

GOERING CENTER

FAMILY BUSINESS REPORT



Finding Solutions
Sharing Experiences



PROFESSIONALLY SPEAKING

A SUPPLEMENT TO THE BUSINESS COURIER JULY 21, 2006



Dr. Sidney L. Barton
Founding Executive Director

A Strategic Management System Must Reflect Reality

Two months ago in this column, I made the case for a strategic management system as a superior management tool to traditional strategic planning for businesses. Last month, the case was made that such a system is even more critical for a family business. Assuming you bought the arguments outlined in these two articles, we are ready to explore the key criteria of a suc-

No matter how one represents the strategy of the organization, what matters is how the resources are really allocated.

cessful strategic management system. In other words, how can you tell if a strategic management system is effective? By the way, if you didn't agree with the premise of the last two columns, then you likely are not even reading the column this month! But for those interested, here we go.

The first criteria for a successful strategic

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Successful Family Business Entrepreneurs Are Catching a New Dream

Family Business Of The Year Event • August 29, 2006 • Music Hall

It's very natural for us to hang on to something that we have played a significant role in creating, developing, growing, and managing. Family businesses certainly fall into this category. Many studies have shown it is very difficult for the senior generation of a closely held family firm to relinquish ownership and control to a new and younger generation. There is no ideal way to transition a family business from one generation to another, but it does seem there are some common elements practiced by those firms that do it successfully. One of these common traits is that the senior generation member or members are able to create a meaningful second career for themselves. They are able to find a new challenge and pursue a new dream with plenty of passion.

This new challenge and new dream may take the form of being a Social Entrepreneur, by creating and managing a Private Family Foundation. You really do not have to be a Carnegie or a Ford in order to create your own private foundation. In fact, statistics show that about 90% of the 30-40,000 grant making organizations in the United States gives away less than \$100,000 each per year. When a successful family business owner reaches a certain point in life, after they have learned their trade very well, the learning curve begins to level off and many times declines. Usually this occurs after the age of 60, and it is during this time the business owner should be teach-

ing others how to carry on the trade and be developing a stronger sense of stewardship outside the business.

A private foundation is a significant way for a successful family business owner to put their personal stamp on something outside the business. It also helps address significant estate tax issues and provides an opportunity to be very productive during later years in life. The estate tax strategy alone, in creating a private family foundation, can help the family maintain control over assets that would otherwise end up in the hands of the tax man. The family foundation also provides an opportunity for many family members to participate in a family activity that may help develop some com-

mon ground between generations.

Like any activity worth pursuing, planning is important when considering creating a private family foundation. To get started, a family business may want to take a portion of its profits each year and capitalize the foundation over a number of years. If it's a \$50,000 contribution each year for ten years, the foundation would have well over \$500,000 at the end of ten years. Every family has close connections to certain charities, and the opportunities are limitless when it comes to being creative and entrepreneurial in charitable practices. Simply writing a check for a certain cause is generally not enough. Most successful social entrepreneurs want to have significant input in the organizations they are supporting - not to a point

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W. Kent Lutz,
Director

CONGRATULATIONS TO THE 2006 WINNERS AND FINALISTS OF THE FAMILY BUSINESS OF THE YEAR AWARDS

Under 100 Employees:

Winner – Long Stanton Manufacturing Co.
Finalists – SFA Architects and ST Media

Over 100 Employees:

Winner – Hilltop Basic Resources
Finalists - Lykins Oil & Valley Interior Systems, Inc.

Innovation:

Winner – J&N Auto Electric
Finalists – Club Essential and Snooty Fox

Community Service:

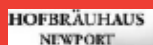
Winner – Restoraid/Coit
Finalists – Clark-Theders Insurance Co and Ghent Manufacturing Co.

Winners and Finalists will be honored at the Family Business of the Year Awards on August 29, 2006 at Cincinnati Music Hall

Goering Center Partners



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Hiring Family Members In Your Business

By Patrick Dolle, Fifth Third Bank Private Client Group

We all are familiar with the story of the traditional family owned business, where the husband, wife, and children all work to make the business successful. Often with a family business, the non-owner spouse contributes significantly, but isn't always compensated as an employee. Rather, the owner-spouse is the only one who draws pay out of the business (with the exception of non-family employees). However, paying the non-owner spouse reasonable compensation for work performed can make a lot of sense from a tax and employee benefits perspective.



