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The Journal of Wealth Management for Estate-Planning Professionals—Since 1904

Top 10 things owners should be considering now

By Leonard Leader, Daniel L. Daniels and David T. Leibell,
Partners in Wiggin and Dana LLP's Stamford, Conn. Office

Closely Held Businesses in Troubled Times

Large public companies have the luxury of in-house staff and large outside consulting, accounting and law firms. During this economic downturn, they've gotten loads of expensive, expert advice on how to manage risk and take advantage of opportunities to gain a competitive edge when the recovery inevitably arrives.

Closely held business owners are more alone and—busy putting out fires to stay solvent—can lose perspective.

So attention advisors! Help your smaller business-owning clients grab hold of the big picture. Walk them through this list of the top 10 things that closely held business owners should consider in these turbulent economic times:

(1) Be Opportunistic—Even in the face of current economic uncertainty, your company may be well positioned to make moves to capture market share and set the stage for strategic growth.

For example, your company may be poised to strike favorable deals with other companies through joint ventures and strategic partnerships. You also should consider opportunities for growth through acquisition. While acquisi-

tion financing from lenders and investors may be limited, that should soon change. If borrowing alternatives are limited and cash on hand is scarce, there also are other alternatives, including payment in the form of stock or other equity, contingent consideration (for example, earn-outs) and promissory notes or other deferred payment arrangements.

As with any recessionary period, this time will pass. Taking a pro-active approach through strategic partnerships and acquisitions can help your company build a solid foundation for future growth.

(2) Manage Expenses Intelligently—Cost-cutting measures have been a priority for almost all businesses during the economic downturn. Many companies are considering or already have engaged in layoffs, salary cuts and facility closures. These are difficult decisions that can have an impact on the bottom line and on cash flow. But, beware; cutting costs too aggressively now can make it difficult or impossible for the business to grow in the future. Here are a few suggestions for trimming:

- Negotiate better deals or “loyalty discounts” with your company’s long-time vendors.

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- Engage a consulting firm to renegotiate supplier contracts, but be sure the consulting firm's compensation is based solely on your company savings.
- To keep your cash in the bank, consider bartering arrangements with vendors.
- Solicit expense management suggestions from your employees and consultants--the people who are on the business' frontline and may have unique perspectives.
- Consider the costs and benefits of outsourcing some non-essential functions that may create unnecessary overhead costs.
- Do a complete review of all of the company's benefit plans, including medical, disability and life insurance, along with the business's property and casualty insurance coverage. Comparable coverage may be available for less cost.
- Downturns are a great time to renegotiate existing leases as well as to obtain new space at bargain prices.

(3) Stay Visible—In an economic downturn as severe as the current one, there is a tendency to cut advertising and marketing budgets rather than lay off employees or close operations. It seems a cost-effective and relatively painless way to ride out the storm. But previous downturns have proven that reducing visibility with existing and potential customers is far less effective in protecting the business than maintaining or increasing marketing and advertising budgets. Effective marketing and advertising keep you on the client's radar and keep your clients away from competitors. "Out of sight" in business is clearly out of mind.

The good news is that because of online media outlets like the Internet, email, and social networking, marketing and advertising don't have to be expensive to be effective. So spruce up your website, send out email blasts and if you don't know how to Twitter or communicate through

LinkedIn, find a young employee who does. Hiding your head in the sand may work for an ostrich, but it is a disaster for your business.

(4) Handle Any Workforce Reductions With Care—While you may already be operating and managing lean, this environment still may force you to implement a reduction in force (RIF). This decision never comes easily. Layoffs can destroy morale and leave a company in an uncompetitive position when the recovery occurs. There are alternatives to reducing personnel. Consider alternating work weeks/work hours, hiring and/or salary freezes (or salary reductions), job sharing, reducing or eliminating bonuses, canceling fringe benefits and identifying employees who would agree to retire early in exchange for attractive exit packages. If it becomes apparent that these alternatives are undesirable or insufficient to ensure economic needs are met, a RIF may be the only viable option.

If you need a RIF, do it carefully. RIFs are fraught with legal risks. You can help limit the risk of being sued by a departing employee by having the employee sign a release of claims in connection with any severance packages. But the release needs to be crafted carefully to comply with labor laws. Also, be sure to carefully plan and thoroughly document the process of selecting employees who'll be terminated, including drafting written business justifications for the

According to recent Standard & Poor's research, U.S. firms will face nearly \$800 billion in debt maturities through 2009 and the first quarter of 2010. As credit facilities expire, companies (both healthy and distressed) will need to consider refinancing their debt in an effort to continue meeting payment obligations.

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RIF itself and the criteria for selection of individual employees. It also should go without saying that everyone at the company should treat the departing employee with courtesy and respect and that you should comply with applicable laws regarding wages and related tax obligations.

(5) Communicate With Lenders—In a weak economy, many companies become unable to make required payments under their credit facilities, and others face financial covenant defaults under their loan agreements.

