

The Business Owner

The Balance Sheet

Accounting is a system for measuring the results of business "activities" and communicating them to interested parties. "Interested parties" are owners, managers, investors, creditors, regulatory bodies and taxing authorities. When the interested parties are internal, such as the managers of the business, there is great flexibility on how the reports may be prepared and presented. When the audience is made up of outside parties, such as creditors or regulatory bodies, rules and guidelines (generally referred to as GAAP) dictate how transactions should be recorded and what and how information should be reported. GAAP is an acronym for Generally Accepted Accounting Priniples.

The "activities" of a business can be categorized into three broad groups:

1. Financing Activities – How the business is funded, such as with equity and/or debt capital.
2. Investing Activities – How the money of the business is invested, such as in working capital (receivables and inventory), facilities, equipment, systems and tools.
3. Operating Activities – The process through which products or services are created and delivered to the customer, such as the purchase of raw materials, production, processing, delivery, billing and collection.

This article will focus on one common report type - the balance sheet - which is required under GAAP, is commonly requested by creditors and regulatory agencies, and is very useful for internal/managerial purposes.

The Balance Sheet: Statement of Financial Position

The balance sheet presents the financial condition of the business at a *single* point in time. The basic organization is the grouping of the firm's resources (assets) and claims on those resources (liabilities and owner's equity). The term "balance sheet" draws its name from the fact that it shows the following balance, or equality:

$$\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$$

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The Business Owner

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MAY / JUNE 2004

The Reference Source

for owners of
small and mid-size
businesses and
the professionals
who advise them
... since 1975.

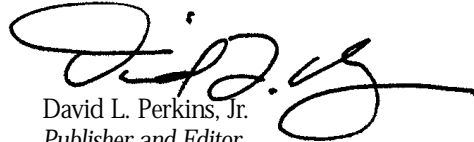
From The Editor

Gentlemen, start locking in those interest rates. Okay, ladies too. As the article on page ten suggests, interest rates have nowhere to go but up. As the economy remained moribund, there was little risk of a rise in rates. Now, the signs of the rebound are ... well ... abound. If you have adjustable rate debt, consider locking in a fixed rate very soon. An additional interest dollar spent doesn't add any value to your business.

Not without notice, tax season has passed! To commemorate, this issue contains no tax tips, articles or to-dos. In their place is more than the usual allotment of soft issue space – marketing, sales, leadership traits and family business. Relax and enjoy. If you just can't, tackle the articles on employee retention, the balance sheet or private placements.

Finally, the election season has begun to heat up. Begin taking time to express your interests to the local and national politicians that represent you. We all want tort reform, lower insurance costs and a simpler tax code. Our national government is also going to have to begin living within its means (i.e. a balanced budget). We can get these things if we all do our small part. Express your views and begin identifying the candidates that share your beliefs and values.

Sincerely,



David L. Perkins, Jr.
Publisher and Editor



David L. Perkins, Jr.

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ECONOMICS

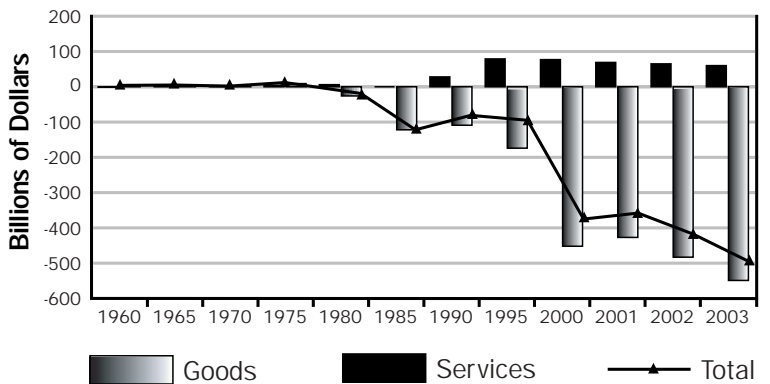
Econ Bits

Balance of Trade and Value of the Dollar

The accompanying two tables show macroeconomic data of interest and importance to all U.S. citizens. Owners of small and mid-size private businesses have a particular interest as they have a heightened need to understand basic economics, finance and related concepts that might impact their business, decisions, etc. Business owners are also natural leaders to whom others look for guidance on issues related to our shared U.S. citizenship and the future health and prosperity of our country.

Table #1 shows the historical U.S. balance of trade, which is simply the total dollar value of imported and exported U.S. goods, and the annual net difference or “balance”. Economics experts generally agree that a trade deficit, or the import of more goods than are exported, causes a “currency drain”. A currency drain means that more U.S. dollars flow overseas than foreign dollars flow into the U.S. Over time, foreigners will have an abundance of U.S. dollars and little of their own currency.

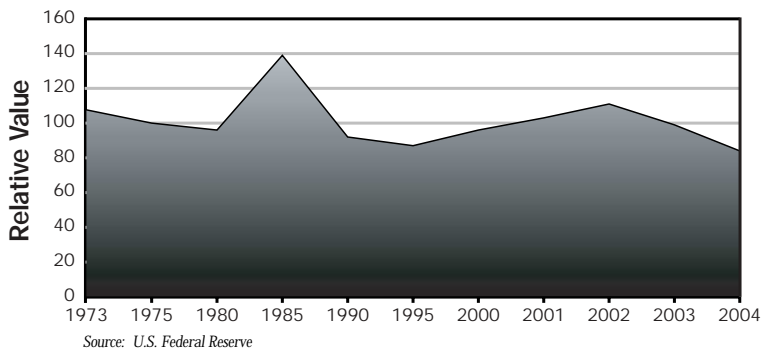
Table 1: U.S. International Balance of Trade



Source: U.S. Department of Commerce

A currency is just like any other commodity. When there is plenty, prices fall. As such, economists contend that our persistently negative trade balance will result in a declining value of the U.S. dollar. A lower U.S. dollar relative to other world currencies will mean that foreign goods and services will become more expensive to U.S. citizens and U.S. goods and services will become more affordable to foreigners. The result will be that foreigners will buy more U.S. goods, U.S. citizens will buy fewer foreign goods, and the U.S. trade deficit will shrink. The standard of living of U.S. citizens, relative to non-U.S. citizens, will also decline □.

Table 2: Value of U.S. Dollar



Source: U.S. Federal Reserve

Best Family Biz Experiences Revolve Around Family

Fifteen family business owners and I had crossed some very thorny territory as we sorted out family relationship issues that were affecting their business decision making.

Near the end of the seminar day, I asked each of them a question: "In your years of leading your family business, what's the most meaningful positive experience, the best moment, you've had?"

To nobody's surprise, hard-nosed Jack immediately put on a sour expression and stared up at the ceiling. Ron shrugged and looked around the group. It was Marsha who broke the ice.

"Well, as I've told all of you," she said, "my son and I are still trying to reach agreement on some operating principles for our company. When my husband died in an accident three years ago, leaving us to run the business, I was devastated and my son was just plain furious. He fumed for a few months and then announced he was quitting the business. I told him I couldn't carry on alone. He said maybe I should sell the whole thing." She sighed. "My husband always said the business would provide financial security for us and for our kids and grandkids if we managed it well. So I wanted to keep it running.

