his passing.

### How does gifting work?

John has heard about gifting, but isn't sure it makes sense for him. In theory, he likes the idea of transferring a portion of the business to his children, but he doesn't want to relinquish control of the company. He also has heard of "step-up" in basis, or the loss of step-up, though he isn't really sure how it should affect his decision.

Step-up means that the basis of certain assets John owns at death — his company shares and other securities — automatically adjusts to fair market value. If John owns the property when he dies, its basis steps up to the fair market value on that date (or, in certain circumstances, an alternate valuation date). But if he gifts the asset during his life, his basis carries over to the recipient.

So, if John has a \$1 basis and gives the property to his children, they get his basis. If they sell when the property is worth \$1 million, they have a \$999,999 gain. On the other hand, if John dies owning the property when it is worth \$1 million, and his children then sell it for the same amount, they will have no taxable capital gain.

Of course, the \$1 million would be included in John's estate and, at the highest current federal estate tax rate of 45%, be subject to a \$450,000 tax. It also might be subject to state estate tax.

## Finding the answer

Because his children have consistently expressed the desire to continue running the company, John likes the idea of gifting shares in the business even though he realizes they won't get a step-up in basis on those shares.

Besides, his other assets include long-held securities that have appreciated significantly. It's more likely the children would sell those assets after his passing — and benefit from a step-up in basis — particularly if they needed liquidity for estate tax purposes. So it seems more prudent to John to focus on giving company shares and keeping the other assets.

He therefore decides to give each child a 10% interest in his company. Not only does this meet his objective of keeping control, but he learns that, as a bonus, the

shares are probably eligible to be discounted for gift tax valuation purposes.

A formal valuation determines that a 30% discount is appropriate for Sharp Hardware shares. Using the company's \$4.5 million value, John is able to make the gifts without fully expending his \$1 million lifetime gift tax exemption.

## Have you thought it out?

Whether to give away all or part of your company during your life is one of the toughest decisions you'll face as a business owner. Of course, the nontax issues, such as choosing the best people to run the company and maintaining family harmony, could even eclipse the financial considerations. But it's essential to be informed about all the issues in order to make the most appropriate choice. 🏠

## Does your successor have what it takes to succeed?

Are you preparing a successor to eventually take over your company? To become CEO material, your next-in-line needs to know how to effectively manage your overall business operations. A college education can provide a foundation. After that, he or she must learn to apply management concepts in a real-world business environment.

Require your successor to learn about different areas of your family business by working in each one. Start him or her at the staff level, and award greater managerial responsibility over time. Key functional areas include:

**Office administration.** Performing general office duties or handling the mail room is a good way to develop a fundamental understanding of your company's overall organization and departmental connections.

**Operations.** By working on the production floor or, if your family business is service-based, in the practice, your heir apparent can develop a true grasp of your operations.

**Accounting and finance.** To help increase revenue and profitability, your successor should develop a solid understanding of your financial records management, reporting and tax compliance requirements, performance measurement and analysis.

**Human resources.** A future CEO must invest time with your family business's most precious asset — its people. This includes working in recruiting, hiring, benefits and compensation, and training and development. Your successor should become familiar with key employment and legal issues, such as employee safety, discrimination and sexual harassment.

**Marketing and sales.** To carry forward your company's marketplace success, your next-in-line must know how to apply targeted marketing strategies and participate in customer account management and sales calls.

**Customer service.** Experience handling customer inquiries can give your successor valuable insight into their product and service needs, preferences and issues.

**Information technology.** Although IT requires highly specialized technical skills, your heir apparent should at least become familiar with your information systems maintenance and support requirements.

Finally, encourage your successor to work a few years for an outside company. Broader experience can help establish credibility when he or she takes over the family business.

# No more guessing games

## How to improve management decision-making

*Better, faster and more, more, more. As the demands for service in today's business world increase, so does the need for quick, informed management decisions. For a family business to compete, it's crucial that managers be able to efficiently make decisions. How do you go about improving your management's decision-making capabilities?*

### Collaborate and communicate

Start by applying a collaborative approach. Your management team can make informed, effective decisions only if they're all on the same page. Your goal should be to create a shared understanding.

Develop and clearly communicate your company goals and priorities to management team members, so they'll work together and make decisions in line with your family business's direction. If your goal is to target a product or service to a new market, for instance, you don't want to have employees spend all their time and your resources on existing markets. So constantly update managers on what you're aiming for.

