

# GOERING CENTER FAMILY BUSINESS REPORT



Finding Solutions  
Sharing Experiences



UC College of Business

## The Age Old Question Answered

For centuries philosophers and religious leaders have debated “Why are we here? What is our purpose on this planet?” And the discourse will likely continue for millennia. But, with a concise strategy, business organizations can clearly answer the question, “Why are we here?” So it is for the Goering Center for Family and Private Businesses at the University of Cincinnati.



Larry Grypp,  
President

The Goering Center exists to drive family and private firm success through excellence in training and education. Since twenty years ago when John and Gloria Goering endowed the Center, our focus has been on these firms in the Greater Cincinnati area. With the support of the UC College of Business, hundreds of member firms have participated in a variety of programs. But it is not a one-way street since our member firms regularly share their experiences, both victories and disappointments, with their peers. This dialogue is priceless.

My personal career included twenty years with a Fortune 100 company, MassMutual. In the mid 90s, we launched an extensive research and marketing effort to support Family Owned Businesses.

MassMutual continues to fund periodic research of this segment of industry. Every research report they have conducted finds the same top concern of the owners of family businesses – “Who will lead and own this company in the future?” Whether it is the founder or subsequent generations currently leading the business, this question is of foremost relevance. Since family and private companies are the backbone of our economy, it is critical for a community to provide support to answer this question as well. Again, the Goering Center is uniquely funded and positioned to meet that need.

Since joining the Goering Center last August, I have had the opportunity to meet and hear our members describe their challenges and triumphs. This occurs regularly in our Next Generation Institute (NGI) program at the Center. NGI is an eight month institute where the eight steps to family business succession are introduced and debated in half day sessions. Both the current owners/leaders (G1s) and their potential successors (G2s) participate in the learning and sharing. As you might expect, G1s and G2s have different paradigms about the strategy and future of their businesses. NGI gives them a safe haven to enhance com-

munication about these sometimes testy issues. Past graduates of the NGI are guest presenters, often sharing compelling tales of the evolution in their businesses.

Over the last three years the Center has listened to the voice of our members. When asked their number one need for future programs, they called for information and training on strategic business planning. Thus, we are rolling out a three phase set of meetings, forums, and institutes. Our February 5th program (described below) launched this series. On March 17th we will conduct a half-day forum covering the why, how and tools of planning. In late April we will begin our Strategic Business Planning Institute – a staged three day program that will guide just four companies through the planning process.

As a community educational center, we have different types of members. Our ‘core’ members own and operate family and private businesses. Their success is the focus of our efforts. In addition, many other advisors and providers of services to family and private businesses join the Goering Center. They want to learn more about the issues our core members face and, obviously, hope to develop relationships with them. Along with many of our core members, these advisor/provider members contribute countless volunteer hours to the Center. They often organize projects and help design our mem-

ber meetings, working closely with our core members to have relevant programs. For example, one of our recent luncheon programs addressed the fundamentals of strategic business planning. The session was designed and presented by advisor Mark Signorelli, but featured a panel of five business owners.

As a non-profit organization, the Goering Center enjoys the financial support of our Sponsors. Currently nine local firms contribute funds and volunteer resources to our programs. Again, the family and private firms of our region benefit from the corporate community generosity.

Each year four family owned businesses are recognized for their growth, community service and innovation at our annual Family Business of the Year banquet. It is a festive event drawing over five hundred members and community leaders. Since this is our tenth anniversary of this celebration, this year on August 25th we will award and honor the Goering Center’s Family Businesses of the Decade! Save that date if you want to recognize the best of the finest firms in our region.

Therefore, the answer to that age old question “Why are we here?” is that the Goering Center exists to support our region’s family and private businesses. If on a personal level you know the answer to that same question, you are very fortunate indeed.

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## Steering Your Business Through a Slowdown

By Kim Halbauer, Fifth Third Bank

As a result of tightening credit, rising prices, turmoil in the housing and investment markets, and other factors, many individual and corporate consumers are holding back on spending.

Whether or not your business is experiencing slowing sales and narrowing margins, now may be a good time to take a comprehensive look at your current strategies and business practices. Here are some measures that your business should consider taking.

### Draw Up a Contingency Plan

Develop a list of "what if" scenarios that have the potential to hurt your business. Then develop responses your business can take to counter these threats. This exercise will help you act quickly and decisively if any of the threats you've identified materialize. Use these questions to get started on this process.



