PIFF Newsletter

Winter Edition

PIFF | Purdue Initiative for Family Firms

February 2017

Included in this Issue:

Welcome to PIFF!

The Purdue Initiative for Family Firms (PIFF) is an initiative in Purdue's College of Agriculture. PIFF is an integrated research, outreach, and teaching program. It offers educational programs that address the major competencies needed for effective family business ownership and management. The goal of the initiative is to prepare family business stakeholders—strategically, financially, and emotionally—for the significant and sometimes unpredictable transitions and decisions that must be made, which determine the success and continuity of the family business.

PIFF provides multi-generational family businesses with research-based business management resources aimed at improving personal leadership performance and driving operational growth. Our ambition is to prepare family business owners, managers, and stakeholders (including non-owner spouses and future owners) to be effective stewards of their family enterprises.

PIFF publishes a quarterly newsletter that will house an article from each part of the pie, found on our website – purdue.ag/piff. The four quarters of the pie include topics of: estate and personal financial planning, strategic business planning, maintaining family bonds, and leadership and succession planning. Each section houses articles, guides, and assessments of related topics which can be viewed online or downloaded. Also found on the website is a *Question of the Month*, PIFF Research, an option to subscribe to our quarterly newsletter, and upcoming events.

Family Business Income Taxation

Gerald Harrison

Estate & Personal Financial Planning

This article will focus on federal taxation of the individual taxpayer who very well may be obtaining some or all of his or her income from a closely-held family business. Also, other legal topics relative to owning land in Indiana are discussed.

For 2016, at least for full time, farm crop producers, net income may be quite small if any and likely the same will be true for 2017 given the outlook for crop prices. Costs of crop production are substantial compared to the current and near future level of income from crop sales. In fact, crop producers may have a tax loss for 2016.

Tax law allows business losses to be applied to taxable incomes in a prior year to get a refund of prior taxes paid. The loss also may be carried forward and applied to reduce otherwise taxable incomes in a future year of business. Business losses may be carried back five years or carried forward for 20 years. The application of a business loss to a year with taxable income requires various adjustments to obtain what is referred to as an economic loss. To make these calculations detailed instructions must be followed requiring appropriate tax calculating software or reference to IRS tax publications or the assistance of a tax preparation expert.

Another feature of the tax law is the very low tax rate on capital gains and domestic corporate dividends. Capital gains (net sale price minus capital asset basis) may arise from the sale of farm produced breeding stock or from the sale of a capital asset such as an interest in farm land or any other capital asset. The **capital gain tax rate is zero on the gain that lands in either of the first two tax brackets**. Sale of capital at a gain has been and is a handy way to generate tax free income perhaps when an individual owner or couple are without or with very little other income. If the gain is added into the third or fourth tax bracket, the rate is only 15%, much lower than the rate on ordinary income. This favorable tax rate is true for domestic corporate dividends. This favorable rate structure should encourage a family business that is operating as a regular corporation to pay dividends. The dividends may be going to family stock owners who are in a low tax bracket, perhaps with very little or no regular, ordinary income -- perhaps a college student or a stockholder without a job. This dividend or capital sale opportunity could benefit family members who have a capital interest in a family business but are not employed in the business with income as an employee.

The federal tax law holds many other opportunities for reducing an individual's annual income tax. Such will be discussed in the future. If the reader of this note has a question about tax law, estate planning or any of numerous legal topics, you may contact the author Gerry Harrison by e-mail: harrisog@purdue.edu evenings and weekends at gah104@comcast.net . However, Gerry is a teacher and Extension Specialist at Purdue University and not in the practice of law or tax preparation.

Disclaimer: The information in this tax discussion is not to be interpreted as legal advice. If tax or other legal questions arise in the reader's personal or business affairs, seek the advice of licensed, legal or tax practitioners.

Updated Business Planning Tool to Aid Family Businesses

Maria I. Marshall

While entrepreneurs may benefit from formal business planning, many fail to do so or do so in an unstructured way that leaves them open to errors. To overcome such problems, Purdue University's Department of Agricultural Economics developed a six-stage methodology for business planning. This model, INVenture, helps increase the likelihood of successful businesses by systemizing and sequencing new business planning. This web-based model to facilitate the collection and analysis to create a business plan. The six stages of the Business Planner are as follows.