Collaboration has other benefits as well. More individuals participating in decision-making can mean more creative and thought-out decisions.

A collaborative approach also distributes the decision-making burden, so it doesn't fall on just your shoulders or those of chief officers. Particularly as your family business grows, sharing responsibility for decisions becomes vital to facilitate progress and seize opportunities.



### Empower with knowledge

Improving management's decision-making capabilities also means developing knowledge about your company's overall business and environment. All managers should fully understand:

- Your operational functions,
- Your market positioning strengths, weaknesses, opportunities and competitive threats,
- Market forces and trends, including supply and demand,
- Specific customer behaviors, needs and preferences,
- Economic and political conditions, and
- Regulatory compliance requirements and changes.

Developing a base of insightful knowledge about your operations and market environment is commonly referred to as "business intelligence." Gathering business intelligence provides management with relevant, quality information needed to make decisions. This knowledge will also help managers anticipate and quickly and efficiently react to changes.

Fortunately, many software applications facilitate data collection, storage, analysis and reporting. For example, you can use enterprise management software to develop business intelligence for such operational functions as human resources, financial, supply chain and customer relationship management.

### Turn your management into a power team

Creating an effective management team also requires managers to learn to tap each other's skills and collaborate on solutions to challenges and decisions that affect your family business's strategic direction. To unite your managers into a power team, apply strategies such as:

**Assessing performance.** This entails a confidential review of interpersonal and other leadership, technical and business issues that may be affecting your team's effectiveness. To make the process objective, leave the

task to an outside consulting firm specializing in executive assessments.

Assessments may be customized based on your family business's needs. They generally consist of some combination of in-depth, face-to-face executive and group interviews, and online or written evaluations. Feedback is provided via written reports and debriefing sessions on both an individual executive and overall team basis. The purpose of the feedback is to provide insights into individual and group strengths and weaknesses, team dynamics, barriers to success, recommendations for improvement, and untapped opportunities.

**Retreating.** One way to make use of executive team assessment feedback is to send your managers on a retreat. Doing so will help managers bond and learn to leverage each other's skills and knowledge for the benefit of the organization.

Executive retreats typically follow a more intense format than staff team building events and may be structured to your business's needs and based, for example, on a popular TV show such as *Lost* or *The Apprentice*. If you can't afford to send your executives to a tropical island or New York City, try a simulated or local setting — it's just as effective.

Retreats may also include an outdoor adventure or excursion such as whitewater rafting or rock climbing. Options are limited only by a team's creativity, physical abilities and budget. In any case, the end goal is to break down functional silos and communication barriers and establish a strong unity.

To fully realize the potential value of the above activities, you must follow up. That means combining the feedback from the group assessment with the experiences from the retreat into an action plan for furthering the development of teamwork back at the office.

## Run interference

Although your primary focus is making quick and efficient decisions, at times you may need to slow your management team down and run a little interference. When family members work together in a business, emotions can sometimes create bias and impair their professional judgment. At such times, they may not act in the family

## A moral compass for decision-making

Even as you strive to improve the speed and efficiency of management decision-making in your family business, you must not act hastily. What's right isn't always immediately clear. And, sometimes, a decision that seems conducive to business growth and profitability may not be the most ethical course.

Before finalizing a decision, consider these questions:

1. Does it comply with local, state and federal laws?
2. Does it align with your company's values?
3. Is it in the best interests of other stakeholders, such as family members and employees, nonfamily employees, business partners and the community?
4. Does it support your own personal values?

As a final test, consider how you would feel if the general public and media were made aware of your decision.

business's best interests, particularly when it comes to nonfamily employees.

If you're facing difficult decisions with complicated ramifications, there's nothing wrong with seeking outside help to gain a more impartial, independent perspective. Try consulting a family business advisor or establishing an advisory board. Generally made up of experienced outside professionals, an advisory board can help evaluate decisions regarding sensitive issues such as compensation and succession planning.

## A winning move

Uninformed business decisions can result in costly mistakes and lost opportunities. To win the game in today's increasingly competitive market, you and your management team must develop the ability to make quick, efficient and informed decisions. This requires a collaborative approach, in-depth knowledge about your company's business and environment, and an objective perspective. 🏠