"But I didn't do such a good job. Just when I was about to give up, I got a phone call from my son. He said, 'Mom, I've been selfish and dumb. I was hurt and angry at Dad for dying like that and leaving us with all that responsibility. I know the business was important to him and to you. And it's important to me, too. I'm coming home, Mom.'

"My son and I still have some things to work out, but those four words – 'I'm coming home, Mom' – will always be warm in my memory."

Others in the room spoke up. One of them was Matt. "If you'd asked that question a year ago, I couldn't have thought of a

single thing that I'd call a positive family business experience," he said. "My father and I had been on one another's backs since the day I graduated from college and came to work there. I could never do anything to suit him, and to me he seemed like a dinosaur the way he ran the place. I thought he treated me like just another one of the employees, and I was ready to quit."

"What changed?" I asked.

"About six months ago," Matt said thoughtfully, "one of our biggest customers visited the plant. I expected my father to shuffle me off to the side. But he asked me to join him and the customer in the conference room. When I walked in, my father stood up and said, 'Mr. Robinson, let me introduce my son Matt, who'll be our next president.' I shook hands with Mr. Robinson and then spent the rest of the day trying to absorb what I'd heard. Both of us have behaved a lot differently since then. Up till now, that's been my best moment in the business."

"I'm sure there'll be more," I said. "OK, Jack. What about you?"



**James
W. Lea**

Jack's expression had softened, and he was staring down at his hands. "I don't like touchy-feely stuff," he growled. "I came here for straight answers to some tough questions. But listening to all of you talk, it's hit me that the business I took over from my father 20 years ago has been more than just a good job that nobody could fire me from."

He looked around the table. "You've all had to struggle through bad times, and you've learned to appreciate the other family members in your companies," he said. "But I've always just done things my own way and let the rest of them buzz off if they didn't like it. My best moment was buying a new boat with all the money I'd made."

Jack paused, then continued.

"But I just took my first good look at how much other people have contributed to my success, how much of a total family effort our company is. The business, the people who work there, my family who's in it with me, our future – they all mean something different to me now.

"Today has been my meaningful experience."

Ron shrugged a few more times, but the others nodded with Jack and thought their own thoughts. Sometimes the best and most meaningful moments in family business come when we least expect them and change us forever. □

© 2004 James W. Lea. James Lea is a professor at the University of North Carolina at Chapel Hill and a nationally known family business speaker, author, and advisor.

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Password for May 1 through June 30, 2004: **Interest**

Customer Satisfaction Does NOT Pay the Bills

The customer satisfaction movement began nearly 20 years ago with Tom Peter's classic book *In Search of Excellence*. This book spawned hundreds of copycat books, seminars, and millions of dollars spent on customer satisfaction campaigns. Despite all the money and effort, disciples of customer satisfaction don't see any more loyalty today than they did 20 years ago because customer satisfaction alone will not create customer loyalty.

Loyalty and satisfaction are two different things. Customer satisfaction is an opinion. The only activity associated with customer satisfaction is the completion of a survey.

Customer loyalty is an activity. Loyalty is the specific activity of your customers coming back to buy from you again and again. Customers vote with their pocketbooks. Many customers are totally satisfied with a product yet buy from someone else at the next opportunity. They are satisfied but they are not loyal. Satisfaction does not pay the bills unless it translates into loyalty.

Customer satisfaction is a worthwhile goal, but it won't automatically create loyalty. Businesses that want to create lasting customer loyalty must concentrate their efforts and instruct their front line employees on five principles.

The five principles that create lasting customer loyalty

1. **People do business with people.** Businesses look like they are made up of buildings, machines, products, services and supplies. But the heart and soul of every business is people. How you deal with people determines your success.
2. **Differentiation.** Differentiation distinguishes one business from another. If there is no difference between you and the competition, your customers have no reason to choose you. Still, just being different is meaningless. Differentiation only works when you differentiate with value that has meaning to your customer.
3. **Value and assurance.** A customer's specific tastes and preferences determine value. Every customer applies his or her own definition of value. If you know how to listen carefully, customers are always willing to tell you what they value.
4. **Effective communication.** Customers want straight talk. What you say to your customers and how you say it is critical in creating loyalty. Effective communication builds consensus and leads the customer. Effective communication involves listening, learning, and speaking.
5. **Focus.** Focus is the object of your current attention. If you are most interested in new customers, your attention will be focused there. If you are most interested in creating loyalty, your attention will be focused on existing customers.

Some people ask, "What's the big deal about customer loyalty.

Isn't a dollar from a new customer the same as a dollar from a repeat customer?" The answer is an emphatic "No." Repeat customers are predictable. Predictability allows you to staff, inventory and schedule with greater efficiency and productivity. Repeat customers also already know about your business. There is no cost to attract people that are already doing business with you.

Repeat customers are easier to do business with. You already know about them and they know about you.

These advantages mean profit to your business. The cost to attract, the lack of predictability and the difficulty in doing business with someone the first time consumes any profit you might have made. Your only source of profit is from loyal customers.

The five principles are working for you or against you all the time. Your business is prospering from the abundance or suffering from the lack of loyal customers right now. These principles are impacting your business whether you recognize them or not. □

Manzie R. Lawfer shows businesses and professionals how to get their customers to come back to buy from them again and again. He is the author of Why Customers Come Back (Career Press December 2003.) Contact: manzie@loyaltynow.com, www.loyaltynow.com.



**"A man's errors are his portals
of discovery."**

James Joyce

Getting Serious About Key Employee Retention

According to an old adage, "Most of us never recognize opportunity until it goes to work in our competitor's business." Both family and non-family business owners face the dilemma of how to retain the individuals that have been identified as key.

One way is to reward key employees for their loyalty with deferred compensation plans, sometimes referred to as "golden handcuffs". Here are three types of such plans.

Rabbi Trust. This is the name commonly given to an irrevocable trust set up for the future benefit of a key employee. Its special tax advantages were discovered when the IRS provided a letter ruling to a Synagogue that had set up a deferred compensation arrangement of this type for its Rabbi. One weakness to this option is that the assets in this type of

trust are subject to the claims of creditors of your business. As such, you might want to make some provision to protect the employee's interest in the event your business falls on hard times and the creditors attempt to attach to the Rabbi trust's assets. One way is to purchase an insurance policy that will cover any shortfall in the prescribed payments. This method has been sanctioned by the IRS as a method that does not sacrifice the attractive income deferral feature. Ask your accountant or tax attorney to obtain for you a copy of the IRS's model Rabbi Trust form.

Phantom Stock. Under this plan, a benchmark for the value of the company stock is established. If the value of the stock increases ... as determined by a pre-determined valuation method ... a portion of the increase is allocated to the key employee's deferred compensation account. The key employee will receive the amount in the deferred compensation account upon events such as the sale of the company, death, retirement, or after a specified period of time. One of the advantages, particularly in a family business, is that the employee need not be given an equity interest in the company. Instead, a "phantom" stock agreement can provide ownership-like incentives and benefits. Further, rises in the value of the company result in cash payments into an account for the employee rather than the employee's accumulation of minority, illiquid shares of the company stock.

