BUSINESS PERFORMANCE ADVANTAGE

Nov/Dec 2003

2003 Tax Law- Tax Cut
Phone Customers Celebrate New Choices
Golden Handcuffs
Performance Meaurement at Work
Managing Cash Flow

CFO Plus LLC
Partners In Growth

Our mission is to provide information and strategies to business owners and managers for improvement in the effectiveness of its business management so that key objectives can be realized.

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2003 Tax Law Gives Small Businesses and Families a Big Boost

You may have heard about recent changes in the tax law. And, unlike previous tax law changes, the 2003 changes offer something for everyone. The new tax package includes a mix of tax cuts and credits, instant rebates and relief provisions that may surprise you. Signed into law on May 28, 2003, by President Bush, the "Jobs and Growth Tax Relief Reconciliation Act of 2003" calls for the third largest tax reduction in United States history. As such, this law provides substantial tax savings for both businesses and individuals.

No new taxes – try out the new tax cuts instead. Believe it or not, the new law collapses time for tax cuts originally scheduled to occur in phases until 2006. If you were in the 38.6% tax bracket in 2002, for example, your 2003 rate will be only 35%. On the other end of the scale, income ceilings for the 10% and 15% tax brackets have been raised. In all, most Americans have gained an increase in their take-home pay. Small businesses, however, may be getting the best deal of all.

A big boost for small business. The new tax law was designed, in large part, to stimulate small business growth. To this end, the Section 179 Expense Deduction was liberally increased from $25,000 to $100,000 for listed business property purchased after May 5, 2003. In other words, small businesses can now write off $100,000 in equipment expenses. Qualifying business property generally includes, but is not limited to automobiles, pickup trucks, photographic and phonographic equipment, communications equipment, computers and peripheral equipment, and office furniture and fixtures. In addition to this, business owners may take 50% "bonus depreciation" in the first year for qualifying equipment. This is up from 30%.

Both Section 179 deductions and the bonus depreciation provision may be combined to generate significant tax savings for most any small business. These added allowances, however, will expire over the next two or three years unless further action is taken by Congress. So, it may well be in the best interest of your business to strategize accordingly in order to take full advantage of these incentives while they are available. Section 179 applies to both new and used assets while the bonus depreciation applies only to new assets, so you may want to explore the possibility of expensing purchases of used assets while depreciating new assets.

In addition to reduced marginal top tax rates, small businesses may also benefit from the substantial reduction of the top tax rates for dividends and capital gains. Beginning January 1, 2003, these top rates were reduced from 38.6% to 15% on dividends and from 20% to 15% on long term capital gains. On an individual basis, it will prove beneficial to most stakeholders of dividend paying corporations, as well as investors, who have substantial, locked-in capital gains. It is important to note, however, that dividends and capital gains will now be treated equally. Previously, dividends were taxed as regular income and portions of capital gains were deductible. As a result, some investors may wish to adjust their strategies to take advantage of the new provisions.

On the home front. In addition to the previously mentioned tax cuts, the new tax law may help some couples book their second honeymoon – at least those couples filing jointly. The act increases the standard deduction for married couples to double the amount for those filing single. If this is not enough, the Child Tax Credit will increase from $600 to $1000 per qualifying child under the age of 17. Remember, a tax credit reduces your tax dollar for dollar where a deduction reduces the amount of your income subject to taxes. This means you may be eligible for a rebate of up to $400 per child. These two features of the new tax law are also scheduled to expire, or revert to a lesser amount, at the end of next year, but should provide significant savings during 2003 and 2004.

The "Jobs and Growth Tax Relief Reconciliation Act of 2003" has something for almost everyone. It will affect individuals differently depending on their income level and family situation. The new tax law gives a big boost to small business by encouraging spending. To develop a sound strategy to take advantage of all the benefits the new tax law has for you, give us a call today.

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Golden Handcuffs – New Executive Perks On the Rise

You have inevitably heard of them by name. They were legends in their own time – the golden barons of corporate America. Their names are Kenneth Lay, Bernard Ebbers and Jack Welch – the former CEO's of Enron, WorldCom, and General Electric respectively. These three sovereigns of Wall Street were so highly regarded by their respective enterprises that they seemed irreplaceable. o, what exactly could the stakeholders do to keep these golden barons in place? Offer them more gold, of course! How about a pair of golden handcuffs?

