INSIDE Family Business

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How to keep customers during times of transition

You've planned for this day with great expectation: You're finally ready to retire and hand over the reins to your successor. Although it may be a day of celebration for you, it can be a dreaded day for the customers you've served for years. How can you help keep your loyal customers at ease during the transition period?

LEARN FROM OTHERS' MISTAKES

Tom and Rose have owned and operated their furniture manufacturing and repair company for 35 years and are ready to retire. Their son, Ken, has been with the company for many years and has learned the business inside and out. So it was an easy decision for Tom and Rose to give a portion of their ownership to Ken and set up an installment sale so he could buy their remaining interest over time. Through careful planning, they were able to structure the succession so that they would have sufficient income for their retirement.

Unfortunately, like other family businesses, this one didn't survive the transfer. According to the Family Firm Institute, only about 30% of all family businesses transfer successfully to the second generation and only 12% survive into the third. Although Tom and Rose groomed their son in many areas of the company, they made crippling mistakes when handling clients during the transition.

For example, one of their biggest customers called to speak with Tom about a large order she was planning to place and was told by the receptionist that Tom had retired. When Ken picked up the call, he was unfamiliar with the special terms his company had offered the customer in the past, and it was obvious to her that Ken knew nothing about her business. Thoroughly frustrated, she decided to switch to another manufacturer that had been courting her for years. So what should you do differently?

Share the news. Timing is critical, particularly when it comes to announcing your retirement. Giving customers a heads up on the news can

eliminate hearsay and rumors about your company and help reassure customers that they'll continue to receive quality service.

Get some face time. Schedule a meeting with each of your key clients to introduce your successor to them. They need to get to know the next company leader so they can continue entrusting their business to your company.

Give the skinny. Before each customer meeting, brief your successor on the customer's business, covering key areas including:

- History, size and location,
- Objectives, products and services,
- Competitors,
- Sales,
- Buying habits and payment methods, and
- Background on key personnel, such as owners and managers.

A lack of knowledge in these important areas can hurt your successor's ability to build a rapport and provide the necessary customized service and support to ensure future business.

Hand off the steering wheel. Encourage your successor to take the lead in client meetings and share his or her vision for the company. Although your presence is needed to make clients feel at ease, allow your successor to take the driver's seat as much as possible, because this is the time for him or her to win over clients. Consider role-playing beforehand to give your successor the opportunity to discuss potential client concerns in a controlled setting.

Let your fingers do the walking. It's unlikely that you and your heir apparent will be able to visit all your customers, so call those you don't meet with to introduce your successor and express thanks for their business. If you can't reach your contacts by phone, send a personalized letter inviting them to call you or your successor at their convenience.

KEEP LINES OF COMMUNICATION OPEN

When a business changes ownership, customers may naturally worry about the future of the organization. You can ease their minds by informing them about upcoming changes and reassuring them that they'll continue to be in capable hands with your groomed and experienced successor.

> DO NEW ACCOUNTING RULES APPLY TO YOUR FAMILY BUSINESS?

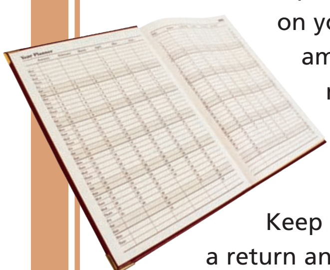
Under recent accounting rule changes, some businesses must disclose uncertain tax positions on their financial statements. Is yours one of them?

The new requirements, found in Financial Accounting Standards Board (FASB) Interpretation 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, apply to all companies — both public and private — that prepare their financial statements according to Generally Accepted Accounting Principles (GAAP).

FIN 48 applies to fiscal years beginning after Dec. 15, 2006 (the 2007 calendar year for most organizations). But FASB has provided an extension for private companies that haven't already implemented the new rules; they need not comply until periods beginning after Dec. 15, 2007. For most private businesses, this means that FIN 48 will apply to financial statements for the 2008 calendar year and later.

To comply with the new rules, you'll need to review every tax position taken on your federal and state income tax returns for the current year and years still open to examination by the IRS and state taxing authorities. A tax position is virtually anything that results in a tax benefit, such as claiming a deduction or determining how certain income should be characterized. It may also include a decision not to file a return in a particular jurisdiction.

For each tax position, you must determine whether it's "more likely than not" that the position would be sustained if it were challenged in an IRS audit. To make this determination, consider the taxing authority's policies, practices and prior rulings, and any relevant court decisions.



If a position fails the more-likely-than-not test, the tax benefit shouldn't be recognized on your financial statements. If it passes the test, you should recognize "the largest amount of tax benefit that is greater than 50% likely of being realized upon ultimate settlement with a taxing authority." FIN 48 requires financial statement disclosures regarding uncertain tax positions — whether you recognize the tax benefits or not.