Kim Halbauer

- What will happen if revenues fall by 10%? By 15%?
- What if your expenses increase by 15% or 20%?
- What will your competitors do if their sales decline? Will they cut prices?

- What steps will you take if your accounts receivable collections slow down?
- Will your business be able to handle it if lenders increase their interest rates?

One practical step you can take now is to develop a contingency budget based on how you perceive a slowdown might affect your business in the coming year.

### Cut Expenses

Does your company have fixed costs that can be reduced? Your spending on sales, administrative, and general expenses should always be kept to reasonable levels — levels that are in-line with a business of your size, geographic location, and sales volume.

Look into ways you can cut back on your energy and fuel use. An energy audit is a good place to start since it can reveal areas of potential savings. See whether there are any government incentives for the energy-saving projects you'd like to undertake.

Examine your inventory levels, since excess inventory can tie up your cash. Just be sure that you don't cut inventory so much that your company's operations are compromised.

### Improve Cash Flow

Cash is king, especially when the economy is weak. That's why it's so important to review your company's cash flow on a regular basis. You can help speed up collections if you tighten your collection procedures or, perhaps, offer cash discounts for prompt payment.

Keep your eyes open for any warning signs that your customers may be having financial problems. Typically, longer and more frequent delays in settling invoices are a sign that a customer might be ex-



periencing cash flow problems. Be sure that you screen new customers for creditworthiness before you extend credit. During times when the economy is slowing, it may be smart to behave more conservatively when it comes to taking on credit risk.

### Talk with Your Lenders

It's always a good move to keep your lenders informed of your financial position and of any noteworthy developments within your business. Your lender is more likely to work with you through tough times if you have established open lines of communication and a sense of trust.

Proactive planning can help your business through good times and bad. We can work with you to devise strategies that can help your business prosper.

*Kim Halbauer is vice president and team lead in the Middle Market Commercial Banking group at Fifth Third Bank. She can be reached at 859.283.6812 or Kimberly.Halbauer@53.com.*

## STRATEGIC BUSINESS PLANNING FORUM

GOERING CENTER FOR FAMILY AND PRIVATE BUSINESS  
In Partnership with Pathway Guidance, LLC

MARCH 17, 2009 - 7:30 - Noon (Breakfast Included)  
Crowne Plaza Hotel, I71 & Pfeifer Road (Blue Ash)



### CAN YOU ANSWER "YES" TO THESE THREE QUESTIONS?

- Do your employees spend the majority of their time on the priorities most important to you and to the future of your business?
- Is your strategy an active, tangible element of your business or is it just sitting in a binder gathering dust?
- Do you know where you stand right now relative to your goals?

If your answer to each of these questions was "yes," congratulations! You may be well positioned for success. If your answer was "no," we can help you assess the potential of strategic business planning for your organization. Recent research has found that 63% of family businesses have **no strategic business plan**. The Goering Center's process won't take 6 months to complete and it doesn't fill a binder. Learn how a 6-step process, 6 insightful questions, and honest dialogue among your leadership team can translate into an actionable strategy in 3 simple pages.

Join us for a 4-hour forum to help you master this methodology for your business. In addition, you will hear from others how it transformed their business. Register today!

#### Members - \$99 — Non-Members - \$199

Make checks payable to:  
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# The Stock Market and the Economy in 2009

Dale Coates and Michael Jordan, Johnson Investment Counsel

In most years, when the clock strikes twelve on New Year's Eve, there is a sense of positive reflection on the past. This year, at least from an economic and investment perspective, we were all ready to close the book on 2008 and look toward the future. Recessions and bear markets, while not unusual from a historical standpoint, are not pleasant. We experienced an outlier year for stock market returns, as the Dow Jones Industrial Average had its worst calendar year since the 1930s.

History does tell us that recessions don't last forever, and although good economic news is not expected in the near-term, compared to other periods of severe recession or market duress, the economy is much stronger today. We know the current government intervention will be imperfect and have unintended consequences, but the actions should provide some stability in the short-term and be beneficial in the final analysis. Valuations for stocks are attractive and at levels not seen in decades, especially for many high quality companies that were indiscriminately sold. The forces of capitalism and free enterprise, while currently paused, will move forward by year end.

## Give me the bottom line.

### Is the market done falling?

Let's begin with a historical perspective on the market decline during the past year. Since 1900, only in 1931 did equities actually experience a larger drop. The encouraging news is that the periods following such large declines are generally much better, with double digit growth rates commonplace. But the market does not rise simply because it previously fell – it requires a catalyst to draw investors back, and that catalyst



Dale Coates



Michael Jordan

is often valuation.