Wondering what golden handcuffs are? It will not surprise you to learn that the term "golden handcuffs" is yet another buzz word from corporate America. It refers to supplementary executive perks that are structured to attract and keep top performers and other key personnel. Stock options, deferred compensation and low interest loans are examples of some of the perks that have served as golden handcuffs. However, these perks are only effective as golden handcuffs if they contain forfeiture provisions that require continued employment and/or include non-compete agreements.

How were golden handcuffs applied to the three golden barons? Kenneth Lay was clandestinely awarded a 7.5 million dollar line of credit that could be repaid with stock that Enron had given him. He built a 'house-of-cards' and it imploded! Bernard Ebbers mysteriously received more than $400 million in personal loans, with very soft repayment terms. WorldCom has since filed for the world's largest bankruptcy! General Electric secretly spent $15 million on a penthouse for Jack Welch. He had to give it back! After these incidents, and others, the Sarbanes-Oxley Act of 2002 was introduced.

The Sarbanes-Oxley Act of 2002 was enacted following several corporate scandals similar to the three portrayed above. This law makes it incumbent on corporate America to establish a system of corporate governance and internal controls based on the highest ethical principles and standards. Among its many provisions, it specifically requires detailed disclosures of off-balance-sheet transactions and bans company loans to officers and directors. This law, in effect, put a stop to a growing corporate trend of ever-richer executive benefits packages whose costs were not disclosed to shareholders. Corporate America still uses the golden handcuff principle, with full shareholder disclosure, to attract and keep top performers and other key personnel.

Most companies now take a proactive approach in the use of golden handcuffs to retain their most talented personnel. The practice of offering cash bonuses or similar perks based on meeting certain performance standards can be effective; however, once these awards are granted, they have no lasting value when it comes to ensuring the individual's continued performance, loyalty and/or stability. The golden handcuff approach provides added incentive for the individual to stick-around. These perks may come in the form of a retention bonus that is cleverly coupled with a repayment and non-compete agreement. If the individual leaves, the company then has the right to partial or even full repayment. In some cases, retention bonuses are used to provide the employee with cash for a home mortgage down payment. These agreements usually provide the company with the right to place lien on the individual's personal residence. Probably the most effective golden handcuffs are those that provide the individual with some form of equity in the business.

"Equity is the bonus that keeps on giving," according to Paul Lemberg of the Stratamax Research Institute. "The value of equity compensation is likely to increase over time, often considerably. Equity acknowledges your employee's past contribution, but the real payoff is for work still to be done – and your people have to stay around to reap the rewards. In real

Golden Handcuffs – New Executive Perks On the Rise (cont.)

terms, the current cost of equity compensation is cheap, especially relative to the loyalty it can purchase. Plus, since no cash changes hands at the time of the equity bonus, you can use it as a reward even if your company is cash-strapped." Equity compensation might include outright stock grants, non-qualified stock options or phantom stock. Such equity grants will not be effective as golden handcuffs unless they are coupled with a defined vesting period.

In today's economy, successful companies need to offer ample perks and benefits to attract and retain top-notch executives and employees. These perks need to be tied to the company's future performance in order to assure that key personnel will stay-the-course to reap the long term payback. Benefits tied to equity in the company appear to be most effective golden handcuffs available. To learn more about establishing employee incentives and managing peak performance, call us today.

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Managing Cash Flow – A Key Ingredient for Business Success

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Cash flow has often been characterized as the "life-blood" of any business. The reason is quite simple. Any business, no matter how large or small, that fails to properly manage cash flow is doomed for failure. By simple definition, cash flow is the number of dollars collected verses the number of dollars paid out over a given time period. A negative cash flow means more dollars were paid out than were taken in. If this continues over a long period of time, the business may find itself in bankruptcy. Many profitable businesses, including some with enviable sales growth rates, have found themselves on the brink of disaster because cash flow was not being properly managed. Many methods have been used to manage cash flow. Three methods, in particular, have condensed the cash conversion cycle in many businesses, or the time required for a dollar spent to be returned. These three methods include placing controls on spending, accelerating receipts and maintaining lean inventories.