At first blush, paying the spouse compensation appears to increase the business' costs -- the pay itself, unemployment insurance premiums, etc. -- without a clear advantage. However, several benefits can be derived from making the spouse an "official" employee.

Social Security Benefits

Placing the non-owner spouse on payroll makes him/her eligible for Social Security benefits. This increases the total amount of Social Security benefits received by the husband and wife compared to the benefits they would receive if only one

spouse had a significant earnings history.

Retirement Plan Benefits

By employing the non-owner spouse and providing that spouse with retirement plan coverage, the husband and wife can

put aside more tax-deductible retirement plan contributions. This benefits both the business and the owner's family. This strategy works best when the owner is making or receiving the maximum allowable contributions under the business' plan.

If the business does not have a retirement plan, the non-owner spouse can make an annual deductible contribution of up to \$4,000 (\$5,000 starting in 2008) to an Individual Retirement Account for his/her benefit. Individuals age 50 and older can make additional "catch-up" contributions (\$1,000 for 2006 and later years).

Other Benefits

The non-owner spouse also can be covered by the business' group-term life and disability insurance plans.

Other Family Members

Additional tax advantages can be obtained by paying a child who is employed by your business. For example, suppose you

are in a high federal income-tax bracket. Your 17-year-old child is in the lowest bracket. You pay the child \$3,900 a year for part-time work performed for your unincorporated business. You can claim a deduction for the full \$3,900, resulting in a tax savings to you. Moreover, you reduce by \$3,900 the amount subject to your 15.3% self-employment tax. And neither you nor your child has to pay FICA (Social Security tax) on the child's wages, since wages paid to an unincorporated business owner's child under age 18 are exempt from FICA. If the business is incorporated, you can deduct the full amount of the child's pay as a business expense.

Fifth Third does not provide tax advice. Please contact your tax accountant for advice pertinent to your personal situation. Illustrations are for informational purposes only and do not depict actual strategies or results. The information presented in this material is intended for educational purposes only, is general in nature and is not designed to address your specific financial situation or particular needs. The information is current as of the date of publication and is subject to change due to changes in tax regulations.

Catching a New Dream, Continued from Page 1

of minimizing the tremendous impact the full time stewards of those organizations are having - but rather offering their own unique talents and gifts to help make the organization better.

Private family foundations can help promote the values of the family and the family business at the same time. Such foundations require a mission statement and a structure, not entirely unlike the family business itself. The main challenges of the family foundation is spending money wisely, finding the best people to spend it on, and engaging as many family members as you can to help be good stewards of the foundation. The foundation's existence also gives the family business some incentive to make additional profits, so that some of it can flow back into the family foundation, in order to do more good for others.

The idea of creating and managing a private family foundation can be energizing, fun, fulfilling, and very challenging. It can bring out all the entrepreneurial skills that one possess, and can provide an opportunity to rekindle one's passion for creating and doing. Here are some basic

thoughts on getting started.

1. Contributions into a private foundation are limited as to a percentage of your income if given as cash vs. appreciated property.
2. Distributions made out of the foundation must be at least 5% of the assets each year.
3. Administrative expenses must be reasonable and necessary.
4. The foundation can contribute to any cause as long as it's a charitable activity.
5. A staff is usually not necessary, but the foundation can be managed by the benefactor and the family.
6. There are some legal and accounting fees to initially set up the foundation, but they are not cost prohibitive.

The experience, challenge, and satisfaction of creating, building, and managing a private family foundation can be equal to or greater than that of creating, building and managing a for-profit business. In fact, in most cases the satisfaction is much greater, because the end result focuses on helping others rather than benefiting ourselves. Most of us will be remembered in our life for what we did for others, not for how much money

we were worth, or what assets we accumulated, or high low our golf handicap was. The sooner we begin to realize that giving is far better than receiving, and our real reason for being is to give to others as much as we can. We can help accomplish that through our own private family foundation and enjoy the last third of our life far greater than the first two thirds.

Family Business of the Year Event

Please remember to mark your calendar for the evening of August 29, 2006, from 5:30 til 9:00 p.m. at Cincinnati Music Hall when we all come together at the Goering Center's Family Business of the Year Event to recognize the enormous impact that family business has in our community and world at large. Mr. Michael Flannery of WCPO's 9 on Your Kid's Side will emcee this annual celebration of family and the businesses they run. Invitations will arrive at the end of July, but you can reserve your table now by calling the center at 513-556-7185.