Obviously, today's lending climate is not as favorable to borrowers as it has been in recent years. Consider reaching out to your lender now to engage in a dialogue about your company's position so that it's no surprise later if you need a little help. Plus, you may have more leverage by taking action now to renegotiate new terms before your debt becomes due.

(6) Take a Look at Your 401(k) Plan Matching Contribution—These days, many employers are looking to the employee benefits area for cost savings opportunities. One of the most common targets is the company's 401(k) matching contribution.

Like most things in the employee benefits area, reducing or suspending the company match isn't as simple as it might seem.

First, any change to the matching contribution likely requires a plan amendment with formal approval by the company (unless your plan says any matching contribution is purely discretionary).

Second, if you have a safe harbor plan (a plan design that allows you to disregard certain nondiscrimination testing in exchange for a certain level of matching contributions), your company must comply with certain technical requirements, including providing employees at least 30 days written notice of the change, allowing them to change their contributions to the plan

during that period. And, prior to giving the notice, you need to amend the plan to provide that the applicable nondiscrimination tests will be satisfied for the entire year.

(7) Consider Equity-Linked Compensation—Although many companies are focused on reducing workforce levels, business owners shouldn't lose sight of the need to retain the best employees who might otherwise be poached by competitors. Equity-linked compensation is a time-honored golden handcuff for key employees. Often, this compensation comes in the form of stock options, restricted stock or phantom stock.

Existing option grants may be underwater to the point that they no longer provide much incentive and may even encourage employees to explore alternatives. The reduction in corporate valuations in the current environment can provide a compelling opportunity to grant new, fair market value stock options, at a lower exercise price. Such new grants may go a long way in keeping critical employees on board and motivated.

(8) Think About Shareholders Agreements—It's always true and less tolerable these days that the death, disability, retirement, divorce or personal bankruptcy of a major shareholder in a closely held business can create great upheaval and uncertainty that, if not handled properly, could lead to the unnecessary, premature liquidation of the business or sale to a third party at less than optimal value. Providing a mechanism for handling major shareholder transitions is crucial and a shareholder's agreement can help. Commonly called "buy-sell" agreements, these provide for the mandatory purchase (or right of first refusal) of a shareholder's (or, if applicable, a partner's or limited liability company member's) interest, either by the other shareholders or by the business itself, or some combination of the two, upon the occurrence of certain events described in the agreement. The agreement

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explains when the buy-out provisions apply and the mechanisms for determining who can purchase the shares, the sale price and how the purchase will be funded (typically life insurance or a promissory note).

(9) Don't Go It Alone—There is a tendency among closely held business owners to try to solve all of the problems associated with the economic downturn on their own, without seeking outside help. That works great for a John Wayne and Clint Eastwood western, but it's usually not the way to go in business. No single person has all of the answers and many entrepreneurs are better at dealing with economic growth than contraction. For both business and psychological reasons, it's crucial that a business owner reach out to family, employees, other business owners and independent advisors. Consider adding independent board members, creating an advisory board, and/or joining a family business organization. Taking advantage of all the wisdom out there increases the chances that your decisions will be effective.

(10) Protect Your Assets; Take Advantage of Low Values for Estate Transfers—No one ever wants to think about potential creditors and the inevitability of death. Now that times are tough, these issues probably feel like even less of a priority. Wrong. Now is exactly when you should be planning to insulate your non-business assets from claims relating to the business. Your lawyers should be talking to you about ensuring that the business is conducted through an entity, such as a corporation, limited liability company or limited partnership. In this way, if there's a lawsuit against the business, only the entity's assets will be exposed—not all of your assets. For protection purposes, it's also generally wise to segregate different business activities into separate business entities. But, of course, the first line of defense against any creditor claim involving the activity of the business should be adequate property and casualty insurance.

Planning to protect the owner's assets from claims unrelated to the business is more complicated. In general, what's needed is a broad spectrum of techniques including transfers to spouses and other family members or trusts for their benefit, as well as transfers to both domestic and offshore asset protection trusts.

In addition to potential creditor claims, one of the biggest potential drains on the assets of a business owner is a large estate tax at death. Without proper planning, federal and state inheritance taxes combined can result in the loss of as much as half of a business owner's estate. Now may seem like a particularly bad time to transfer assets out of your estate, setting money aside for your kids and charity. But it happens to be a particularly good moment, because you can transfer assets out of the estate now when they have a low value, in the expectation that any appreciation in value will occur outside the transfer tax system.

The economic storm seems to be easing on Wall Street. At least that's what's indicated by Ben Bernanke's testimony before Congress and Goldman Sachs's recent announcement predicting record bonuses for 2009. There's also been a spate of recent positive earning announcements from large public companies. But Bernanke and other economists are warning that storm clouds may hover over Main Street for some time to come. So, closely held business owners, the mainstay of America, need to stay vigilant, work hard—and be clever. In that way, they'll not only manage their way through the current economic turbulence, but also thrive in the post-debt bubble future.

— For their assistance with this article, the authors thank their firm colleagues, including corporate partners, Mark S. Kaduboski, Mike Grundei, William A. Perrone, Mary Gambardella and Sherry L. Dominick; plus corporate associate, David B. Schaffer.