To gain a better understanding of cash flow management, it is important to first understand the difference between cash flow and profitability. Cash flow is not only concerned with the movement of dollars in and out of a business, but more importantly, the timing of that movement. Profitability, on the other hand, is a measure of the surplus (or shortage) of dollars remaining after all obligations have been met for the reporting period. It is possible, and not uncommon, for a profitable business to experience a critical short-term cash flow deficiency.

Suppose a business purchases the raw materials in January to manufacture a product that will be sold during the following Christmas season. In this case, a significant dollar outflow might occur in the first quarter with little or no dollar inflow expected until the fourth quarter. If the business does not adequately plan around its seasonal sales cycle, the routine expenses that occur during the second and third quarters could create the need to borrow operating capital just to survive until Christmas sales begin. Borrowed capital then creates additional interest expense that ultimately serves to reduce profitability. This cycle might be repeated year after year, exposing the business to a declining profit margin and eventual bankruptcy. To avoid this trap, a business must forecast, budget, analyze and proactively manage its cash flow on an ongoing basis.

Spending Controls. Cash conservation must start with the spending habits of the business. Businesses generally require cash for wages, equipment, raw materials, office furnishings and fixtures, rent, taxes, utilities and more. Many of these costs are fixed and little can be done to reduce them. Discretionary items, on the other hand, may provide a fertile field for conserving cash. Fancy offices and luxury automobiles may say something about management's style, but do they help the business stay afloat during hard times? How about new equipment? Leasing new equipment may make more sense than purchasing it. Lease payments not only conserve cash on-hand, but they are tax deductible. And, what about outsourcing? It may be more efficient to outsource certain jobs than supporting the overhead associated with a full time employee.

Accounts payable could be the most important area of all for proactively managing cash conservation. Discounts for prompt payment can be rewarding. For example, a 2% discount for paying a bill within ten days may be better than earning double digit interest on the balance due for the next month. It is also important to negotiate better purchase terms. Many suppliers will agree to defer billing or extend no-interest loans to make the sale. Controlled spending is only a part of managing cash flow, accelerating cash receipts is another.

Managing Cash Flow – A Key Ingredient for Business Success (cont.)

Accelerating Cash Receipts. Accounts receivable represents sales that have not been converted into cash. The longer it takes to collect these amounts, the more detrimental the effect on cash flow. Early payment discounts may expedite the receipt of cash, but at what cost? The simplest way to improve cash flow would be to require cash-on-delivery. This requirement also has a downside. Some companies facing this dilemma have reverted to selling accounts receivable to a third-party on a discounted basis. This is known in financial circles as "factoring." Again, this is not without cost. The answer to managing this facet of the cash flow equation may best be resolved by the establishment of a corporate credit policy that serves as a guide for extending customer credit. The credit policy essentially sets the terms and conditions based on the individual customer's credit history. The final piece of the equation for cash flow management lies in inventory control.

Inventory Controls. Inventory describes the extra materials and/or products that are on-hand for future use. Excessive inventories of raw materials or finished products can be detrimental when it comes to managing cash flow. The dollars tied up in this inventory are not capable of earning interest and they are not available for other business use. So, determining the minimum acceptable inventory level and maintaining it, is an absolute must for responsible cash flow management. With the advent of computerized technology and automated warehousing, many progressive businesses have adopted an inventory control system known as "just-in-time inventory." This system basically coordinates the upstream logistics of moving the required materials or products to the right place at the right time, just as they are needed. Needless to say, cash flow management has a real friend in "just-in-time inventory."

Cash Conversion Cycle. The business of managing cash flow may be condensed into a fairly simple empirical equation known as the "cash conversion cycle" or CCC for short. Using the metrics of days, the cash conversion cycle equation may be stated as follows:

$$\text{CCC}_{\text{days}} = \text{sales outstanding}_{\text{days}} + \text{sales in inventory}_{\text{days}} - \text{payables outstanding}_{\text{days}}$$

This equation allows a business to actually grade itself, with a real number, on its overall effectiveness at managing cash flow. For example, your business has the equivalent of 45 days of sales in accounts receivable, 20 days in inventory and 30 days in accounts payable, its cash conversion cycle would be a very acceptable 35 days. To phrase it another way, a dollar spent today would theoretically be returned in 35 days.