The rapid decline in stock prices this fall pushed the valuation for equities down to its lowest level in more than 25 years. One key metric to evaluate the value for stocks is the price to earnings ratio (PE), and this measure fell to 10 times trailing earnings in mid-November. This now places the value of stocks within the lowest 10 – 15% range historically, providing investors with some conviction that the market may have fallen far enough already and could be in the process of going through a bottom-

ing process. While this does not prove the market is done declining, it does suggest that we can ultimately earn superior returns from here.

Finally, the only periods throughout history when this valuation measure for stocks was forced even lower was during a small handful of extremely dire economic periods. These include the 1930s with massive levels of unemployment and extreme contraction in economic activity, the hyper-inflation years immediately following WWII, the double-digit inflation years of the mid 1970s, and the conditions of stagflation in the early 1980s when both unemployment and inflation reached double digits - a very rare occurrence. As difficult as the current economic environment is, it simply does not compare to these other periods in history.

### We may not be in a Depression, but won't the economic news continue to get worse during the year? Why won't stocks decline further due to the problems in the economy?

First of all, the news on the economy is going to get worse – there is very little doubt about that – but it will not approach the deep struggles of the

1930s. The unemployment rate, which has already risen from below 5% to more than 7% is expected to continue to climb and could possibly rise to as much as 10% before peaking. While significant, this still pales in comparison to the 25% unemployment rate reached during the depression years. Consumer spending is now under great strain and is declining at rates comparable to some of the deepest recessions we've experienced since 1950. Housing remains weak, declining at a pace that is one of the worst on record. Lower interest rates will ultimately help slow this decline, but a turnaround is still several quarters away. With the global economic environment also suffering, international trade is losing strength and its ability to support growth. The reality is that the fourth quarter of 2008 and the first half of 2009 are going to be three of the worst quarters for growth in decades. But the cumulative decline in economic output is unlikely to reach even 5%, well below the 50% contraction experienced during the 1930s.

Despite the ongoing economic struggles, it is quite possible that the market's turbulence could begin to fade. The broad equity market tends to lead turns in the economy by a period of 6 to 9 months. So if economic behavior improves later this year, stocks should begin to anticipate this sometime during the early part of 2009. Should we remain in recession into the summer months, this will be the longest post-war recessionary period on record and recovery becomes more and more likely.

Investors will require patience in the near-term as we transition through the current recession. We have not even touched on the massive amount of stimulus that the government is injecting into the system as that has been well covered in the news. Markets react to economic environments. Anticipation of improvement will help once again turn the market to the positive.



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Goering Center  
For Family & Private Business

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### The Family Business Report

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# Mitigating Risk in Challenging Economic Times

## Slowing Economy Increases the Importance of Security Deposits, Guaranties and Letters of Credit in Commercial Leases

GRAYDON HEAD  
LEGAL COUNSEL SINCE 1827

By Daniel E. Reitz, Partner, Commercial Real Estate Industry Group, Graydon Head & Ritchey LLP

2009 will be a challenging year for many family businesses, as economic activity slows to levels unimaginable only twelve months ago. The effects of the slowdown are already apparent, as unemployment continues to grow and capital investment continues to shrink. Inevitably under such conditions, some family businesses will fail, with consequences – usually negative – for a wide spectrum of constitu-



Daniel E. Reitz

fulfill its lease obligations. The default will typically cause the landlord and tenant to review their lease – often for the first time – to determine their respective rights, remedies and obligations. The news may not be good.

Landlords frequently wish they had greater security for the tenant's obligations (in the form of security deposits, personal guaranties and/or letters of credit), and tenants and guarantors frequently

regret the security they have provided. Unfortunately, however, discovering security problems after a default occurs provides little solace. Instead, prudent landlords, tenants and guarantors will carefully consider the nature, terms and implications of any security deposit, personal guaranty or letter of credit before the lease is signed. The most common method of securing a tenant's lease obligations is a security deposit. A security deposit is a payment by the tenant to the landlord of a set sum upon lease execution, to be applied by the landlord against delinquent amounts owed by the tenant under the lease, and otherwise returned to the tenant upon expiration of the lease term. Security deposits raise questions which many leases fail to address. For example, from a tenant's perspective, does the lease set a deadline by which the landlord must return the security deposit (or any remaining balance thereof) to the tenant after the lease expires? Does the lease require the landlord to provide the tenant with written itemization of any amount expended from the security deposit? From a landlord's perspective, if the landlord elects to expend a portion of the security deposit to cure a tenant default but not to terminate the lease, does the lease require the tenant to replenish the security deposit amount upon demand? Is the amount of the security deposit sufficient? Often the parties will agree to a security deposit equal to one or two months' rent; if the rent increases during the lease term, a prudent landlord will require the amount to be based upon the months in which the rent is highest, rather than basing it upon the rental amount due at the beginning of the lease term, when rent is often lowest.