Keep in mind that you must analyze your tax positions for every state in which you file a return and evaluate any decision not to file a return in a state where you do business.

Caring for parents while preserving family harmony

For Mary, caring for three young children and meeting with customers in the family business while barely squeezing in lunch is a normal day. Now Mary and her husband, Jeff, are caring for her elderly parents. Taking care of her family and helping run the business means a lot to Mary, but she admits that she often feels overwhelmed.

Welcome to the sandwich years — the time when you're sandwiched between the demands of caring for elderly parents and raising children while trying to address your own needs. In addition to the emotional issues of managing it all, there are some complex financial and legal issues.

But, with planning and information about what to do and what to expect, you can better handle this period in your life and even find time to enjoy it.

ADDRESS FINANCIAL ISSUES

Eldercare can be expensive, whether your parents remain in their own home, move in with your family, or enter an assisted living or nursing home facility.

Assuming your parents are able, discuss with them some options that can be implemented now to finance their long-term care. Here are areas to review:

Long-term care insurance. These policies help cover what your parents' health insurance policies and Medicare won't, such as assisted living arrangements, nursing home residence and long-term home care. However, if individuals already have health problems, they may not be able to qualify.

Reverse mortgage. This is an arrangement under which a lender makes payments to your parents for their home's equity, and the proceeds are generally tax-free. The loan doesn't come due until they sell the home or die. The only way the bank obtains ownership is through foreclosure. Before entering into a contract with the lender, make sure you have an elderlaw attorney review it.

Taxes. You may be able to claim a dependency exemption for your parents if you provide more than one-half of their support.

Ownership interests. If your aging parents have ownership interests in the family business, there are

> DO YOUR PARENTS QUALIFY FOR MEDICAID?

Extended long-term care for aging parents is expensive, sometimes exceeding $200 or more per day. Medicaid, a government-assisted program for individuals with a low net worth, may help offset some of the expenses if your parents have depleted all assets or otherwise qualify.

Be aware of two changes to Medicaid that may require the expenditure of additional resources, including the sale of your parents' home, before they can qualify for the program:

1. Extension of the disqualifying period triggered by asset transfers. Previously, gifts made within three years of applying for Medicaid (the look-back period) would result in a disqualifying period beginning on the date of the gift and measured by the amount of the gift divided by the average cost of nursing home care.

Now, the look-back period has been extended to five years and the disqualifying period begins on the latter of: 1) the date the gift is made, or 2) the date your parent would otherwise qualify for Medicaid assistance. This rule applies whether or not the gifts were made in anticipation of the need for long-term care.

2. Availability of a home as a resource to pay for care. Typically, a Medicaid recipient's home has been exempt as a resource to pay for care, provided the recipient lives there (or, if institutionalized, intends to return), or if a spouse or dependent lives there. However, this is now only for the first $750,000 of equity.

a number of options available to transfer those interests to the next generation, including a gifting program or an installment sale. Another strategy is for them to set up a grantor-retained annuity trust, which allows them to receive annuity payments and offers potential tax benefits. These are just a few of the many options available, and each should be carefully considered for the tax and other implications on the owners and the company.

COVER LEGAL MATTERS

While your parents are of sound mind, it's important to address legal matters such as:

Powers of attorney. Your parents should appoint either you or another trusted individual to make decisions about health and finances — it can even be the same person for both.

Assets and legal documents. Encourage your parents to create a list of their assets and legal documents and where they are kept, including titles and deeds of ownership, financial account information and advisor contacts. This information will be critical in the event you need to complete a financial statement, apply for a loan on their behalf, sell their assets or settle their estates.

MANAGE YOUR EMOTIONS

Living in a multigenerational household can raise a number of issues. For instance, elderly parents may feel they're being stripped of their independence and your children might feel that their personal space is being infringed upon. As the caretaker, you may encounter other problems: Your parents may critique your lifestyle and spending habits, or family members might question how you're handling your parents' care, assets and bills.

For your own well-being, reach out to professional advisors and other family members for support and assistance and keep the lines of communication open in your household. Most important, find the proper balance for all your responsibilities and reserve time for yourself.

BE SENSITIVE

It can be difficult to discuss delicate matters, such as finances and powers of attorney, with your parents, but failing to do so can be detrimental in many ways. For example, you may have to spend time in court sorting out their affairs later. Take the time now, so you can preserve everyone's quality of life — and family harmony.

