THE FAMILY BUSINESS REPORT

Solutions, technologies and shared experiences unique to the family or privately held business.

Quarterly Economic Roundtable Meets and Predicts Cautious Optimism

Family Business Executive Luncheon Series Continues May 20 with Page Busken, President and CEO of Busken Bakery 11:30 - 1:30, Please join us.

W. Kent Lutz, Director, Goering Center for Family & Private Business

Director's Column

In an open forum held in February, the Goering Center's Quarterly Economic Roundtable met to discuss the "State of the Economy." This quarter's participants included: Dr.George Vredeveld of the University of Cincinnati; Jim Barrett of Provident Financial Advisors; Donald Raines of Provident Financial Advisors; Tom Flottman of the Flottman Company; Richard Hannan of Mercury Instruments; and Bill Rumpke of Rumpke Consolidated Companies, Inc. In addition to the panel members, there were several other companies represented including: Argo Construction; The Allen Company; St. Media Group; Cincinnati Growth Partners; Information Management Solutions; Horan Associates; Sunbelt Business Brokers; Whetstone Management; Key Bank; PNC Bank; Mellott & Mellott, CPA"s; and Family Wealth Advisors.

As always, the discussion was lively and very informative, with most participants expressing cautious optimism about the near future, tempered by a number of uncertainties that exist in the world today. Professor, George Vredeveld, Director of UC's Center for Economic Education, discussed several economic statistics that point to the fact the U.S. economy has been in a mild recession-that is mild for some sectors of the economy, but much more severe for other sectors, such as the manufacturing sector.

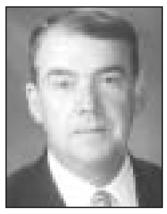
Vredeveld

According to Dr. Vredeveld, manufacturing employment has taken a 10.7% nose dive over the last several quarters, with only modest chances for any significant up tick in the near term. Consumer spending, on the other hand, has held up reasonably well, as has the housing sector, but consumer confidence has been slipping lately, primarily in response to a weaker stock market, uncertainties about employment, and the tensions in the Middle East. At some point, Dr. Vredeveld believes that inventory replacement will begin to pick up its pace again and will help spur economic activity.

Jim Barrett, of Provident Financial Advisors, referred to the very large Federal Gov't budget deficit that is building up, the weakness of the U.S. dollar in the exchange markets, the difficulty most states are having in balancing their own budgets, higher oil prices hitting the U.S. consumer, and a weak stock market, are all real signs that the U.S. economy needs a major boost. Barrett is a proponent of a strong U.S. dollar, and pointed out the importance of the United States being able to attract foreign investment dollars to help finance our large deficit, which may point to an up turn in interest rates.

Barrett

Donald Raines, also of Provident Financial Advisors, discussed the state of the U.S. stock market. According to Raines, investors are going to have to be much more selective in developing their portfolios, and expectations for returns in the market will have to be tempered quite a bit compared to the returns seen in the 1990's. Average returns over the next 3-7 years will probably fall in the 6-9% range.



Raines

Tom Flottman, President of The Flottman Company, expressed his gratitude for having a good year in 2002. His commercial printing company serves a unique printing niche, that helps his firm outpace the general trend in the printing industry, which has been on the decline over the last several quarters. Flottman did express a very cautious outlook, however, over the near term, due to the many uncertainties out there, but feels pretty confident that his company can continue to out perform the norm in his industry.

Flottman

Richard Hannan, Chairman of Mercury Instruments, continues to see the glass as half full. Hannan has seen a big increase in productivity in his

Hannan

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Inside...

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Who Will Take Over Your Business?

By Chris White CFP®, Vice President, Provident Financial Advisors

Small family owned businesses often have problems and concerns unique to their type of organization. Among the big issues that small family owned businesses face is what will happen to the business after the principal owner is no longer involved. If the business will cease operation, the owner should extract all funds possible. If a sale is anticipated, all decisions should be made with this in mind and the firm is to be considered a capital asset. If the business will stay in the family, preparations should start long before the transition process begins. A strong exit strategy is imperative to ensure a smooth transition. A qualified financial advisor can be of immeasurable value in laying out the right business succession strategies for you and your family.