Nearly as common as security deposits are personal guaranties. A landlord with a claim against a corporate or limited liability company

tenant is limited to satisfying the landlord's claim from the tenant entity's assets. This is a problem if the defaulting tenant entity has no assets left to pursue. A prudent landlord will therefore request that a creditworthy third party – often a shareholder or other principal of the tenant entity – guaranty the performance of the tenant's obligations under the lease. The terms of any guaranty bear close attention, though. For example, the landlord should ensure that the guaranty states that it is a guaranty of performance (permitting the landlord to proceed directly against the guarantor without first exhausting the landlord's remedies against the defaulting tenant) and not just a guaranty of payment (requiring the landlord to exhaust its remedies against the tenant before the landlord is able to pursue the guarantor). The guaranty should also require the guarantor to waive his right to trial by jury and consent to jurisdiction in the county where the leased premises are located (thereby saving the landlord time and expense in the event of collection). Of course, if the guarantor has no assets, the terms of the guaranty are moot – so a prudent landlord will closely review the proposed guarantor's creditworthiness at the outset. A potential guarantor should take care before signing a guaranty, in order to minimize the guarantor's

*...family businesses will be operating in uncharted economic waters during the coming year.*

ents, from the business's owners and employees to its suppliers, customers and service providers. While it may be impossible for family businesses and those who do business with them to eliminate the negative consequences of a business failure, it is often possible for those parties to mitigate their risk. One example of an opportunity for risk mitigation can be found in commercial leases.

If the failing business occupies leased space, this may trigger a default under the lease, as the tenant ceases to pay rent or otherwise

regret the security they have provided. Unfortunately, however, discovering security problems after a default occurs provides little solace. Instead, prudent landlords, tenants and guarantors will carefully consider the nature, terms and implications of any security deposit, personal guaranty or letter of credit before the lease is signed.

The most common method of securing a tenant's lease obligations is a security deposit. A security deposit is a payment by the tenant to the landlord of a set sum upon lease execution, to be applied by

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# Health Care No Longer Business as Usual

Family owned business needs to become more paternal to fight the rising cost of health care



By David Rinderle, USI Midwest

As healthcare costs continue to rise and the economy worsens, many family owned businesses, and other small employers, are struggling to find a way to stop the double digit medical insurance increases, while at the same time keeping their employees whole. However, some businesses have already achieved annual medical trends that are low single digit, flat or in fewer cases negative.

How do these best performing companies do it? Do they slash benefits and leave their employees out in the cold? Actually, no they don't. Rather, these employers have adopted best practices that cause their healthcare costs to fall below the norms. They are companies that put their employees first, creating a culture of health in their organizations and turning their medical plans back into "Health" plans.

What we are learning, with increasingly transparent claims data, is that indiscriminate increases in deductibles and copays have a very limited effect on lowering utilization. Instead of hacking away at the medical plan – death by a thousand cuts – these best performing employers are relying on data, strategic initiatives and employee engagement to attack the real culprit in today's runaway medical utilization: chronic illness. By most accounts, chronic illness, and its associated causes and conditions, accounts for 70% of healthcare claims.

One of the key strategies employed by many of these top performing health plans is a concept called Value-Based Healthcare Management (VBHM). In a nutshell, this strategy is based upon the fact that you get what you pay for. Unfortunately, in healthcare today most employers are paying for higher utilization and lower quality of care. In the end, most employers' attempts to



David Rinderle

reduce costs by spreading increases in copays and deductibles across an entire employee base are actually raising point-of-care costs to the level where many plan members are going without treatment for chronic conditions. Also, many chronic conditions are going undiagnosed due to the lack of preventive and early diagnostic screenings. Lack of care, and delayed diagnosis, for chronic illness is the breeding ground for catastrophic claims and out of control costs.