- **Stage 1.** Fundamentals of Your Business: an initial review of your business. This introductory stage requires a cross functional overview of the business, including the primary motivation for beginning the business, the product (or service) that is proposed, the customer identification, and preliminary break-even calculation.
- **Stage 2.** Analyzing Your Market: a detailed examination of the target market. Users complete a thorough review of the market and its characteristics, including an assessment of the competition.
- **Stage 3.** Producing Your Product or Service: a broad-based inquiry into producing products and managing the business. The business management team is identified and profiled, production methods are outlined, ownership of the business is reviewed, and intellectual property issues are identified.
- **Stage 4.** Marketing Your Product or Service: a rigorous inquiry into the marketing plan. The target customer is profiled, and the components of a complete marketing plan are developed in depth, including the product definition and bundle, the pricing plan, the distribution methods, and promotion efforts.
- **Stage 5.** Financial Analysis of Your Business: the creation of forecasted financial statements. Estimations of operating revenue and expenses, capital outlays, financing, and required rates of return are constructed.
- **Stage 6.** Executive Summary: a focused review of the business. An overview of the business is written.

The format used to elicit information in this model is question and answer. Each transition to the next stage is a decision point at which entrepreneurs review the work done previously and decide, consciously, whether or not to continue to the next stage. To aid in the answering of questions, sets of "considerations" are provided to stimulate thinking and analysis about issues relevant to each of the questions. The stage-gates exist as quizzes that pose critical questions on the quality of the work done in the stage and the continued viability of the project overall. In essence, the model decreases the uncertainty and poor planning often found in business development by acting as an electronic mentor. Find the planner here: purdue.edu/newventure.

Family Business as a Competitive Advantage Webinar

What competitive advantage does your family business have? PIFF and the Center for Commercial Agriculture hosted a webinar on January 31st, 2017 discussing how you can take advantage of the key attributes of your family business to enhance competitiveness. The family business is a unique organization. It is a cross section of two systems often thought to be incompatible: the family system and the business system. Research has shown, however, that the *familiness* of a family business can and does enhance the competitive advantage of the business. In this webinar, we discussed the distinctive competitive advantages that family businesses possess and how you can put those advantages to work in your firm. If you missed it, you can find a recording here.

Ownership vs. Management Transfer

Renee Wiatt

Leadership & Succession Planning

The succession process contains three separate components, two of which can transpire either concurrently or asynchronously (3). The process includes a managerial leadership component in which the management decisions of the business are transferred, an ownership component in which the financial possession of the business is transferred, and finally the transfer tax component (2; 3; 4; 6). While there can be overlap and correlation between the ownership and management transfer, these categories are two distinct sub-processes under succession planning.

In non-family businesses, the turnover of a CEO or chief often follows low performance of a firm, while succession in a family business is tied to other factors such as retirement, death, and the want to bring in a new generation (1). Koffi et al. (4) noted that the majority of family businesses would transfer from the older to younger generation by 2024. The management and ownership transfer processes of the family businesses were two ways to move the business from one generation to another. Giarmarco (3) explained that the succession process could get tricky when owners have more than one child, especially when some were active in the business and others were not. Equality was found to be very important to many business owners. Owners often wanted to reward those children active in the business while not estranging those who were not. Options for such owners would be to include non-active children in an ownership role, while leaving the active children in an ownership and management role. Adult children who were active in the business found much peace of mind when the owner wrote down succession plans to let that child stay active in the business after it transitions in both management and ownership.

Earlier is better when it comes to planning for the transfer of a family business. There are four main types of planning that a family business can take part in, including (business) strategic planning, family strategic planning, succession planning, and estate planning (7). Training successors for management transfer could take years, as could retirement from day-to-day business operations for owners and managers (3). Planning for ownership and management transfer can take a large investment of time of the family and the business. Businesses need to groom their candidates and progress them through positions of responsibility to better prepare them to take over (1).

1. Bradley et al., 2012
2. Churchill and Hatten, 1997
3. Giarmarco, 2012
4. Koffi et al., 2014
5. Mishra and El-Osta, 2007
6. Morris et al., 1996
7. U.S. Small Business Association, 1997

Want more information about leadership and succession planning? Check out PIFF's "Leadership and Succession Planning" page for some great resources and publications.

Keeping the Family in the Business: A Family Business Workshop

As you look towards the future of your business operation, there are many issues to consider. One issue of extreme importance is the development of a son, daughter, or partner to be the future manager of your business. To help you begin development of your management succession plan, the Department of Agricultural Economics at Purdue University will host a Family Business Workshop on March 9-10, 2017, at the Purdue Beck Center. This workshop provides information and work time to develop answers for many issues involved with bringing a new manager into the operation. The workshop provides an opportunity for you, and your son, daughter, or partner to begin making decisions together about the future of your business operation. This conference is also a wonderful opportunity to spend a weekend with a family member who is attending Purdue.