Several options are available if the family decides that relatives should retain business ownership. Installment sales, private annuities, or self-canceling installment notes (SCINs) are options that do not require a reorganization of the ownership beforehand. Installment sales allow the seller to defer recognition until payments are received. The seller can also elect to recognize gains in the year of the sale, an advantageous strategy if capital losses can then offset and shelter the gains. If the seller dies during the installment period, only the present value of their receivables, as well as any payments previously received and retained by the decedent, are included in their estate. Any appreciation in the value of the business after the sale remains outside the seller's estate. Gift taxes will be an issue only if the transaction is not for adequate consideration or if the payments are forgiven, and then only the payments not made are taxable gifts.

Provident Financial Advisors

Private annuities can be used when the relative wants to buy the business, but may not have the necessary capital for outright purchase. These are typically structured so the payments cease upon the death of the prior business owners. Private annuities do not qualify for the favorable installment sale rules of delayed income recognition. Therefore, the annuity must be treated as an unsecured obligation to avoid a taxable transaction recognizing the full amount of the gain at the inception of the arrangement. Each annuity payment consists of taxable and non-taxable components. To avoid gift tax issues, the annuity's value should equal the discounted present value of the business property.

The use of self-canceling installment notes is an estate planning technique combining the concepts of private annuities and installment sales. The owner can escape inclusion of the note's value in their taxable estate, since the obligation is relieved upon death. However, IRS rules mandate that the buyer must either pay a premium for the note or a higher interest rate determined by the age of the seller—the older the seller, the higher this additional consideration becomes. This addresses the fact that payments may be cancelled early due to the untimely death of the issuer. Another potential problem of note cancellation due to premature death is the gain portion of the unpaid balance is considered taxable income, recognized by the decedent's estate.

A strong exit strategy is imperative to ensure a smooth transition.

Some strategies requiring foresight and planning include the use of family limited partnerships and buy-sell agreements. The structure of family limited partnerships (FLPs) is similar to limited partnerships, and are usually more appropriate when a family owned business is involved and the owners' net worth is at least two million dollars. Due to the set up fees and administrative expenses, the practicality of a FLP improves as assets increase.

The general partner controls the enterprise and manages the firm. Although the children can be involved in the firm, the limited partners receive income from the partnership and a proportionate share of assets if the partnership is terminated, but have no say in operating the business. Therefore, these interests are discounted for valuation purposes. This makes limited partnership shares appropriate for gifting to children, since the leverage of the discounting can be applied to the annual exclusion of $11,000 per giver per recipient, making it a non-taxable gift. Unlike a grantor trust, the general partner can modify the partnership agreement without the assets being included in the general partner's taxable estate.

One of the FLP drawbacks is the lack of liability protection for the partners. If the general partners encounter financial difficulty, they can be liable for creditors' claims

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Publisher's Note

The Family Business Report is a monthly advertising supplement to the Business Courier in cooperation with the Goering Center.

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THE FAMILY BUSINESS REPORT
A monthly supplement

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Keeping a Small Business in the Family: Important Tax and Insurance Issues

Carlos Teran, Vice President, Small Business, KeyBank, N.A.

The intense short-term demands of managing a small business often distract business owners from focusing on more long-term concerns. Among the most important long-range planning challenges that business owners typically face is protecting the future of their business and their family.

Unfortunately, few businesses can survive the loss of an owner without proper preparation, including appropriate insurance coverage. Insurance can also protect businesses in other difficult circumstances that involve serious tax consequences.

Without specific advance arrangements, a family may be required to sell or liquidate a business. A sale or liquidation often causes the loss of capital and income for survivors, and business heirs and family members may have to struggle to pay taxes and estate settlement costs.

Partnerships also present challenges in times of transition. In partnerships, the personal insolvency of one partner could force partnership liquidation, and the death of a partner creates complex tax and legal problems. Preserving cash becomes vital to keep the business running, recruit and train a successor or handle a buyout. Businesses also need to reassure creditors that their loans are safe, by being able to absorb possible business losses during the transition.