VBHM takes a different track. It puts the health and wellbeing of employees and their families first by managing quality of care, access to care, and the effectiveness of care. You can't manage what you don't measure, so companies that implement these strategies learn to look deeper into their healthcare data through the use of a data warehouse, intuitive software and predictive modeling. Some of the pioneers in VBHM are Pitney Bowes, Glaxo-SmithKline, City of Ashville, Dow Chemical and Intel.

If you're a smaller company you might also be thinking that such data is unavailable or at best unsophisticated. It's quite true that most insurers are reticent to share small employer claims utilization information. This reluctance to share data has condemned many smaller family run businesses to make uninformed decisions around what changes to make to their plans. However, some insurers are beginning to see the value in sharing some data, so vendor selection can become a key objective for successful implementation of VBHM.

In addition to proper vendor selection, brokers and consultants such as USI have invested in solutions and processes to assist their clientele in gaining the information they need in order to implement VBHM and other

similar strategies. For employers that do have access to data but perhaps believe they are too small – not a Pitney Bowes – we can offer sophisticated low cost tools to make Value-Based Healthcare Management practical for small and mid-sized employers.

The creation of a culture of health, necessary for short and long-term cost reduction, goes beyond the VBHM strategy. Communications around disease prevention, healthy life choices, early detection, self care, provider quality, and much more are also necessary. Wellness programs that truly engage employees and their dependents are the third leg of the cost management stool. Health assessments including biometric screening – testing for key risk factors – should be incorporated in any effective wellness program.

There is no doubt that these initiatives require a longer term approach to reducing healthcare costs, but it is clear that they are the only way to affect long-term cost reduction, and employers need to start now. There are, however, very specific high impact ideas to help brace against these uncertain economic times.

A recessionary business environment is causing many employers to take a harder look at healthcare. Many cost reduction strategies that may have been rejected just six months ago by some employers are now on the front burner for consideration. According to our USI 2008 Tri-State Mid-Market Survey, of 405 employers participating, 32% have adopted a Consumer Directed Health Plan (CDHP), primarily Health Savings Accounts (HSAs) or Health Reimbursement Arrangements (HRAs). Properly designed CDHP's can make an immediate impact on health plan costs. Care must be taken to ensure that these plans are designed in such a way that true consumerism is maximized and barriers to care and prevention

are not introduced. Consumer directed healthcare is not just high deductible healthcare. It is a process of employee engagement and ownership.

Other innovations are important to consider as well. Alternate funding, appropriate risk transfer, avoidable claims strategies, eligibility review initiatives, Insured Participation Plans (IPPs), Medical Expense Reimbursement Plans (MERPs), network discount analysis, insurer performance guarantees, and aggressive carrier negotiation are some key targets of any effective cost reduction opportunity analysis.

Family owned businesses and other small employers have a unique opportunity to engage employees in a caring way. With such employers, a higher level of opportunity exists to create a culture of health and to redefine the medical plan into a program that truly encourages health and wellbeing. Paternalistic organizations recognize that trust among employees in their organization is the currency used to get things done and achieve goals. This trust can become the platform to encourage this first generation of reluctant healthcare consumers to take a more active interest in improving their overall health. The dividends can be astounding – improved productivity and higher quality of life, while lowering healthcare costs.

Whatever your company does in today's healthcare and economic environment should be contoured to your company's philosophies, financial goals and employee needs. Employers are finding that they can continue to provide a significant level of benefits, regain the confidence of their employees and still reduce current costs and future trends.

*David Rinderle is a Benefits Consultant for USI Insurance Services, LLC, Cincinnati, Ohio office.*

## Going Green Makes Good Business Sense

By Don Stock, PNC Bank

If you have never considered the affect your business has on the environment, it may be time to take a look at what you can do to operate your business a little greener. Here's the key reason: operating your business in an environmentally responsible manner isn't just a good thing to do; "Going green" can be good for your bottom line and may help improve your cash flow as well.

There are many ways that a company can go green – from simple process improvements to significant changes in operations. But, no matter what environmental enhancements a company may implement, more often than not the ongoing savings far outweigh the upfront costs.

A recent survey by PNC Bank, ranked among the nation's most environmentally responsible companies with more certified green buildings (55) than any other company on Earth, found eight in 10 small business owners say they give some consideration to environmental impact when it comes to running their business. Yet, only half (55 percent) are taking action to reduce energy usage while one-fifth (20 percent) have changed shipping or distribution.

For all types of businesses, promoting green practices at work can boost your business success in a number of ways. First, it can save you some serious "green" – as in cash. Additionally, it can help you engage your employees and make them feel better about where they work. Finally, customers everywhere are increasingly seeking out green vendors and retailers, so it can give you an edge in bringing in business.