Stock Options. The two types of stock options are Incentive Stock Options (ISOs) and Non-Qualified Stock Options (NQSOs). The key employee is given the right to purchase stock in the company at a certain price (Option Price). At exercise, the difference between the Option Price and the price or value at the date of exercise is called the Bargain Element. For NQSOs, the Bargain Element results in regular income tax consequences to the employee at the time of exercise. With ISOs, the Bargain Element is not subject to regular tax at the time of the exercise. However, there may be alternative minimum tax consequences. From a family business standpoint, there may be a concern about granting an equity stake to a non-family employee. One method to alleviate that concern is to limit the options to non-voting stock. This should not run afoul of the prohibition against two classes of stock for Sub S Corporations since a mere difference in voting rights does not create a second class of stock. □

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About the Publisher

David L. Perkins, Jr. owns, writes, edits and publishes *The Business Owner*, the newsletter of choice for over 25,000 business owner subscribers that are serious about building wealth through successful private business ownership.

Mr. Perkins draws editorial ideas and inspiration from his daily work as a merger and acquisitions consultant, where he has advised on over 100 purchase/sale transactions involving both private and public companies. His M&A consulting firm is Vercor, LLC, which he co-founded in 2001. Vercor has seven U.S. offices and five European affiliate offices. Vercor specializes in sell-side representation of businesses valued between \$2 million and \$75 million (see www.VercorAdvisor.com).

Mr. Perkins holds a Bachelor of Psychology degree from the University of Oklahoma and a Master in Business Administration degree from the University of Notre Dame. He has formal training in business valuation, is a Certified Business Intermediary, and is a licensed real estate broker. He also editorially pulls from prior experience in commercial real estate leasing and brokerage, commercial bank lending, and private company financial management.

David L. Perkins, Jr. is the author of *A Concise Overview of Business Valuation* and co-author of *The Business Sale, An Owner's Most Perilous Expedition*. Both may be purchased at www.TheBusinessOwner.com.

When time allows, Mr. Perkins will accept engagements to speak to groups of business owners on topics within his areas of expertise, including buying a business, selling a business, business valuation, strategic planning and financial self-assessment for the business owner.

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Your Marketing Mess Back To The ~~Drawing Board~~

age
Branding
Iron

Customers today have an overwhelming number of choices. How do they cope? They buy the familiar. More accurately, they buy the one they trust. Or, the one with whom they feel comfortable, fun, appreciated, etc. How do you make sure they choose you? Create awareness for your company, products and services. But that is not enough. You must get them to like you and trust you. How do you do this? It rarely occurs by chance.

No Pain, No Gain

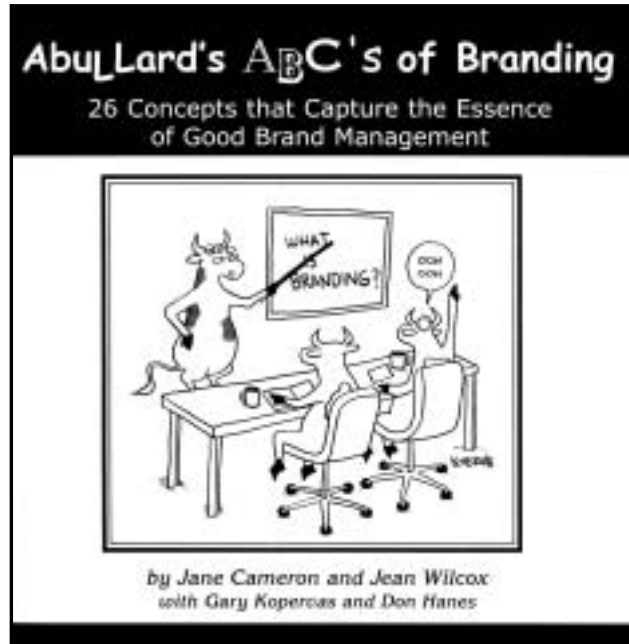
Sure, some companies develop a winning "brand" without knowledge of how it occurs. In the 1700's, one smart cattle rancher began branding (a distinctive mark burned on the hide) his cattle to identify them from others. Over time, people were willing to pay more for his cattle as they recognized them as being just a bit better. Whether they really were or not is not known, but it is likely that the rancher did have a strong vision and a commitment to quality that led him or her to try to set his product apart. The burned-on brand itself allowed people to identify his product over others. Branding was born in a way that the inventor never intended.

One Way or Another

Some companies today develop strong brands and achieve success without explicitly trying to do so. Typically, it is the natural result of an owner having a firm grasp on who he or she is and for what he or she stands. Further, the owner has a firm and passionate grasp on the ideals by which she will run her company, conduct business, develop products, etc. In fact, the reputation, image or "brand" of a small or midsize business is typically simply the qualities embodied by the owner or owners. Or, in another way, the company brand is simply the reputation, feel and trust that customers have for the owner himself or herself.

However, many of us were not blessed with a crystal clear "winning" vision and a natural instinct for effective marketing and branding. Luckily, the process has been studied and can now be learned and implemented. It is a process that begins with setting and creating the vision that every successful venture requires. A crystal clear vision for who you are, what you stand

for, and why customers will come to you rather than your competitors. Establish this vision clearly and answers to your "what to do" and "what to say" questions of your marketing, advertising and selling campaigns will more readily present themselves.



This article is the introductory article of a nine-part article series on branding called *The ABC's of Small Business Marketing*. Coverage will include the natural offshoots of branding: marketing, advertising and selling.

This issue: *Your Marketing Message: Back to the Drawing Board*

July-Aug '04 Issue: *Avoid Marketing Mayhem: Establishing Your Brand Vision*

Sept-Oct '04 Issue: *Logo and Look: Selecting the Visual Elements that Support Your Brand Vision*

Nov-Dec '04 Issue: *Tag Lines and Ad Copy: What You Say Should Support Your Brand Vision*

Jan-Feb '05 Issue: *Guided Missile*

Marketing: Selecting Mediums with Maximum Payload

Mar-April '05 Issue: *Marketing for Dummies? Build in Quality Control*

May-June '05 Issue: *Master Your Marketing: Monitoring and Feedback Enable Continuous Improvement*

July-Aug '05 Issue: *Creative Creatures: Working with Marketing, PR and Ad Professionals*

Sept-Oct '05 Issue: *Win the Marketing Game: Be Proactive or Perish*

Jean Wilcox and Jane Cameron contributed their expertise to this article and the article series. They are partners of CattleLogos Brand Management Systems, LLC and co-authored *Abullard's ABC's of Branding*. □

"Every act of creation is first an act of destruction."