Upcoming Event!

Keeping the Business in Your Family: A Family Business Workshop

Click here for info!

Introducing a New Family Business Functionality Assessment

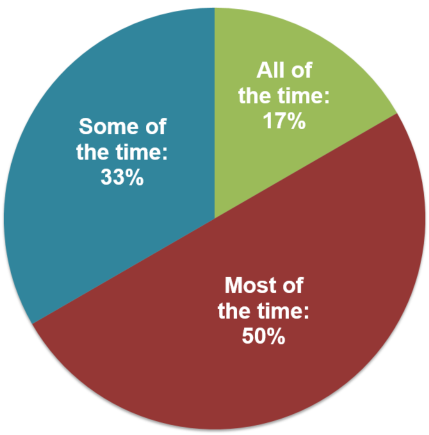
Renee Wiatt

Maintaining Family Bonds

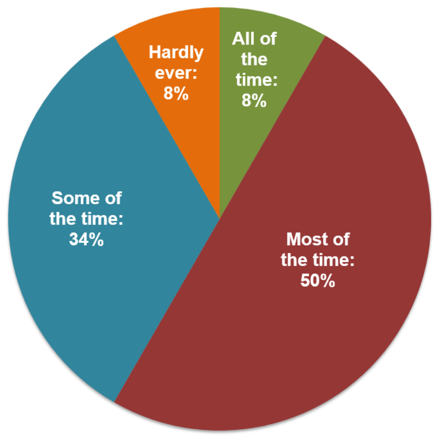
Understanding family business functioning from the multiple viewpoints of family and business stakeholders could help enhance communication, ultimately improving overall family business functioning. In a family business, the family and the business are constantly competing for limited amounts of time, attention, and resources. PIFF developed an assessment, the FB-BRAG, for family businesses who would like to examine their businesses' functionality. The FB-BRAG allows users to measure family business functioning from a variety of viewpoints, in a way that holistically incorporates family and business functionality into one assessment.

The four questions included in the assessment are modeled after Smilkstein's (1978) family APGAR and work APGAR assessments. APGAR assessments measure **a**daptability, **p**artnership, **g**rowth, **a**ffection, and **r**esolve (Smilkstein, 1978), while the FB-BRAG measures **f**amily **b**usiness **b**alance, **r**esolve, **a**daptability, and **g**rowth. Administering the FB-BRAG takes very little time and effort. At the end of answering the 4 questions, a score is assigned to assess your family business functionality as *highly functional*, *moderately dysfunctional*, or *dysfunctional*. Scores from the FB-BRAG (January's Question of the Month) as well as responses to each question are shown below.

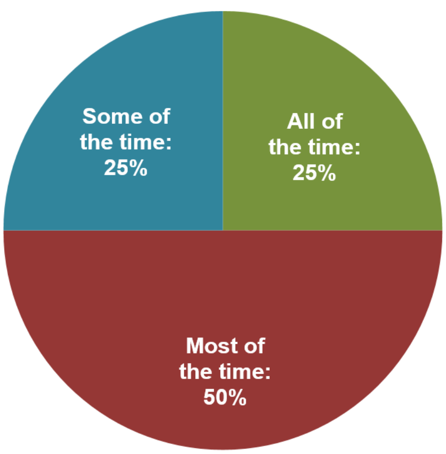
The full FB-BRAG in downloadable format for use in your own family business can be found here.



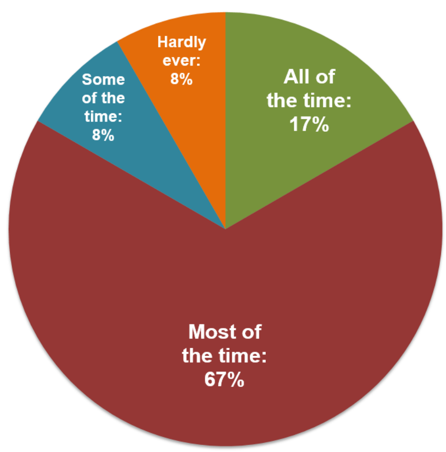
Family **B**usiness **B**alance:
How often are you satisfied with the outcome when a decision has to be made in favor of what is best for the family versus the family business?



Resolve:
How often are you satisfied with the way others in your family and business share time together?



Adaptability:
How often are you satisfied that you can turn to people at home and work for help when something is troubling you?



Growth:
How often are you satisfied that your family and business accept and support your ideas or thoughts?

Family Functionality Scores	
Highly Functional	46%
Moderately Dysfunctional	46%
Dysfunctional	8%

Meet the Authors

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