### Develop a Plan and Get Your Employees on Board

Okay, you have made the decision to go green with your business, so where do you start? The answer is to approach it like any other important initiative – develop a plan



Don Stock

of action by examining each area of your business and determining where you could be operating in a more environmentally friendly manner.

You don't need to hire a vice president of sustainability to get the job done. Simply rely on the people who are closest to the issue – your employees. Since they are the ones who will have to implement your plans, it is a good idea to get their buy-in from the start. You also may want to consider offering your employees bonuses for green ideas that save your business money.

*no matter what environmental enhancements a company may implement, .....the ongoing savings far outweigh the upfront costs.*

### Simple Ways to Be More Environmentally Friendly

Many business owners believe that changing their processes to be more environmentally friendly will be expensive and time-consuming, but that is simply not the case. No matter what your core business may be, there are a host of simple steps you can take to make your business greener.

PNC recommends the following changes to improve efficiency and reduce environmental impact for your business. Here are some starters to consider:

- **Reduce Energy Usage** – Set a concrete goal to reduce your utility bills by 5 or 10 percent. Here are some ideas that can help:
  - Make a habit of turning off lights, appliances, computers and other office equipment when not in use.
  - Replace standard light bulbs with energy-efficient Compact Fluorescent Light (CFL) bulbs).
  - Install a programmable thermostat to control heat and air

conditioning.

**Eliminate Disposable Cups, Dishes and Utensils** – The average American office worker uses nearly 500 disposable coffee cups a year. Help reduce this waste by buying your employees personal coffee mugs and stocking your kitchen or break room with permanent dish-ware and eating utensils.

### Replace Bottled Water With a Water Filter

Bottled water is more expensive per gallon than gasoline, and it generates millions of tons of plastic each year that ends up in landfills. A water filter costs pennies per gallon.

### Use Less Resources

Print and copy on both sides of a sheet of paper when possible and reuse misprints as scratch paper. Also, look for ways to use less paper throughout your operations, such as with online banking and bill payments, electronic invoices, online payroll solutions, remote deposit services, etc.

### Recycle Wherever Possible

This one probably goes without saying, but don't limit your recycling efforts to paper, plastic and aluminum. You can cut toner and ink costs by recycling your used cartridges, and you may want to consider donating your computers to a local school.

### Get a Loan

For more substantial renovations, you may be able to get a special loan. PNC, for example, offers small businesses a discount loan rate for energy-efficient improvements for such items as the purchase of low-



emission fleet vehicles, Energy Star appliances and upgrades to energy-efficient HVAC systems and windows, among others.

### The Time Is Now

The green movement is here to stay, and there are countless ways your business can take advantage of the positive energy associated with going green. With the recent rise in energy costs, there is more incentive now than ever to start a green program at your business. It's a smart business decision that can pay you big dividends in a variety of ways.

### Letting the World Know About Your Eco-Friendly Stance

You may feel uncomfortable about "blowing your own horn" about your green program, but don't keep your eco-friendly activities and achievements to yourself. Be sure to promote your green initiatives to employees, customers and vendors.

Many consumers now choose products and stores based at least in part on their environmental friendliness, and many companies now have programs in place that place a priority on doing business with green vendors.

Make sure potential customers and business partners are aware of your green program by promoting it in your business materials and advertisements, as well as on your web site and via workplace or in-store signage.

You may even want to go a step further and take a leadership role in the green movement in your community, such as by sponsoring a tree-planting initiative or by holding a recycling or community shred event at your place of business.

*Don Stock, senior vice president, PNC Business Banking in Cincinnati. To find out if you have the best solutions for the changing needs of your business, or to learn more about 'greening' your business, talk to your local business banker at the nearest PNC Bank branch, call 1-877-BUS-BNKG, or visit [www.pnc.com](http://www.pnc.com)*



# If you want to Transfer the Family Business to the Next Generation...What are you Waiting for?

By Mark Gaudet, Clark Schaefer Hackett & Co.

The combination of today's historically low interest rates and depressed asset values are certain to cause many family business owners heartburn. However, this troubling combination may provide business owners with the opportune time to transfer their family businesses and minimize estate and gift tax consequences. It appears that the federal estate and gift tax system is here to stay. Therefore, business owners should take advantage of today's current economic conditions by planning now.