Pablo Picasso

Raising Growth Capital via Private Placement

Growing a business requires capital. Often, when a business is initially formed, the only money contributed is personal funds of the founders and their friends and family. As a business becomes viable and its existence is more certain, bank lending becomes an option. Sometimes, however, the growth plans call for more money than these sources can and will provide. What are the options? Usually it's additional equity capital. This means either venture capital or a private placement.

Venture capital companies typically, by their nature, look for businesses that have the potential for explosive growth. They want to earn something in the neighborhood of 10x their investment in a few short years. If your business plan can't support such a claim, your option is the less glamorous private placement route.

What is a Private Placement?

A private placement is the sale of securities of a private company to private individuals or other entities to raise capital. Private placements are typically used by companies in conjunction with bank financing to fund certain projects and initiatives, such as expansion. The sale of any security in the U.S. is regulated to some degree. Raising capital through the public markets is regulated by the Securities and Exchange Acts of 1933 and 1934 (the Act). Most private placement transactions are exempt from the Act under Regulation D but may require a federal and state review of the prospectus that will be used by a company to raise private funds.

Here is a summary of a few common types of private placement transactions.

RULE 504 – Offerings Up to \$1 Million

Rule 504 of Regulation D provides an exemption from the registration requirements of federal securities law for some companies when they offer up to \$1 million of their securities in any 12-month period. The exemption generally does not allow companies to solicit or advertise their securities to the public, and purchasers receive "restricted securities" meaning they may not sell the securities without registration or an applicable exemption.

Rule 504 of Regulation D allows some companies to make a public offering of freely tradable securities if one of the following circumstances is met:

1. The company registers the offering exclusively in one or more states that require a publicly filed registration statement and delivery of a substantive disclosure document to investors;
2. The company registers and sells the offering in a state that requires registration and disclosure delivery; and also sells in a state without those requirements, so long as the

company delivers the disclosure documents required by the state where the company registered the offering to all purchasers (including those in the state that has no such requirements); or

3. The company sells exclusively according to state law exemptions that permit general solicitation and advertising, so long as the company sells only to "accredited investors."

RULE 505 – Offerings Up to \$5 Million

Rule 505 of Regulation D provides an exemption from federal securities law if the following circumstances are met:

1. The company can offer and sell up to \$5 million of its securities in any 12-month period.
2. The company may sell to an unlimited number of "accredited investors" and up to 35 other persons who do not need to satisfy the sophistication or wealth standards associated with other exemptions;
3. The company must inform purchasers that they are receiving "restricted securities", meaning that the securities cannot be sold for at least a year without registering them;
4. The company may not use general solicitation or advertising to sell the securities.
5. Financial statements need to be certified by a certified public accountant.

RULE 506 – Offerings of Unlimited Amounts

Rule 506 of Regulation D provides an exemption from federal securities law if all of the following circumstances are met:

1. The company sells its securities to "accredited investors" and up to 35 non-accredited investors so long as each are sophisticated and have knowledge and experience in business and financial matters that make them capable of assessing the merits and risks of the prospective investment.
2. The company must inform purchasers that they are receiving "restricted securities".
3. The company must provide non-accredited investors a disclosure document and provide any information that has been provided to "accredited investors."
4. Financial statements need to be certified by a certified public accountant.
5. The company may not use general solicitation or advertising to sell the securities.
6. The company must be available to answer questions by prospective purchasers.

continued on page 9

Raising Growth Capital via Private Placement, continued from page 8

The Private Placement Process

A well-planned and executed private placement should take less than 12 months to complete. The following illustrates the typical activities.

Month 1 – The “deal” is evaluated, including the financial statements, business plan, business model, etc. Feasible options are established given the opportunity and the current investment marketplace. A preliminary valuation and deal structure/offering is developed.

Month 2 – The deal structure and offering terms is agreed to and set. Offering documents are prepared and filed with appropriate regulatory agencies.

Months 3 through 12 – The opportunity is introduced to the marketplace, investors are courted and secured and the desired capital is raised (in a successful offering).

Accredited Investors

The above introduced the “Accredited Investor” classification, which is a distinction made amongst investors in securities law. An accredited investor is a person with a net worth of \$1.5 million or more, has had an annual income of \$200,000 or more in each of the two most recent years (\$300,000 jointly with a spouse), and has a reasonable expectation of reaching the same income level in the current year. Publicly-traded assets under management of \$750,000 must be in place at the time of accreditation or shortly thereafter. Accredited investors are required to complete a questionnaire to determine the knowledge, suitability and experience of the investor in evaluating the risks of the prospective investment.

Disclosure Requirements

A private placement transaction requires the issuer of the security to disclose information about the business and the transaction in an offering memorandum. The following list of disclosure items are typical:

- Description of the Offering
- Disclosures of Risk and Restriction
- Description of the Issuer
- Offering Period
- Offering Price
- Executive Summary
- Historical Financial Information
- Prospective Financial Information
- Use of Proceeds
- Dilution
- Management
- Professional Advisors
- Shareholder Liquidity

- Business Plan
- Suitability Questionnaire

Investments in Private Placements are Illiquid

A private placement investor must sign a letter stating that he intends to hold the stock for investment purposes only. The stock certificates must bear a legend indicating that the shares are restricted, usually for a period of at least one year. Because of these restrictions, the shares are considered illiquid.

Private Placements are Time Consuming, Complex and Expensive

Raising capital in the public marketplace is very expensive and is not a viable option for most private companies. Raising capital in the private marketplace is an option for many private companies, but it requires substantial work, expertise and a bit of up-front money. The total cost is typically 10 percent to 15 percent of the total proceeds raised.

Where to go for Help Raising Funds via a Private Placement


Securities law provides that an individual or business may raise money via private placement without the help of anyone (i.e. “do it yourself”). However, the rules are complex and it is advised that a knowledgeable specialist be used. This means that you hire a broker-dealer – a firm that is registered to sell securities. For more information about private placements call your business attorney, banker or financial advisor. Jeffrey J. Presogna, a registered investment advisor, performs private placements and provided the expertise for this article. He can be reached at (814) 455-3864. You can also go straight to the source and study the rules yourself by downloading Regulation D at www.sec.gov/divisions/corpfin/forms/regd.htm. □

**A CONCISE OVERVIEW
BUSINESS VALUATION
FOR BUSINESS OWNERS, MANAGERS, AND
THE PROFESSIONALS WHO ADVISE THEM**

Straight Talk that Will Help You:

- Value Any Business
- Read Income Statements and Balance Sheets
- Recognize Value “Drivers”
- Discuss and Understand Goodwill and “Blue-Sky”
- “Recast” Income Statements and Balance Sheets
- Understand and Deal with Minority and Control Positions
- Check Your Value Conclusion for Reasonableness
- Know the Difference between Individual Buyer, Financial Buyers and Synergistic Buyers
- Understand Types of Value, including:

- Fair Value	- Replacement Value	- Pay-Back Period
- Market Value	- Present Value	- Going Concern Value
- Book Value	- Future Value	- Fair Market Value
- Tangible Book Value	- Adjusted Value	- Liquidation Value