Managing cash flow is one the key ingredients for success in any business. Proper forecasting, combined with the implementation of spending controls, accelerating cash receipts and monitoring inventory may be the recipe for success. We have a great deal of experience in this area, and can work with you to maximize cash flow. Give us a call today.

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Phone Customers Celebrate New Choices

On November 24, 2003, consumers celebrated their choice to be able to take their current cell phone number with them when switching cell phone providers, and to transfer their home phone number to their cell phone (in limited circumstances) – if they live in the top 100 metropolitan areas. For those consumers living outside the top 100 metro areas, phone companies must implement number transfers by May 24, 2004. To see a list of the top 100 metropolitan areas, go to http://wireless.fcc.gov/wlnp/documents/top100.pdf.

One phone company reports that, from 2000 to 2002, customers disconnected 5 million of their 192 million phone lines. During that same time, cellular companies gained 31 million subscribers to end with 140 million users. These numbers make land line phone companies nervous about the new phone number portability.

In a perfect world, these changes should increase competition between providers and result in better service and more competitive calling plans for those who decide to stay land-locked. But, as with anything, be sure to read the fine print before you jump ship.

According to Consumers Union (www.consumersunion.org), an independent, nonprofit testing and information organization serving only consumers, and the publisher of Consumer Reports, there are at least seven things you should consider:

Price: Most cell plans are priced per minute, and get pricey when you exceed your limit. However, local landline (home wireline) service is often a flat rate in which you pay the same fee no matter how much you use the phone. Many cell phone plans charge for incoming calls, but landlines do not. Take care to consider how much you will use the phone and whether the cell plan includes a sufficient number of minutes for your outgoing and incoming calls.

- **Extras and Long Distance:** Home wireline service typically charge extra for such things as caller ID, voice mail and, of course, long distance. Cell phone plans often include the extras and long distance in their service. If you switch from a home wireline to wireless, your long distance service will not move with you, so make sure to verify your long distance options when changing to a cell phone provider.

- **Safety:** If you dial 911 from your home phone, the emergency operators can immediately pinpoint your location. If you dial 911 from your cell phone at home or on the road, most emergency operators cannot readily locate you, and unfortunately, there is no guarantee that your call will get through.

- **Service:** Consumers frequently complain about wireless service quality, such as dead zones and dropped calls. Overloaded networks and "dead spots" can affect your ability to use a wireless phone in ways that are not a consideration for landlines.

- **Fees:** Companies are allowed to charge a fee to departing customers for their cost of switching over phone numbers, but cannot charge in excess of these "porting" costs. Some companies may pay your current phone provider's cost in order to get your business. Consumers should remember that if they change service before their contract ends, they likely will pay a termination fee. They should also keep in mind that while they get to keep their cell phone number, they might not be able to keep their cell phone, so consider the cost of a new phone before switching.

Phone Customers Celebrate New Choices (cont.)

- **Initiating a Switch:** If you want to change cell phone carriers, or move your home wireline to a cell phone, contact the new carrier, who will start the process. Do not terminate service with your existing carrier before initiating a switch. Also, know that you are obligated to pay any early termination fees that may apply with your existing cell phone provider.

- **Switching Time:** It should only take a few hours to move your current cell phone number to a new cell phone provider (wireless-to-wireless transfer). It is expected to take several business days to complete a home wireline to cell phone transfer (wireline to wireless). Make sure to ask the cell phone company you are moving to if you will still be able to use your home wireline during the transfer process.

Phone companies continue to try to block the number portability that goes into effect November 24. To follow changes in the law, go to the Consumers Union Web site, www.escapecellhell.org. There you will find links to government pages, frequently asked questions, and resources to help you shop for a cell phone provider. To access a free shopping guide, go to link to http://www.consumersunion.org/campaigns//learn_more/000377indiv.html.