Until next time..... WKL



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The Family Business Report

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Key Changes in the New Tax Law

By C. Michael Whittaker, Clark, Schaefer, Hackett & Company

The new tax law -- officially entitled the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA) -- extends several important tax provisions that were scheduled to expire. But those changes were expected from the outset. Unexpectedly, the new tax law contains several other tax breaks that may benefit affluent individuals.

Significantly, the new tax law will enable more individuals to take advantage of Roth IRA (individual retirement account) conversions in the future. Conversely, it also increases the time period that families will be subject to the dreaded "kiddie tax."

The following is a brief overview of the key changes in the new tax law:

Roth IRAs: Unlike a traditional IRA,

contributions to a Roth IRA are never tax deductible. However, distributions from Roth IRAs are completely tax-free, providing an advantage over traditional IRAs. In addition, you don't have to take mandatory lifetime distributions from a Roth IRA.



In the past, a taxable conversion to a Roth IRA was allowed only in a year in which your adjusted gross income did not exceed \$100,000. Effective for the 2010 tax year, the new law removes the \$100,000 cap for Roth IRA conversions. For conversions in 2010, you may elect to spread the resulting tax ratably over a three-year period.

Kiddie tax: Under the kiddie tax, a child's unearned income above a specified limit (\$1,700 for 2006) is taxed at the top

marginal tax rate of the child's parents. Prior to the new tax law, this tax rule applied to children under the age of 14. However, the new law hikes the age limit to 18, effective for the 2006 tax year.

Capital gains and dividends: Currently, the maximum tax rate on long-term capital gains and qualified dividends is only 15% (5% for low-income taxpayers) as opposed to ordinary income rates reaching 35%. This preferential tax treatment was scheduled to be repealed after 2008, but the new law extends it through 2010.

Alternative minimum tax (AMT): The AMT continues to affect a wide range of middle- and upper-income taxpayers. Congress had created higher exemption amounts in the AMT calculation through 2005. The new law grants an additional one-year reprieve with even slightly higher

exemption amounts for 2006.

Section 179 allowance: Under Section 179, a business can currently deduct the cost of assets in the year they are placed in service, within certain limits. The maximum expensing allowance under Section 179 was quadrupled from \$25,000 to \$100,000 by the 2003 tax act. This dollar cap has been subsequently increased slightly over a period of years. Originally, the allowance was scheduled to revert to \$25,000 in 2008, but the new law extends enhanced write-offs for two more years.

Note that a separate "trailer law" includes revivals of expired tax breaks for research and development costs, special "targeted jobs" credits and optional state sales tax deductions.

Business Anniversaries: First to Fiftieth, How to Get There

By Don Mellott, Jr., Mellott & Mellott

Sixty six percent of new businesses don't reach their second anniversary, and of those that fail, 80% don't reach their first anniversary (U.S. Bureau of Labor).

Only 9% of businesses with fewer than 20 employees celebrate a tenth anniversary (Dun & Bradstreet).

So how does a new business reach its first anniversary? How does a family-run business survive long enough to celebrate its fiftieth anniversary?

To answer these questions, an interview was conducted with Don Mellott, Jr., Managing Partner of Mellott & Mellott, a family-lead CPA Firm of 35 employees located in downtown Cincinnati. In addition to providing accounting, auditing and tax services, they provide business counsel to entrepreneurs and closely held businesses, and this year are celebrating their 50th anniversary.

Q: What advice would you give to someone interested in starting a new business?

A: My first piece of advice is to write a business plan. This critical process helps the founder take his or her ideas and concepts and put them into the form of a business model. A key part of the plan, and an area where we often help, is in developing financial projections. What are projected sales, cost of goods sold, expenses, and resulting

profit for the first five and ten years? While this exercise has many purposes, it serves to crystallize the investment required. This is a critical factor when going to other potential investors or to banks for financing.

I also strongly recommend that the

founder surround himself with outstanding professionals such as an attorney, a CPA, and a banker who will be integral to his or her success.

Q: So tell me about the start of Mellott & Mellott and its keys to success in the early years.