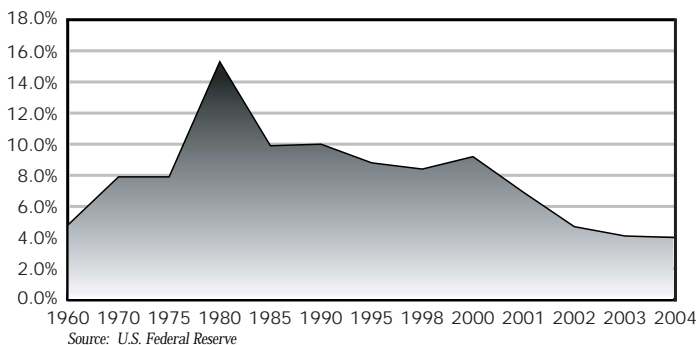
\$24⁹⁵

Written by David L. Perkins, Jr., of *The Business Owner*.
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Gentlemen: Start Locking in Your Interest Rates

Interest rates are at a historic low, as you can see in the accompanying chart. It is not easy to predict the future, but change is certain ... and if interest rates are going to change, the only way for them to go is up. So, you should consider protecting yourself and your business from the coming rise in interest rates.

Table 1: Historical U.S. Prime Rate of Interest



If you want more evidence that rates may be rising, listen to the comments being made by the chairman of The U.S. Federal Reserve, Alan Greenspan. The Federal Reserve sets interest rates. They are poised to raise rates and the chairman is telling us all to prepare. Why does he warn us? Because he wants order in the financial markets and in economy. He doesn't want the world to go into shock when the Fed makes a move.

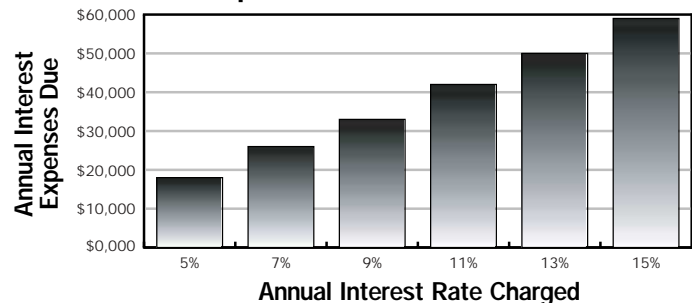
Here are some things to consider:

- 1. Convert Variable Rate Debt to Fixed:** If you have debt outstanding, consider locking in the lowest rate possible. This means if you currently have debt on which you pay a rate that changes as the prime rate changes, talk to your lender about re-booking the loan at a fixed rate. You will pay a slightly higher rate but you will be protected from future rises in interest rates. This will help you with budgeting as your payments will be constant throughout the term of the loan.

Credit card debt is variable rate debt ... usually at penalizingly high rates. You should always make great efforts to avoid credit card debt. If you carry a balance, talk to your local bank as to whether they can pay off your credit card(s) for you in exchange for a loan at more reasonable, fixed rates of interest.

- 2. Refinance Fixed Rate Debt:** If you have fixed rate debt at a rate that is two percentage points above the rate that you could today obtain by refinancing, look into it. The following table shows how the change in interest rates can affect the annual interest expenses paid on a loan. Over the life of a loan, the interest rate impact is even more

Table 2: How Rate Changes Affect Interest Expense



significant. For example, a two-percentage-point interest rate reduction on a \$100,000, 25-year mortgage saves \$39,000 over the life of the mortgage!

- 3. Pay Attention to the "Terms" of Debt Financing:** In evaluating loan options, there is more to consider than the interest rate. Up-front expenses such as "points," closing costs and even legal fees must be evaluated. When evaluating loans with varying terms, one must find a way to compare them. The method is to calculate the "effective rate of interest" as opposed to the stated rate of interest. The most common approach is to total up all the non-interest costs of the loan, divide the total by the number of months of the loan, and then add this monthly amount to the monthly loan payment. This yields your effective monthly loan payment from which you can calculate your effective interest rate.

A two-percentage-point interest rate reduction on a \$100,000, 25-year mortgage saves \$39,000 over the life of the mortgage!

If this is confusing, call your banker, financial advisor or math teacher-neighbor. There is also an "Effective Interest Rate Loan Calculator" in the members only section of the *The Business Owner* website (www.TheBusinessOwner.com). Enter the subscriber password, which is always located at the bottom of the left hand column of page four of each issue *The Business Owner*.

To illustrate, the following two tables display the effective rate calculations for various points paid on loans with five year and 25 year amortizations. One point is simply 1 percent of the loan value. So, for a \$100,000 loan, two points is \$2,000.

Comparing the two effective interest rate tables, one can see that up-front expenses have a far more substantial impact on short-term loans compared to long-term loans. When points are required to "buy down" an interest rate, doing so is far more

continued on page 11

Gentlemen: Start Locking in Your Interest Rates, continued from page 10

Effective Interest Rates for 5 Year Loan

Stated Interest Rate	Points Paid at Closing			
	One	Two	Three	Four
4%	4.44%	4.87%	5.30%	5.73%
5%	5.43%	5.86%	6.28%	6.71%
6%	6.42%	6.85%	7.27%	7.68%
7%	7.42%	7.83%	8.25%	8.66%
8%	8.41%	8.82%	9.23%	9.64%
9%	9.41%	9.81%	10.21%	10.61%
10%	10.40%	10.80%	11.20%	11.59%

Effective Interest Rates for 25 Year Mortgages

Stated Interest Rate	Points Paid at Closing			
	One	Two	Three	Four
4%	4.13%	4.25%	4.38%	4.50%
5%	5.12%	5.24%	5.36%	5.48%
6%	6.12%	6.23%	6.34%	6.46%
7%	7.11%	7.23%	7.33%	7.44%
8%	8.11%	8.21%	8.32%	8.42%
9%	9.10%	9.21%	9.31%	9.41%
10%	10.10%	10.20%	10.3%	10.40%

attractive when the loan term is long. Regardless, calculate effective rate on all your loans and you will be able to compare apples-to-apples. *Note:* A time value of money component has been used in the preparation of the above tables.

- 4. Pre-Payment Penalties:** Many loan terms include prepayment penalties. Calculating their affect can be tricky because they only cost money if you need to pay off the loan before its natural expiration date. This most often comes into play when interest rates fall and you wish to refinance. The chances of this happening to you on a loan you close today are slight, but you should consider this feature nonetheless. For simplicity, consider treating the prepayment penalty as if you were paying one point (i.e. one percent of the loan balance) and factor that into the effective rate calculation. □

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“Can anyone remember what our core business is?”