Fortunately, insurance options can ease these transitions. Business owners would be wise to review their options with insurance representatives and other business advisors, to understand the different types of insurance and how to use them to keep a business in the family.

Key person life insurance.

When a key executive dies, this coverage provides a tax-free death benefit, providing the business with funds to recruit, hire and train a new key executive, and to remain solvent during the transition to new leadership. This coverage also helps assure customers and creditors of business continuity. The corporation purchases the insurance policy on the key employee's life, becoming the owner, beneficiary and payer of premiums. After the death of the employee, the corporation receives the total death benefit, tax free.

Business overhead.

When a business owner becomes partially or totally disabled, this type of coverage provides comprehensive protection against financial disaster. It generally covers building operations such as rent, utilities, equipment rentals and mortgage payments, plus a wide range of professional expenses including salaries and group insurance for employees.

Buy-sell agreement.

The most common use of life insurance in a partnership is to insure each partner for the benefit of the other partner or partners, in conjunction with a buy-sell agreement. This technique involves the transfer of a business interest to another party as the result of an early death of a key company executive. It is a contractual obligation involving the purchase of all or a portion of a business by an established party at a set value.

Disability insurance.

Disability insurance is essential financial protection that covers an injury or illness that prevents a business owner from working -- a circumstance that can be devastating to a business and the owner's source of income. Although health insurance may cover most medical costs, it does not replace lost income.

Long-term care.

Long-term care insurance can protect a business owner's assets when the owner can no longer be independent. This type of insurance may be less costly for a business owner under a group discount plan than when purchased individually. Purchasing this coverage through the corporation may bring a significant tax advantage.

Many businesses also arrange such important types of business insurance as employee health coverage and benefits, general liability coverage and property insurance. As with other services, reviewing insurance options regularly can provide business owners with information on the best protection for their specific business situation, especially as market and business structures evolve.

Many skilled professionals, particularly accountants, attorneys and bank representatives, are available to business owners to offer advice and guidance on the tax consequences of family business transitions and on important insurance protections.

For example, KeyBank offers a full-service insurance division, in addition to a wide range of other financial services, such as private banking and investing, designed to help business owners customize their financial planning.

It's never too early to secure the future of a family business through sound planning and providing adequate insurance protection.

About the Author: Carlos Teran is Vice President for Key's Small Business division. Mr. Teran's office is located on at 5181 Natorp Blvd., in Cincinnati. He may be reached at (513) 229.2623 or carlos_teran@key.com

***Executive Luncheon**...continued from page 1*

industry, which has helped shake out weaker companies and make more room for innovative companies. He also continues to see strong optimism on the part of middle managers, while at the same time, sees top management as much less optimistic as to economic outlook.

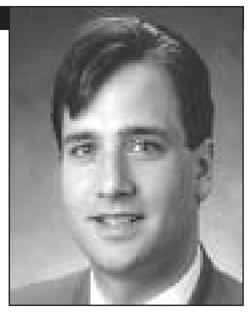
Bill Rumpke, President of Rumpke Consolidated, has seen some impact to his business, due to a weaker economy, but generally business has held up reasonably well. The rise in fuel costs has definitely been a factor for Rumpke, but he is able to pass a good part of that cost increase, through to his customers. Rumpke has also been able to take advantage of the low interest rate environment by being able, to not only reduce debt, but substantially reduce his company's cost of borrowing, and overall he sees his business continuing to have steady growth in the foreseeable future.

Rumpke

In polling all the attendees of the Roundtable, the general consensus for the economy over the next six months came in at a positive .5, which on a scale of -2 to +2, does indicate cautious optimism. Let's hope our panel participants and attendees are correct. Thanks to all who were in attendance, and a big thanks to our distinguished panel.