A: In the mid 1950's, my grandfather, Leo Mellott, was working for an accounting firm that also did legal work. When the Bar association required a split of accounting and legal functions, my grandfather and Henry Nuelson opened the accounting firm Nuelson and Mellott in November, 1956. Then in 1958, my father joined the firm after spending a few years in the Army and graduating from Xavier University. In 1963, Nuelson split off and the firm was renamed Mellott & Mellott. Like most founders, my father and grandfather had to work long days to grow the business. They also realized the value of their clients and went above and beyond delivering a quality product and providing unmatched service. Another key was the ability to generate business. My dad was ag-



gressive in his business development efforts and networking -- and did the bulk of it after hours. He sat on boards, joined clubs and worked hard to generate clients and establish relationships with those who could refer clients to the Firm. Many of the clients referred from those initial contacts are still with the Firm today. Lastly, they worked hard to keep costs under control. Francis, my grandmother, served as the firm's secretary in the early days. They truly watched their pennies.

Q: Ok, so a new company gets through the first couple of years, what do you advise their leaders to do to take their company to the next level?

A: People become key. When a company starts out, its founders are dedicated, work hard, and must wear a variety of hats. As the business grows, the founders must relinquish some of their responsibilities to others, and this typically creates a number of issues.

First, founders must understand their own strengths and weaknesses. For instance, hiring great people is a skill, and a skill that founders may not have. Yet great people are critical to success. So where entrepreneurs have weaknesses or need expertise, I advise them to hire or retain others to fill those needs. As the firm grows in size, it is important for everyone to be on the same page. Businesses evolve, and I have never seen a new business play out exactly as detailed in its original business plan. Therefore, the

business plan must be updated to reflect the realities that exist at different points in time. This can help focus efforts, especially with new employees.

Q: After Mellott & Mellott's early success, how did the firm continue to facilitate its growth?

A: Client service has always been a key. We were fortunate that many accounts that started small grew large. I believe that the level of personal service we provided was the primary factor in retaining these growing businesses and that we helped facilitate this growth.

Q: A firm enjoys success and the founders' children are beginning college. What is your advice?

A: Communication is key. My advice is to set the rules well before family members are ready to join the firm. The rules should include hiring qualifications, expected performance, requirements to advance, etc. The entire extended family, including spouses, should be informed about the parameters for joining the firm and potential advancement. The Goering Center's Next Generation Institute is an outstanding program that covers the issues family businesses encounter, including succession planning. We have had several of our family business clients complete the program and they have nothing but great things to say about it.

Q: Looking back, what were the keys that

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Mellott & Mellott, P.L.L.

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10 Steps for Marketing Communications Success

Bryan Holland, Holland Communications

Consider some of the great television advertisements, jingles, slogans, or other marketing communications efforts - the ones that stand out in your mind. They probably involve a refreshing cola, a chlorophyll-enhanced giant, a lonely appliance repairman, or something you could order at a drive-through window.

How did advertising agencies come up with those ideas? Did the creative department have an "aha!" moment where someone uttered a concept everyone agreed upon as genius?

Not exactly. Marketing communications involves careful research, planning, and execution to determine how best to cater a marketing communications program to a client's needs. It's a process, and it can be broken down into 10 steps that businesses ranging from the largest consumer products advertisers in the world to the smallest family company can follow to make the most of the marketing budget.

Step 1: What are your goals?

The first step is determining what you want your marketing communications to accomplish - and you'll need to think hard about how to quantify that success. Do you want to gain market share, increase sales, drive traffic to your store, enter a new market, change perceptions about your existing product or reinforce an existing perception?

Establishing your goals will set a course for the remaining nine steps.

Step 2: What's your current situation?



When you established goals, you decided where you want to be down the road. Your current situation is an honest (painfully honest, if necessary) assessment of where you are now. For example, are you a family business with a lot of competition? Or, is your product so new or specialized that there aren't many com-

petitors, and you need to "teach" potential customers how to use it?

Step 3: Research

We all want to believe we know our companies and markets inside and out, but fresh research can reveal things you hadn't thought about before. For example, are you quietly losing customers and prospects to a competitor, and you don't know why? Interviews with your existing customers, (and lost customers and prospects) as well as employees, can provide enlightening answers.

Step 4: SWOT Analysis

A SWOT Analysis examines your business's Strengths, Weaknesses, Opportunities, and Threats to help you size up your organization against the competition and determine where you should focus your marketing efforts.

Step 5: Product Description and Benefits

There's a key question you need to ask

yourself: what are you really selling? It may be less about the product or service you're offering and more about the by-product it offers (and that your customers value) such as convenience or cost savings. For example, you might be proud of the quality food you serve at your diner, but if your customers value quick service and low prices over a four-star meal, you'll know the kinds of benefits to tout in your advertisements.