Pay to grow

A bonus program could strengthen your company

Companies use tried-and-true strategies to stay competitive, including cutting costs, enhancing customer service, expanding product lines and branching out into new markets. But implementing an incentive bonus program — which uses a predetermined set of criteria to award special payments separate from salary to employees — could help strengthen your family business. That's because it may motivate employees to perform well and achieve important business goals — both of which can help improve your company's earnings and cash flow. Let's look at the pros and cons of a bonus program and how to make the most of it.

DEFINING YOUR PURPOSE

Before you can design and implement an incentive bonus program, you must establish a clear purpose and set of objectives. Let's say that you want to motivate family employees while leveling the playing field between family and nonfamily workers. The goal of your program might be to motivate individual drive, initiative and implementation of new ideas as well as convey the message that exceptional efforts will be rewarded regardless of familial ties.

What objectives are important to your company? Here are some to consider:

- Focusing staff on your business's key success factors,
- Providing all employees a share in your company's success,
- Encouraging teamwork and collaboration,
- Reinforcing continuous improvement efforts for all, and
- Increasing your family business's ability to attract and retain new talent.

By first establishing a purpose for the bonus, you can better focus your program efforts to maximize results and create a gauge for evaluating its effectiveness.

BUILDING TEAMS

Team incentive programs generally use multiple performance measures to encourage employees to perform at or above certain levels. In family businesses where many financial measures are highly sensitive, these programs typically focus on other types of measures, such as reduced costs and improved services. This helps protect private information while encouraging employees to focus on key performance drivers. Two such programs are:

1. Gain sharing. Designed to reward productivity and improved product quality, gain sharing works best when employees become responsible for production quantity and quality and are encouraged to improve the way the product is made. Rewards are typically based on a percentage of the value of increased productivity as calculated by a designated formula.

2. Goal sharing. This program uses one or more qualitative or quantitative measures, such as financial, operational and customer impact, to define a range of goals. Rewards can be set as a fixed dollar amount or a percentage of salary.

Both programs clearly define the performance objectives upfront and provide rewards based on achievement. However, for the managers who must oversee the programs, they can be time-consuming and tedious because measures and targets must be defined and progress communicated regularly.

GOING SOLO

Individual incentive programs determine rewards based on performance against a set of personal objectives. Goals can be tailored to each staff member's role and responsibilities in the company, and rewards can be clearly differentiated between those who contribute significantly and those who make little or no effort. These types of bonuses are often used with managers and executives.

FOCUSING ON THE COMPANY

Other incentive bonus programs give employees rewards based on the company's performance (organizationwide bonus) or a certain share of the company profits (profit-sharing) regardless of the performance of workers or teams. Typically, a predetermined amount is added on top of the employees' base salary. These types of bonuses encourage employees to understand how their work affects the company's performance and to improve the business's profitability.

PLANNING FOR THE COST

When planning your bonus program, project the costs of achieving different levels of performance and balance the reward between what your family business can afford and what your staff will find meaningful. Fortunately, some programs pay for themselves because the funds are drawn from an overage above threshold profits.

In many instances, payouts are expressed as a percentage of an employee's salary. The payouts may differ by levels based on role, impact and marketplace practices. For example, common practices for administrative and operational employees are to have payout opportunities in the range of 5% to 10% of salary. As job responsibilities increase, a bonus increase of 10% to 20% of salary is more appropriate. There should be a minimum payout level for threshold performance, a target payout for target performance and a high payout for exceptional performance.

Don't forget about the tax impact. Both you and employees are required to pay FICA tax, and workers are taxed at their supplemental tax rate. If you'd like to award employees a $1,000 cash bonus, for example, the employee would likely net between $600 and $700 depending on the state he or she lives in, the total taxable income of his or her family and whether the total salary exceeds the taxable wage base for Social Security tax purposes. Another factor is whether the employee participates in a 401(k) plan or a cafeteria plan, either of which would reduce taxable income.

SETTING IT UP

Effective bonus programs are based on measurable, quantifiable goals and objectives, have an internal control structure, offer fair and reasonable bonus rewards, and are well managed. They also have a detailed process that determines the payout levels and administers them in a consistent and timely manner. Delays in paying bonuses may create apprehension and tension, which are counterproductive.

Be certain to include nonfamily members in the bonus pool. Paying bonuses to just family employees can create feelings of entitlement and discourage best performance among the clan. It can also make nonfamily employees feel that their best efforts are unnoticed or your company doesn't conduct business fairly, both of which can diminish morale and contribute to turnover.

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Also, put your program in writing. Doing so helps prevent misunderstandings among employees, and it may even be required by your state.

DOING HOMEWORK

Every bonus program has benefits and drawbacks. So do your homework first to determine which program — or combination of programs — best enables you to balance your business objectives with providing sufficient incentive and rewards for your family and nonfamily employees.

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