Two final thoughts before we close. One, please plan to join us on May 20 from 11:30 a.m. - 1:30 p.m. for our third Executive Luncheon Series program, when our guest will be Page Busken, President & CEO of Busken Bakery Company. Page will talk on the challenges he faces in running his closely held family firm. Secondly, we have officially kicked off our 2003 Family Business of the Year event. We are in the nomination process period, which runs through the end of April. We want to encourage you to nominate your own company, a client's company, a customer, a competitor, or anyone you believe should be recognized for being a Family Business of the Year. The event culminates in a community wide dinner celebration in late August, attended by nearly 600 guests. It's a big evening, and we want you to be part of it. Please call our offices(513-556-7185) for more information, or simply fill out the nomination form in this insert and fax(513-556-6044) it off to us. Someone will be very glad that you did. Thanks for listening and until next time……WKL

Starting the Succession Planning Process



Goal Articulation and Communicaton with Stakeholders

Chris Kramer, Deloitte & Touche

The biggest threat to the successful transition of a business from one generation to the next lies beneath unturned stones. Thus, succession planning should not only begin with the articulation of the owner's goals and vision for the future of the business, but it should also account for the desires and expectations of all of the other key stakeholders, meaning selected individuals significantly affected by the owner's succession plan. By including all the stakeholders in a formalized goal setting process, the decision makers can compile information about the issues that are important to other individuals who are integral to the success of the plan. Strategies that are unilaterally implemented from above with inadequate communication and little thought given to the needs of the people affected often fall apart. Even the most innovative and elegant wealth transfer techniques can fail when assumptions are made regarding the desires of others.

By including all the stakeholders in a formalized goal setting process, the decision makers can compile information about the issues that are important to other individuals…

It is important to understand that the decision-making authority of the senior owners is not diluted by the involvement of stakeholders. They are not being granted voting rights; those rights still belong with the owners of the company. The purpose is to provide the stakeholders with a formalized mechanism to express their goals, expectations, and desires, while supplying the ultimate decision makers with a complete frame of reference for making good choices. Further, the stakeholders will feel a sense of ownership in a succession plan which was developed with their participation, greatly improving the likelihood of its ultimate success.

Deloitte & Touche

Every business, whether it is family owned or comprised of non-related business associates, needs to define and establish a commitment to a shared future. This "blueprint" for success is commonly referred to as a vision: an image of the future state of your organization and a description of "where you see the company" years from now. More than a dream or a set of hopes, it must include management's commitment to making the vision a reality. If well articulated, scalable, and appropriate for the organization, it will help to build consensus among the key people in the business. It should be ambitious and set clear standards of excellence. All the stakeholders should participate in the development of the company vision and contribute to the articulation of a well written vision statement.

The next step is for the individual stakeholders to design their personal sets of goals which should be consistent with and support the over-arching vision for the company. Time consuming yet necessary, the goal setting process should start with a definition of the desired end result. If you don't know where you're going, how will you be able to get there? It is important to note that if you are a family business owner you must not only develop goals for the business but establish personal and family goals as well, including those related to exit strategy, retirement, lifestyle, and family harmony.

Individual goals can be reviewed and refined by sitting down with your family and other stakeholders to share ideas and brainstorm. This will give decision makers a sense of everyone's perspective and where they may see themselves fitting into the future. It will also help coordinate the stakeholder goals to work in concert.

Even the most innovative and elegant wealth transfer techniques can fail when assumptions are made regarding the desires of others.

Finally, the stakeholders should commit their refined goals to writing, including short-term tasks and tactics that will be needed attain each goal. It is important to monitor the progress of each stakeholder against his or her goals.

There is always a temptation to skip the goal setting process and attempt a "quick fix." Experience has shown, however, that quick fix solutions often fail. A participative and formalized goal setting process can do more than allow business owners to better evaluate the management grooming and ownership transfer options proposed by consultants and tax specialists. It will provide structure, information-sharing and improved understanding of a process that is too often veiled in secrecy. These ingredients are the keys to improving the likelihood of ultimate success.

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The Global Consulting Partnership
The Greater Cincinnati Foundation
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Whetstone Management
Wilson Assoc. Financial Group

Long-Term Care and the Family Business

By Donald J. Riggin, SKS

Insurance marketing, especially for personal insurance such as life and health coverages, often employs variations on the old chestnuts, "If you died today…", or "If you had a horrible accident and couldn't work…" Honestly, most of us would rather have a root canal than listen to this sales approach. The reality is that these fundamental questions are real and must be addressed, especially if you're an integral part of a family business. This article is not a sales pitch disguised as journalism, but if you're responsible for the success and perpetuation of your family business and have not planned for the remote possibility that you could end up in a nursing home watching your inept brother-in-law drive the business into the ground, perhaps you should spend some time thinking about this.