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Performance Measurement at Work-
Subaru-Isuzu's Success with the Balanced Scorecard

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Over the years, many buzz words have been thrown around in corporate America. If you aren't familiar with terms such as co-opetition, B to B, ROI, PDA and the like, the business world may just be passing you by. Two new buzz words have been born from actual practice and proven success. These are performance measurement and the balanced scorecard.

Large organizations select and use performance measurement systems to determine whether they are fulfilling their vision, meeting their short-term objectives and achieving their long-term, strategic goals. The measures focus on a critical few that link directly to the company's strategic plan, and are a combination of financial and non-financial indicators. Some financial performance measurements are historical, whereas non-financial performance indicators allow an organization to review its performance in real time and implement immediate adjustments. In any case, the specific indicators selected should best represent the factors that lead to improved customer, operational and financial performance.

Today, many companies are using a relatively new approach to strategic management developed by Drs. Robert S. Kaplan and David P. Norton of the Balanced Scorecard Collaborative, Inc. The "Balanced Scorecard" system is a management system that enables organizations to clarify their vision and strategy and translate them into action.

With a properly deployed and automated balanced scorecard approach, each management level can monitor the key performance measures within their control and responsibility, and understand the relationship to the overall success of their company. This approach provides management with visibility into the operations and issues of each business unit. It enables management to implement and track key initiatives for the purpose of addressing problem areas earlier or pursuing additional business opportunities faster and more effectively.

A good example of **Putting Performance Measurement** to Work may be found in Subaru-Isuzu Automotive, Inc., a joint Japanese automotive manufacturing venture between Fuji Heavy Industries and Isuzu Motors Limited.

In 1996, Subaru-Isuzu became conscious of the fact that that they were using only historical data measures to judge the venture's overall performance. They realized that they had only vague goals and objectives to drive current and future growth. They were unable to effectively forecast targets and objectives for one, three, five and ten year plans. In 1998, the official decision was made to implement the balanced scorecard approach to performance measurement – a system designed in such a manner that the measures selected would actually support organizational goals and objectives.

The next step was to decide what needed to be measured, the frequency of measurement and finally, what type of system was needed to maintain and display the performance trends. After juggling numerous ideas on what needed to be measured, it was concluded that too many measures would likely create an unmanageable data overload. So, a decision was made to use the Malcom Baldrige National Quality Award criteria. This way, "approved" performance measures could be categorized under one of seven business performance objectives. The objectives include leadership, strategic planning, customer and market focus, information and analysis, human resource focus, project management and results. Subaru/Isuzu ultimately reduced the seven down to five major categories that best represented the venture's key business performance goals.

Performance Measurement at Work – Subaru-Isuzu's Success with the Balanced Scorecard (cont.)

Now, for the logistical end of the deal – How could Subaru/Isuzu provide a one-stop, easy to use, data management and measurement system for their end users that included security for sensitive data? It was also essential to find a system that would allow the organization to measure performance data against one another, so that the trends in one performance measure might help predict how another performance measure would react to change. To this end, the venture considered all the applications programs currently being used in house (Excel, Paradox and Access). None of these were acceptable to management. Subaru Isuzu selected **pbviews** to satisfy the perceived system criterion and to ultimately maintain and display the balanced scorecard.

While it is still early in the process, Subaru Isuzu has identified numerous areas for improvement. According to Mr. Brent Lank, Senior Business Performance Specialist, "By far, the best success so far is working toward having all necessary data in one system in one location. We wasted countless hours and dollars 'browsing' for reports in our network, calling people for data, etc."

Subaru Isuzu is now forecasting targets and objectives for one, three, five, and ten year plans based on this system of measurements. Lank went on to say, "This is truly a revolutionary change for our organization".

Companies of all sizes are experiencing the dramatic results associated with performance measurement. Small and large alike are using meaningful performance measurements to look into the future, and to make critical adjustments that will help meet and exceed established goals and objectives. By combing performance measurement with the balanced scorecard approach, organizations can clarify their vision and strategy allowing them to translate these into action. It provides feedback around both the internal processes and external outcomes in order to continuously improve strategic performance and results. An automated balanced scorecard focuses on proactive communication for addressing problems earlier and pursuing opportunities faster and more effectively than traditional management models. Find out more about how you can put these tools to work for you, give us a call today!