Check Before Signing or Renewing a Lease

Real estate is one of the largest expense categories for most businesses. It is also an area in which hard-earned money, sometimes a lot, can be wasted very quickly. When renewing or negotiating a lease, be sure to check out the following:

1. Landlord and other tenants, particularly tenants who manufacture products. *Reason:* Disturbances, hazards, chemicals, liability that could arise from proximity.
2. Economics of the local market including zoning requirements. If the market is soft, negotiate harder to obtain additional concessions.
3. Conservatively assess your present and projected needs. You don't want to be stuck leasing space that you don't need or that does not fully meet your needs. When in doubt, go with a shorter lease term.
4. *Rentable vs. Usable:* Usable space may be only 80% of rentable space because of hallways, elevators, bathrooms, etc. Consider this fact when analyzing your needs and costs. Be sure to actually measure the usable space and calculate the rent per usable square foot compared to alternative space options.
5. Use a standard lease form. *Advantages:* It's readily available and its clauses have been tested in the courts. Add to or delete from it with caution and with the advice of a lawyer who is experienced in real estate transactions.
6. Try to build into the lease an option to renew, expand, cancel, sublet and purchase. You always want as many options as you can get.

Editors Note: If you can include an option to purchase the building at a predetermined price or formula, get it. You never know what the market will do, and it might move in your favor as per the option terms. □

Coming Up in *The Business Owner*

Establishing Your Brand Vision	Marketing for Dummies? Build in Quality Control	<i>Creative Creatures:</i> Working with Marketing, PR and Ad Professionals
Business Value Drivers	Family Limited Partnerships	Alternative Dispute Resolution: Mediation and Arbitration
Independent Advisors – A Business Owner Essential	Health Insurance Options for the Small Business	Inventory Accounting Methods: LIFO, FIFO, Average Cost, etc.
Getting the Most Out of Your Accountant, Lawyer	Retirement Savings for the Owner of a Small Business	Marketing Mediums with Maximum Payload
Selecting the Visual Elements that Support Your Brand Vision	Small, Disadvantaged Business Status – Explained	
“Roll-Ups”	Taking Your Company Public: Dream or Reality?	

If you need to renew, or have any comments or questions, just call us at (800) 634-0605 or email info@TheBusinessOwner.com.

Lost the Sale by a Whisker

I was shaving this morning in my hotel room. I don't shave everyday; it's why I have a beard. I hate shaving. I don't even use a razor. I use an electric shaver. Always have.

I thought I did a pretty good job. When I finished, I happened to glance to the right of me and noticed that there was one of those close-up, make-up mirrors. It even had a little light. I flipped on the light and took a look. With the magnification, I could see that I had missed at least fifty whiskers. Rats.

How could I have done that? I JUST shaved. It looked just fine. The answer is, I didn't look close enough.

Immediately I thought, "what else am I not looking at close enough?" So I rushed to my computer to think about where else that I might be missing all kinds of stubbles. I found plenty. Maybe my list will help you discover overlooked places to shave costs and smooth out your sales presentations.



**Jeffrey
Gitomer**

1. **Take a closer look at the profit in your presentation. How much profit do you have for the prospect in your sales presentation?** Ever lose a sale by a whisker because someone underbid you? Perhaps if you had more value they would buy your profit rather than your price.
2. **Take a closer look at your testimonials.** How many do you use? How many should you use? What do they say? Do they overcome objections, or just pat you on the head? How compelling are they? Whom else should you have in your testimonial arsenal? When (how fast) can you get them?
3. **Take a closer look at how often you're in front of customers and prospects with something other than a sales message.** Examine all of the messages that you convey to your customers and put yourself in their shoes. Would you keep these messages or throw them away? Whatever you would do, that is what they are doing. What messages could you send that will help them?
4. **Take a closer look at your reorders.** Which customers are reordering from you and how often? How many customers did you lose last year? Last month? How much was that worth? How much would it cost for you to get them back? Why did you lose them? What have you done to correct why you lost them?
5. **Take a closer look at the basis of your customer's loyalty to you.** Is it based on relationship or price? If your biggest competitor came at your best customers with a 10 percent lower price, how many would still be loyal? What are you doing about it?
6. **Take a closer look at yourself.** What are you doing to make yourself a better person? A more effective person? What could you be doing? What is preventing you from doing it? What are three things you do to build your skills?

Shaving can hurt, huh?

Taking a close look at your critical success points is often as painful as it is revealing. The good news is that once you discover the whiskers you have the potential of cleaning up your act. All it takes is the desire to uncover them and the fortitude to do something about it.

The first step is *discovery*. Unless you see that whiskers are there, you'll be content to roll along in some form of oblivion until one day you wake up, look around at your lack of progress (or failure) and start looking for someone or something to blame. Anyone but you.

BUT, the truth is, all you have to do is look in the mirror to see the opportunities (and discover who is at fault). Once you see them, you have the best chance in the world for smooth sailing (or selling). □

Jeffrey Gitomer is author of The Sales Bible, and Customer Satisfaction is Worthless, Customer Loyalty is Priceless. He is President of Charlotte-based Buy Gitomer, gives seminars, runs annual sales meetings, and conducts Internet training programs on selling and customer service at www.trainone.com. He can be reached at salesman@gitomer.com © 2004 All Rights Reserved

Humility is the forerunner of success. Until we become humble in our own hearts we are not apt to profit greatly from the experiences and thoughts of others.

The Balance Sheet, continued from cover

As the above equation depicts, a firm's resources (assets) are always in balance with (equal to) the claims on the assets by creditors (liabilities) and owners (equity). In addition, as one can see in the accompanying Exhibit 1, the balance sheet also provides detail as to what *types* of assets are held by the business and from *where* the capital was obtained (trade creditors, lenders, equity providers, etc). Of paramount importance, however, is the *definition* of an asset, liability and equity; at what *value* should we record items that meet the definition of each; and how should they be recorded and *presented* on the balance sheet? Only when all balance sheets are prepared using the same rules and methodology can recipients compare one company against the other and glean useful and reliable information from each (assuming that the reader understands the rules and methodology as well).

The Basic Rules for Balance Sheet Preparation

Asset Recognition and Valuation: A firm may record on its balance sheet an asset when: a) it enters into a *transaction* with a third party, which b) gives rise to a *benefit*, that c) can be *valued* objectively and measured with a reasonable degree of precision. A *benefit* is something that has the ability to generate future cash inflows or reduce future cash outflows. The *value* for GAAP conforming statements is net present value when the asset is classified as current (see below), and is acquisition cost when the asset is classified as non-current. The benchmark for "objective" and "reasonable" is the value at which various randomly picked experts could agree. Usually it is assumed that the most conservative conclusion would result. This conservative standard is set based on the premise that when others look to a firm's financial statements to assess whether to enter into a transaction that exposes them to financial risk, a more conservative approach is merited.

Example 1: XYZ Corp. sells merchandise from their inventory for \$5,000 to be paid in cash in 30 days. A receivable of \$5,000 can be recorded as a current asset because a *transaction* gave rise to the *benefit* of receiving \$5,000.

Example 2: XYZ Corp. acquires equipment in exchange for a \$10,000 down payment plus the obligation to pay an additional \$90,000 over two years. XYZ may record the asset on its balance sheet at \$100,000. Inherent is the assumption that XYZ paid roughly what the assets are actually worth to XYZ. Looked at in another way, it is assumed that XYZ will conservatively receive at least \$100,000 of benefits from the equipment, over time.