Step 6: Target Audiences

Many businesses can define their target audiences in terms of demographics, such as "women between the ages of 25 and 54 who spend more than 45 minutes in their cars each day" or "all people over age 50 living within Hamilton County." Knowing your audience can help determine the images and words you use to communicate the advantages of your product or service and where any ads, radio spots, or direct mail campaigns need to go.

Step 7: Unique Selling Proposition

Your Unique Selling Proposition (USP) should help lure customers away from your competition by focusing on your strengths. To establish your USP, you'll need to describe in as few words as possible the most important thing about your product or service. For example, can you say, "We're the only company in the Cincinnati area installing shingles and siding guaranteed to survive hurricane-force winds with no damage?" Or, can you say, "Our restaurant will have

anything on the menu to your table in 15 minutes or less, or your meal is on us?"

Step 8: Brand Message

The concept of a brand message goes beyond the words and pictures used in a print ad, radio spot or television commercial. Consider an accounting firm, which might need to convey an image of being a buttoned-down, professional, traditional company that can be trusted to certify your financial records. But those accountants wouldn't want to say, "We're buttoned-down, professional traditionalists." Instead, that image can be conveyed in everything from colors, typeface, background music, and logos - all part of the brand message.

Step 9: Strategic Marketing Plan

Strategic Marketing Plans are the "blueprint" of your communications process. Regardless of the size of your company and its marketing budget, it always helps to outline your budget, what needs to be done, when it needs to happen, and who's doing it.

Step 10: Measure, Monitor and Revise

Even the most thorough plans need occasional revisions to keep them on track. Continually monitor the results of our plan, and, if necessary, make revisions to achieve your goals.

Follow those 10 steps, and you'll see how all the elements of your organization's marketing communications—including ads, brochures, Web sites and more—can work together to help you achieve your goals.

Be Sure to Watch Fifth Third Bank Hometown Business Weekly Sundays at 11am on WCPO.

Professionally Speaking, Continued from Page 1

management system are that it must honestly and accurately describe the beliefs and resultant actions of management. One of the earliest definitions of business strategy was coined by Kenneth Andrews, a Harvard professor. Andrews' strategy definition can be paraphrased as "the set of decisions that reveals the goals of the organization and how they intend to achieve them." The genius of this definition is that strategy is plain and simply the allocation of one's time, talent and resources. No matter how one represents the strategy of the organization, what matters is how the resources are really allocated. This may seem to be an obvious criteria, but like many other things in life, it can be painfully elusive to achieve.

For example, the owner of a firm may proclaim that product quality is

the highest goal of the organization, and that it trumps all other considerations. However, management actions may show to the employees that, when short term profitability is threatened by the cost of achieving quality standards, that profit is really the most important goal. Why is this important? It is important because unless the strategic management system allows for an honest assessment of the real goals and actions of the firm, it is impossible to truly understand if the stated strategy is actually being employed, and perhaps more importantly, if it is being successful or not.

Thus the first rule of a useful strategic management system is that it must allow for the truthful review of all "sacred cows," and the challenge of all previously stated beliefs. Nothing less can be considered helpful.

Business Anniversaries, Continued from Page 3

position the firm to celebrate its 50th anniversary and what advice would you give to others interested in sustained success?

A: My grandfather and dad established key traditions of quality, service and integrity that continue to contribute to our success today. Understanding what has led to previous success is important, but it is also critical to understand the changing marketplace and to implement a strategy that makes sense to the business in the long-term. The following is an example of a time where we decided to change one key philosophy of our business while maintaining another.

Shortly after I became managing partner, two factors threw the accounting industry into a state of flux. The labor pool was tightening significantly and accounting firms were beginning to provide financial services. We brought in an outside strategic planning consultant to help us better understand these issues and opportunities and to develop a strategic plan.

Based on the process we went through, it was clear to us that we needed to change our HR policies. While we had always paid

above market rates to attract and retain great people, we made a strategic decision to improve the working environment for our employees and to enhance the benefits we offered in order to better compete for human capital.

At the same time, it seemed like most of the industry was raving about the money they were making in financial services. Yet as we examined the issue, we realized two key factors. First, financial services were not a part of our core competencies. And second, a key source of clients was referrals from financial service professionals. Here, our strategic decision was to stay the course and to stay focused on our core competencies and not to compete with a key source of referrals.

My advice is to know what has contributed to your success, set and communicate rules regarding the employment of family members, hire and retain great people, take special care of your clients and continually market for new customers, and make sure that you continually evaluate your business on a strategic level and then share the strategic direction with your employees.