Basically, family business owners can transfer the family business during their lifetime to the next generation in three ways: either by sale; by gift; or a combination of the two. As most business valuations have dropped due to the current economic crisis, the cost associated with selling or gifting businesses has also decreased. Today's lower valuations can reduce the gift tax exposure or make the potential sale much more affordable for the next generation. In addition, the current interest rate environment is advantageous for any of these transfer planning approaches.

## Sale

Owners looking to sell all or a portion of the family business may consider selling the business outright or using an installment sale arrangement. If only a portion of the business is transferred, the owner may be able to take advantage of potential discounts for valuation purposes. An installment sale occurs when the seller receives at least one payment in a year after the taxable year in which the sale occurred. The seller will have flexibility in structuring the payment terms in order to assist the next generation in purchasing the business. In addition, the installment sale can freeze the value of the business



Mark Gaudet

interest transferred for estate tax purposes and allow any future appreciation in the business interest to be passed to the next generation.

In structuring the sale, the buyer would issue the seller a promissory note stating the repayment terms. As long as the promissory note has a stated interest rate that is greater than or equal to the Applicable Federal Rate "AFR," the IRS will not

*Although the current economic crisis is difficult for many business owners, it may be the right time to use the depressed asset valuations and low interest rate environment to their advantage.*

treat the note as a gift. AFRs are published monthly by the IRS, and the rates vary depending on the term of the loan. The current rates for February 2009 range from 0.60% to 2.96%. These rates are generally lower than any rate that the buyer would be able to arrange on their own. In order to assist the buyer, the promissory note could be structured as interest only during the term of the note with a balloon payment at the end. The seller would generally recognize the taxable gain from the sale of the property over a period of years as the note is repaid. The interest portion of each payment would be taxed as ordinary income to the seller and may be deductible for the buyer.

## Gift

A Grantor Retained Annuity Trust (GRAT) is a popular wealth transfer planning technique that can be used by family business owners. The goal of a GRAT is

to transfer the appreciation on property that is contributed to a trust with little or no gift tax consequences. A GRAT generally functions best in a low interest rate environment and by using property that is expected to appreciate during the trust term. A family business that can provide adequate cash flow and has appreciation potential would be a great candidate for a GRAT.

A GRAT is an irrevocable trust in which the grantor transfers assets into the trust and retains the

right to receive a fixed payment at least annually for a set number of years. At the end of the trust term, the property remaining in the trust passes to the remainder beneficiaries free of any additional gift tax, even if the property has appreciated significantly. The transfer of property to the trust is a taxable gift, however only the value of the remainder interest is subject to gift tax. The value of the remainder interest is the total value of the property transferred to the trust less the present value of the retained annuity interest discounted using the IRS prescribed Section 7520 rate. The Section 7520 rate, also referred to as the hurdle rate or discount rate, is determined monthly by the IRS and is currently at 2.0% for February 2009. The longer the term of years, the higher the annuity payment amount and the lower the Section 7520 rate, the larger the discount may be when determining the value of the gift.

With proper planning, a GRAT can be structured so that there is little or no taxable gift.

GRATs can accomplish an effective estate freeze with little or no tax costs. Over the term of the GRAT, the grantor receives the value of the property transferred to the GRAT in the form of a fixed annuity. In order for the GRAT to be a success, the property in the GRAT must outperform the Section 7520 rate. When interest rates are low, the annuity that must be paid to the grantor is reduced, making it more likely that a significant remainder will pass to the trust beneficiaries. If the trust property is unable to outperform the Section 7520 rate over the term of the trust, the GRAT fails and no value is transferred to the next generation. However, since little or no gift tax was paid on the initial transfer, there is very little down-side risk to using a GRAT. The most significant risk with using this strategy is the grantor's death during the term of the GRAT. If the grantor dies during the GRAT term, some or all of the trust assets will be included in the grantor's estate for estate tax purposes.

Although the current economic crisis is difficult for many business owners, it may be the right time to use the depressed asset valuations and low interest rate environment to their advantage. There are additional planning techniques that business owners may want to consider during this time. Regardless of the strategy, now is the ideal time to contact your advisors for assistance.

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## The Benefits of Lifetime Gifting

By Timothy Rodgers, Senior Trust Administrator, Southwest Ohio District, KeyBank N.A.

Gifting over the course of one's lifetime can be a powerful, flexible tool for estate planning. If properly executed, it can be among the most effective strategies for limiting tax liability as well as increasing the donor's personal satisfaction.



Timothy Rodgers

the probate estate upon the person's death (though there are gray areas for gifts made within three years of a donor's death). This can reduce complications and costs associated with settling the estate.