Example 3: XYZ Corp. has been in business for 75 years and is well known and trusted in the marketplace. This market recognition and reputation is expected to provide XYZ with benefits in the future by way of higher sales and lower required marketing expenditures. This asset cannot be placed

on the balance sheet, however, in that no identifiable transaction gave rise to the benefit and it would be very difficult for persons to agree on a method for quantifying the future benefit.

Note: In preparing informative reports for managers or owners of a business, or those that are meant to supplement GAAP conforming financial statements ... assets and liabilities may be reported and valued on a balance sheet using any method deemed valuable or informative by its creators. Alternatives to GAAP conforming asset valuation methods include:

- Current Replacement Cost
- Current Net Realizable Value
- Present Value of Future Cash Flows

Asset Classification: After the assets that qualify for inclusion on the balance sheet have been identified and valued, accounting standards call for them to be listed or grouped by class. In other words, assets with similar characteristics should be grouped together.

Only when all balance sheets are prepared using the same rules and methodology can recipients compare one company against the other and glean useful and reliable information from each.

Current Assets: Assets expected to "turn into cash" or be sold or consumed during the normal operating cycle of the business are referred to as "current assets." The normal operating cycle of a business is the time that it takes for the business to turn cash into sellable goods or services, which are then sold and turned back into cash. For simplicity, it is generally accepted to assume that the business operating cycle is one year, so that any asset that is expected to be "turned into cash" within a year is listed as current. Notice the various types of current assets grouped together in Exhibit 1. Common current assets include cash, receivables, inventory, and prepaid expenses such as payroll and taxes, etc.

Investments: Equity ownership in other businesses – generally ownership interests of less than 50 percent of the total equity of the business (i.e. minority positions in other business ventures) – are recorded as an asset on the balance sheet at the amount that was invested.

Property, Plant and Equipment: Tangible assets not expected to be sold for cash within a year (not held for resale, such as inventory) and used in a firm's operations are placed on the balance sheet as property, plant and equipment.

Intangible Assets: Items such as patents, trademarks, franchises and goodwill are intangible assets. Expenditures made by a firm to develop intangible assets are not usually recognized as assets due to the difficulty of ascertaining the existence of future benefits. As such, only identifiable intangible assets acquired in transactions with third parties, such as a patent acquired from another business, are recognized as assets ... typically at the acquisition price.

continued on page 14

The Balance Sheet, continued from page 13

Liability Recognition and Valuation: A liability arises when a firm receives benefits and in-exchange promises to pay the provider through cash, goods or services, a reasonably definite amount at a reasonably definite date. If the liability is to be discharged via payments of cash within one year, the obligation is recorded as the sum of the payments to be made. If the payment dates extend longer than one year, the liability is recorded at the present value of the future payments.

If the liability is an obligation to deliver a service, such as the delivery of fabricated equipment, the liability is recorded when the transaction takes place that gives rise to the certain obligation. The price at which the liability is recorded is the price paid by the customer. Once the obligation is fulfilled, such as the satisfactory delivery of the equipment, then the liability is removed from the balance sheet and the revenue is recorded by the business.

Example 1: XYZ Corp. purchases merchandise from a supplier in exchange for a promise to pay \$8,000 in 30 days. The \$8,000 is recorded as a liability (current account payable).

Example 2: XYZ Corp. borrowed \$500,000 from a bank to purchase a building. The \$500,000 is recorded as a liability because XYZ received the benefit and is now obligated to repay the \$500,000 on a payment schedule stipulated in a promissory note (note). The portion of the note that is due within a year is recorded as a current liability (i.e. note payable – current portion). The amounts due to be paid on dates more than a year from now are recorded as a long-term liability (note payable – long term portion).

Example 3: XYZ Corp. provides a five-year warranty on its products. Past experience allows XYZ to estimate with reasonable accuracy the warranty expense it will bear, on average, on each unit that is sold. As such, with each sale of the \$10,000 product, a \$1,000 liability obligation is recorded and reduced as warranty services are rendered and sold units pass the

warranty date.

Example 4: XYZ recently discovered that the warehouse that it has rented and used for 20 years sits over groundwater that has been found to be contaminated. XYZ's attorney has informed XYZ management that a lawsuit has been filed against the owner of the property and that XYZ will likely be named as well. Legal defense costs will almost certainly be required and, if XYZ is found to be responsible in whole or in part, the cost for clean up could be substantial. This event does not yet merit recording of a liability on the balance sheet, however, because the costs are at this time too difficult to estimate.

Liability Classification: After the liabilities that qualify for inclusion on the balance sheet have been identified and valued, accounting standards call for them to be listed or grouped by class. In

other words, liabilities with similar characteristics should be grouped together.

Current Liabilities: Obligations expected to be paid or discharged within one year. Common current liabilities are obligations to suppliers, employees and lenders.

Long-Term Debt: Obligations having due dates or maturities of more than one year are generally classified as long-term debt. See the accompanying Exhibit 1. Bond, mortgage and bank borrowings are common types of long-term debt.

Other Long Term Liabilities: Obligations not properly considered current or long-term debt are classified as "other long-term liabilities". Included are items such as deferred income taxes and deferred compensation obligations.

continued on page 15

Exhibit 1

**XYZ Company
Comparative Balance Sheets for December 31**

ASSETS	2002	%	2003	%
Cash	\$30,000	8%	\$5,000	1%
Accounts Receivable	\$85,000	23%	\$95,000	25%
Inventory	\$75,000	20%	\$90,000	24%
Other Current Assets	\$5,000	1%	\$15,000	4%
<i>Total Current Assets</i>	<u>\$195,000</u>	53%	<u>\$205,000</u>	55%
Investments	\$50,000		\$50,000	
Buildings and Equipment (cost)	\$200,000	54%	\$200,000	53%
Accumulated Depreciation	(\$75,000)	-20%	(\$80,000)	-21%
<i>Total Non-Current Assets</i>	<u>\$175,000</u>	47%	<u>\$170,000</u>	45%
TOTAL ASSETS	<u>\$370,000</u>	100%	<u>\$375,000</u>	100%
LIABILITIES AND EQUITY				
Trade Payables	\$20,000	5%	\$25,000	7%
Salaries Payable	\$10,000	3%	\$11,000	3%
Other Payables	\$5,000	1%	\$5,000	1%
Line of Credit	\$50,000	14%	\$50,000	13%
Current Portion of Long-Term Debt	\$10,000	3%	\$10,000	3%
<i>Total Current Liabilities</i>	<u>\$95,000</u>	26%	<u>\$101,000</u>	27%
Interest Bearing Debt (Long Term Portion)	\$120,000	32%	\$110,000	29%
Deferred Compensation Agreement	\$10,000	3%	\$15,000	4%
<i>Total Liabilities</i>	<u>\$225,000</u>	61%	<u>\$226,000</u>	60%
Paid-In Capital	\$50,000	14%	\$50,000	13%
Retaining Earnings	\$95,000	26%	\$99,000	26%
<i>Total Owner's Equity</i>	<u>\$145,000</u>	39%	<u>\$149,000</u>	40%
TOTAL LIABILITIES AND EQUITY	<u>\$370,000</u>	100%	<u>\$375,000</u>	100%