There is a plethora of life and health-related insurance products on the market today. While no one should be without basic life and health insurance, it is surprising how many people do not carry long-term care (LTC) insurance. This is due in part to ignorance of what is covered in the basic group health insurance package, as well as the availability of LTC insurance as a separate and distinct coverage. Long-term care insurance covers the costs associated with chronic and degenerative diseases and/or conditions such as strokes, Alzheimer's disease and multiple sclerosis. It is not designed to respond to temporary medical costs or finite hospitalization. Let's take an informal poll: How many of you think long-term care is covered in your group health insurance program? If you do, you are wrong. Standard health insurance contracts cover medical costs up to a predetermined limit, and while some plans include sub-limits for such things as in-home nurses, etc., these contracts are not designed to pay for indefinite nursing home, assisted living or adult day-care. These arrangements are known as custodial care and denote the lack of potential improvement in medical condition in the foreseeable future.

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The LTC insurance industry has identified six Activities of Daily Living (ADLs) against which they gauge whether or not a loss has occurred. These include (1) getting out of bed, (2) walking, (3) using the toilet, (4) taking a bath or shower, (5) getting dressed, and (6) eating. If, as a result of a chronic or degenerative illness, you are incapable of performing any two of these without assistance (or at all), LTC coverage is triggered. According to a Wall Street Journal article, one year in a nursing home can cost between $40,000 and $100,000 per year. As unsavory as it is to contemplate, people with chronic illnesses can spend many years of their lives in nursing and assisted living arrangements.

Home care is also extremely expensive. A home health aide that spends 4 hours every other day in the home can cost upwards of $2,000 per month, and 8 hour visits every day costs on average $7,200 per month. Many people begin custodial care in the home but eventually wind up in a nursing facility because of the cost of the specialized equipment and visiting nurses.

…it is surprising how many people do not carry long-term care (LTC) insurance.

LTC insurance is expressed as a maximum daily benefit. Today we know that the average cost of a nursing home bed is approximately $150 per day (and rising). Over time the costs of these services, like everything else, will increase, and your maximum daily benefit must automatically track with these inflationary increases.

As a family business owner or partner, consider who would pay your health care bills in the absence of LTC insurance if you became incapacitated for the rest of your life. Let's assume that there's no one to sue. Your first inclination would be to depend on your personal resources, and then the business's resources. Likewise, grief and guilt-ridden family members would (initially, anyway) offer to help pay for your medical expenses. As the owner of a successful family business you certainly wouldn't be eligible for Medicaid, and you're not old or poor enough to qualify for Medicare. Unless you're independently wealthy, your personal financial condition will inexorably deteriorate unless the family allows you to continue to draw your full salary, which they will do for a while.

In time, your family's feelings of grief and guilt will give way to resentment; you'll be regarded as an albatross and an unnecessary financial drain ("I can't believe he didn't have any insurance for this!") Ultimately, family and friends will limit their visits to the major holidays and your birthday. Your care will become so expensive that you'll be forced to move from your upscale nursing/assisted living residence into a less-than-elegant nursing facility located 200 miles from home. Eventually the financial strain will become unbearable, so you'll have to move all of your remaining assets into your wife's name and then get a divorce, hoping to be become eligible for Medicaid. Your Medicaid application will finally be approved, but the government will force you to move yet again into another facility 250 miles from home. There will be no curtains on your window – just a bent and dusty Venetian blind; no matter, since the window overlooks a giant HVAC chiller that drones night and day. Meanwhile, your former brother-in-law will make the front page of the Business Courier in a story about a once-successful tri-state family business that fell into bankruptcy for one reason or another. Need I say more?