- Gifts can be kept private.

Unlike the provisions of a will, which is a public document, gifts given during the donor's lifetime remain entirely private matters between the donor and the recipient. Naturally, that's generally a major consideration for people of substantial means.

- Property distribution can be more easily controlled. The donor can adjust his or her giving patterns as changing conditions warrant, which is a far harder end to accomplish through the medium of a will or trust once the donor has died.

Who is eligible to receive these lifetime gifts? Spouses and children are among the most frequent beneficiaries of gifting. Gifts to spouses generally qualify for full deductions under federal gift and estate taxes, and some states also have provisions for marital deductions. Gifts to minor children aren't generally a

good idea, except under some form of guardianship, such as a trust. But donors should be advised that such gifts could limit the recipient's chances of qualifying for and obtaining financial aid when they reach college age. Here again, qualified advisors should serve as guides.

Gifts can take many forms. They include:

- **Outright Gifts.** This gives the recipient unrestricted control of the property or other assets. It's the quickest, least complicated and most direct route of gifting.
- **Gifts in Trust.** Trusts offer protection against various negative outcomes, such as spendthrift relatives exhausting gifted assets quickly.

A Trusteed IRA is an option that combines the tax benefits of an IRA with the estate planning benefits of a trust in one document. Using this strategy, an IRA owner, working with his or her estate planning attorney, may customize the beneficiary designation.

- **Debt Forgiveness.** This is considered among the most efficient forms of gifting, in part because it would generally fall under the annual gift tax exclusion. But one caution: you must first have es-

tablished a clear debtor-creditor relationship.

When is the best time to gift? Generally, the earlier you begin, the better off you will be. Beginning to gift relatively early in life will allow you to take advantage of years of annual gift tax exclusions under the tax law. Those annual exclusions, if unused, are forfeited each year. Gifts of real property, on the other hand, should be made when market prices are low since for tax purposes the property is generally pegged to the fair market value on the date the gift is made.

While the potential pitfalls of improperly structured gifting are many, when pursued with competent professional advice, gifting can be among the most effective and satisfying paths to distributing one's wealth during one's lifetime.

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### Mitigating Risk, Continued from Page 4B

potential liability. For example, is the guarantor able to negotiate a cap on the amount he may be liable for? Is the guarantor released from liability if the lease is amended, renewed or assigned without his consent?

Less commonly, a letter of credit issued by a bank may be used to secure a tenant's lease obligations. This may be preferable where the tenant does not wish to tie up a large amount of cash in a security deposit, and would prefer instead to deploy that cash as working capital in the tenant's business. A landlord may prefer a letter of credit for several reasons, not the least of which is that if the lease and letter of credit are drafted properly,

the letter of credit may be drawn upon, and the proceeds applied to the tenant's lease obligations, notwithstanding the tenant's bankruptcy. Letters of credit raise myriad issues for both the landlord and tenant, and parties considering the use of a letter of credit should engage experienced real estate attorneys to address these issues.

In conclusion, family businesses will be operating in uncharted economic waters during the coming year. Those businesses that adapt and take steps to mitigate their risks – such as making sure they understand the nature, terms and implications of any security deposit, guaranty or letter of credit before signing a lease – will be rewarded.

## Goering Center Calendar of Events



### February 2009

25th Leadership Development Institute: Session 1

### March 2009

6th Board of Advisors Meeting

10th Next Generation Institute Cincinnati: Session 5

11th Leadership Development Institute: Session 2

17th Strategic Business Planning Forum 1/2 day

25th Leadership Development Institute: Session 3

### April 2009

7th Breakfast Seminar - Health Insurance (Family & Private Business Members only)

8th Leadership Development Institute: Session 4

14th Next Generation Institute: Cincinnati: Session 6

22nd Leadership Development Institute: Session 5

29th Executive Luncheon Series:  
Board of Advisors -The Busken Family

### May 2009

May 6 – Leadership Development Institute: Session 6

May 7 – Breakfast Seminar – Compensation (Family and Private Business Members only)

May 12 – Next Generation Institute: Session 7

May 20 – Leadership Development Institute: Session 7

May 26 – Executive Luncheon Series  
The Power of Roundtables

**SAVE THE DATE:** Family Business of the Decade Celebration – August 25, 2009.

Please call the Goering Center at 513.556.7185 if you would like additional information, or visit our web site at [www.Goering.uc.edu](http://www.Goering.uc.edu).