Five Traits of Effective Leaders

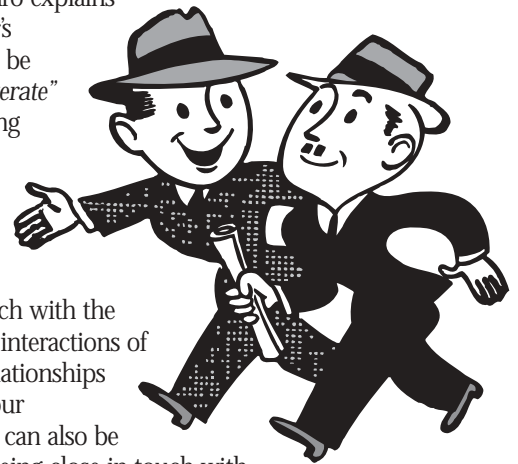
Are leaders born or made? Sure, the nature-nurture argument has been debated for centuries and is an interesting one. However, nobody doubts that humans have an incredible capability to learn, adapt and change. Further, study after study has shown that effective leaders seem to have things in common. More specifically, they do some similar things. They share behaviors or actions that can be considered "effective" in building and growing a successful business. According to Dr. Jay Kent-Ferraro, these things can be grouped into five simple categories:

- **Help Others Feel Valued:** *Identify* particular skill, ability and aptitude in your employees. *Look* for ways that an employee's uniqueness can be applied productively. *Invite* employees to find ways to develop, utilize and expand their aptitudes. *Acknowledge* employees for positive contributions to the culture and bottom-line.
- **Set and Promote Internalization of a Clear Company Vision, Culture and Brand:** The owner must clearly know what it is for which his or her company stands, what is the vision and culture. Then, the owner/leader must find ways for employees to learn about, talk about and put into practice the values and vision. He or she must help the employees internalize these things so that they become a part of it and carry it out themselves.
- **Enroll Employees Into WIIFM:** *Get buy-in* from employees by helping them see the benefits that they will personally receive by helping the company establish and strengthen its particular culture, carry out its vision and reach its goals. Employees must be able to clearly answer the ever-important question of "What's In It For Me?"
- **Admit Your Mistakes:** *Let* your humanity show occasionally by *communicating* not just your successes but also your failures. This allows your employees to feel safe to share their own errors and fears giving you access to "teaching moments" for *them* and valuable information about the company.



- **Stay Close to the Action:** Stay visible, accessible and interact with your employees. Open door policies support this. Join them on sales calls. Walk the floor. Visit other worksites. All of these things provide you with insights into your company and provide opportunities to motivate your people.

Dr. Kent-Ferraro explains that the leader's challenge is to be "emotionally literate" while remaining "tactically focused". Emotional literacy is being "tuned in" and in-touch with the emotions and interactions of people and relationships throughout your business. This can also be described as being close in touch with the *culture*. Tactically focused has to do with using that information to improve the degree to which the personnel are in touch with and aligned with the goals, objectives and vision of the business. □



Dr. Jay Kent-Ferraro consults in organizational effectiveness, provides performance-based training, "coaches" business owners and leaders and is a speaker and author. For those that wish to learn more about effective leadership he recommends three books: Executive EQ (1996) R. Cooper & A. Sawaf; The Emotionally Intelligent (2001) C. Cherniss & D. Goleman, and The Effective Executive (2002) P. Drucker. Dr. Kent-Ferraro can be reached at www.drjayferraro.com.

ACCOUNTING / FINANCE

The Balance Sheet, continued from page 14

Owner's Equity Valuation

The owner's equity of a firm is a residual interest, meaning the owners have a claim on all assets not required to meet the claims of creditors. Creditors are persons or entities to which the firm is obligated to make payments or provide services (and, as such, are recorded on the balance sheet as liabilities).

The assets and liabilities recorded on the balance sheet, therefore, determines the valuation of the owner's equity. This can be seen by viewing the basic balance sheet formula at the beginning of this article. The value of the equity is simply what is left over of the assets after the debt is repaid.

Owner's Equity Classification: Generally, businesses will separate the equity section of the balance sheet into two distinct categories:

- A. The capital contributed by the equity holders.
- B. The earnings or profits earned by the company.

See Exhibit 1 for an example. □

Family Business Facts

The greatest part of America's wealth lies with family-owned businesses. Family firms comprise 80 to 90% of all business enterprises in North America. (J.H. Astrachan and M.C. Shanker, Family Business Review, Summer 1996).

Family owned businesses account for more than two-thirds of all businesses in the world and are becoming more, not less, prevalent. (Harvard Business School Executive Education Brochure, 2001)

The leadership of 39% of family-owned businesses will change hands in the next five years. (Arthur Andersen/MassMutual American Family Business Survey, 2003).

Of CEOs due to retire within 5 years aged 61 or older, 55% have not yet chosen their replacement. (Arthur Andersen/MassMutual, 2003)

Post-World War II entrepreneurs, who created the world's greatest wealth, have reached an age when they must decide how to pass on the wealth secured primarily in their family businesses. (Joseph Astrachan, Ph.D., editor, Family Business Review, June 2001)

Inadequate estate planning and failure to properly prepare and provide for the transition to the next generation, coupled with lack of funds to pay estate taxes, were among the three leading causes for the failure of family owned businesses. In 47.7%, the transition and ultimate collapse of the firm was precipitated by the founder's death. (Survey of 800 family-owned businesses, University of Connecticut Family Business Program website – [www.sba.uconn.edu/Family Business](http://www.sba.uconn.edu/Family_Business))

19% of family business participants have not completed any estate planning other than writing a will; only 37% have a written strategic plan, and over 60% are very positive about their company's future. (Arthur Andersen/MassMutual, 2003)

The average life span of the FOB is 24 years. (Ernest Doud, Sr., "Unraveling the Mysteries of Family Owned Business," published on the USC Family Business Program website [www.marshall.usc.edu/entrepreneur/family business](http://www.marshall.usc.edu/entrepreneur/family_business))

37% of Fortune 500 companies are family owned; 60% of all public companies in the US are family controlled. ("Trust as a Competitive Advantage," The Graziadio Report, Spring 2001)

Of primary importance among family firm wealth holders is transferring not only their financial wealth but also the values surrounding their wealth, to subsequent generations. Primary values taught include encouraging children to earn their own money, philanthropy, charitable giving and volunteering. (Wealth with Responsibility Study/2000, Bankers Trust Private Banking, Deutsche Bank Group) □

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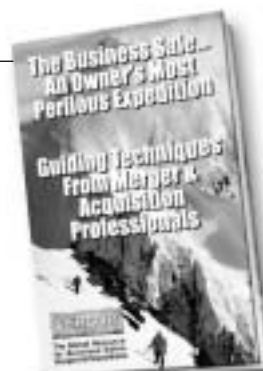
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