University of Cincinnati
Goering Center for Family & Private Business

Calendar of Events for Upcoming Goering Center Programs

APRIL 2003
8th ......Next Generation Institute – Session 7
15th......Next Generation Steering Committee Meeting
30th......Family Business of the Year Nominations Due

MAY 2003
7th ......Quarterly Economic Roundtable
13th......Next Generation Institute – Commencement & Luncheon
20th......Goering Center CEO Luncheon Series – Quality Inn, Norwood
Page Busken, of Busken Bakery, Guest Speaker

JUNE 2003
6th ......Board of Advisors Meeting
30th......Family Business of the Year Applications Due

Please call the Center at **513-556-7185** if you would like additional information on Center membership, or visit our web site at **www.Goering.uc.edu.**

***Who Will Take Over**...continued from page 2*

of the partnership. There is some liability insulation for the limited partners particularly if they received the assets well in advance of the event.

To take the leveraging of the gifted interests a step further, the FLP can be combined with a charitable lead trust (CLT). Putting a limited partnership interest in the trust provides an ability to effectively double-discount the gifted assets and can be a powerful tool for businesses that are expected to grow. The heirs will not receive their interests until after the trust terminates, allowing for a larger charitable gift and minimizing the donor's gift taxes. As the business grows, more is passed (gift and estate tax-free) to the children. The result can be interests in a proliferating business passing to heirs with little or no gift tax. A Charitable Lead Annuity Trust (CLAT), a type of CLT, becomes more advantageous in a low interest rate environment, since the result is more leverage in the calculations. Since we currently have record low interest rates, CLATs have never looked better.

Another technique is an installment sale arrangement of FLP shares to an intentionally defective grantor trust (IDGT). An IDGT is taxable to the grantor for income tax purposes, but is designed to avoid estate tax consequences on the assets involved and their subsequent growth.

This article addresses just a few succession strategies; and there are still others, such as buy-sell agreements. The important issue is to ensure that succession strategies are discussed and arranged early, selecting the most appropriate one. Once established, everyone involved knows the succession arrangement and can work together to make the business successful.

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Don't Forget to Nominate a Company for the Goering Center's 2003 Family Business of the Year Event

Simply fill out the form below and fax to us.

Nomination Form: FBOY 2003

Fax this completed form to the Goering Center office at (513) 556-6044.

About the Nominee..

Company Name ______________________

Address ______________________

City/State/Zip ______________________

Phone ______________________

Fax ______________________

Principal Owner ______________ # Employees ________

Principal Product of Service ______________________

About the Nominator...

Name ______________________

Company ______________________

Address ______________________

City/State/Zip ______________________

Phone ______________________

Fax ______________________

What is your association with the family business you are nominating? ________

____

Deadline for submitting nominations is **April 30, 2003.**
An application will be forwarded to the nominated business upon receipt of this completed nomination form.

August 26, 2003 • 6-9 pm • Music Hall

To honor the enormous positive contributions made by family companies, both large and small, the University of Cincinnati and the Goering Center for Family & Private Businesses are pleased to announce the 4th annual Tri-State Family Business of the Year Awards. The competition will work as follows: Nominees will be judged on the basis of their positive family-business linkage, their business success, their multiple family member and/or multiple generation involvement,their contributions to community and industry, and their innovative business practices, products or strategies.

Awards will be granted in four categories:

- Under 100 employees
- Innovation (Products, Markets, Organizational)
- Over 100 employees
- Community Service

The nominations and judging will take place in two steps. Nominations may be submitted by anyone and businesses are encouraged to nominate themselves. Nominations are due by April 30, 2003. Once a nomination is received, a detailed application will be sent to the nominated businesses, which must be returned by June 30, 2003. All applications will be reviewed by a panel of independent judges from various professional disciplines and by owners of family businesses.

Rules for Nominations

1. Businesses must be headquartered in Ohio, Kentucky or Indiana.
2. A business may be nominated by anyone, including employees or business associates, or by self-nomination.
3. All family businesses are eligible.
4. All nominations must be recieved by no later than April 30, 2003.
5. Awards will be given in the following four categories:
   - Under 100 employees
   - Innovation (Products, Markets, Organizational)
   - Over 100 employees
   - Community Service
6. Applications sent to nominees must be returned by June 30, 2003.