WINTER 2014

Leading EDGE

Kreischer Miller

PEOPLE | IDEAS | SOLUTIONS

ADVICE & INFORMATION TO HELP YOU MANAGE YOUR BUSINESS

IN THIS ISSUE

Commercial Loans: Pay Attention to the 7 C's

Should You Pay Your Key Employees for Performance?

4 Keys to Successful Joint Ventures

Commercial Loans:
Pay Attention to the 7 C's

Mark G. Metzler, Director
Audit & Accounting

External financing is typically the lifeline of a company, providing access to capital to purchase property and equipment, increase inventory, hire employees, and ultimately expand the business. Obtaining a business loan is about risk and relationships.

According to a panel of bank executives, the assessment of the degree of risk of a business is based upon various factors that are often entered into a formula. The factors are based upon both objective and subjective measures. If you have a pre-established relationship with your banker, your chances of obtaining the loan improve. However, before requesting a loan, you must be prepared with a viable business plan, sufficient cash flow to make loan repayments, adequate collateral, and a willingness to provide a personal guarantee for the loan.

Therefore, when it comes to commercial borrowing, it is important to remember the 7 C's:

1. Credit – The borrower must have good credit and any problems on the credit reports must be explained. There is a direct relationship between the owner's personal credit history and the business's credit history.

2. Capacity – The business must be able to support its obligations and expenses, and generate a profit. Reliable financial information is a prerequisite. Audited financial statements carry much more weight than reviewed statements. Compiled financial statements provide little comfort to the lender.

3. Capital – The business owner must have money or equity invested in the business. Banks prefer to lend to owners that have their own "skin in the game" and share the risk.

4. Collateral – Banks want sufficient assets to secure the loan. Collateral is the secondary method of a loan repayment after cash flows. Collateral assets may be business or personal, and lenders discount the value of your collateral.

5. Character – Without this, it is unlikely that the bank will provide the loan.

6. Conditions – Are there any economic or industry trends that will affect your business? You must have a reasonable, comprehensive plan to address these conditions.

7. Commitment – How committed is the owner to the business? Commitment comprises the ability and willingness to succeed which may involve personally guaranteeing the debt even if the company cannot pay it.

While understanding the 7 C's may improve your business's likelihood for obtaining a loan, there are several key points to maintaining a positive relationship with the bank.

First, remember that the bank is a partner in your business and wants you to be successful so that their loan will be repaid. Therefore, be straight-forward; don't over-promise and under-deliver; and, to the extent possible, avoid last minute surprises.

Second, timely and accurate communication is critical to developing and maintaining trust. If conditions change in your business, develop your plan for addressing the change and discuss it with the bank. Any forecasts or projections should be reasonable and consider different scenarios, including those most likely and the worst case. If you are projecting improved business performance, you need to be able to demonstrate how and why.

Lastly, surround yourself with other professional advisors (legal, accounting, insurance, etc.) that have your best interests in mind. They will challenge you, offer guidance, and assist you in achieving your goals. **LE**

Should You Pay Your Key Employees for Performance?

Tyler A. Ridgeway
Director, Human Capital Resources

Privately-held companies are increasingly using performance-based bonuses as a key way of compensating their executives. Today's executives are being measured more by how much value they create for the company's owners than just simply getting the job done. For CFOs, for instance, it is not just about crunching numbers; it is about being a strategic business partner with the organization.

A lot of companies have been through tough times, but they have also learned to better operate their businesses. Many have available cash right now and are wondering whether to pursue an acquisition, launch a new product, incentivize the current team, or upgrade their talent.

If they decide to upgrade their talent by hiring an executive, companies want to make that new executive happy from a compensation perspective, but they do not want to give away everything. While companies realize there is a talent war and know they need to pay for top talent, they also want to share risk. So, they are designing packages that provide long-term rewards.

One way to do this is by offering more in bonus compensation than salary. Companies will negotiate a base salary everyone is happy with, and then determine how to link the bonus to company performance. Executives might be asked to accept less cash upfront in return for the potential upside in bonus compensation and earn-outs.

To do this, companies are increasingly using alternatives like phantom stock plans and stock appreciation bonuses that put a percentage of an increase in revenues over a specified period of time into an executive's retirement plan. These are excellent options for new hires as well as for motivating existing top performers. With these plans, the executive does not own equity in the company but shares part of the increase in value. These vehicles reward executives for growth and profits with a focus on specific goals and objectives that need to be accomplished.

All of this ultimately comes back to companies expecting value creation from their new hires. When an executive joins a company, it is difficult to know upfront exactly where or how he or she will add value. But if the executive helps generate leads that double revenue, for instance, companies are willing to revisit compensation because they want to reward that behavior.

Companies have become more transparent — owners are more willing to allow key team members to know the company's cash position, and understand why bonuses are down if it is not a great year. Their philosophy is that everyone is in this together, and, if the business grows, everyone will win. **LE**

4 Keys to Successful Joint Ventures

John J. Helmuth, Jr.
Director
Audit & Accounting

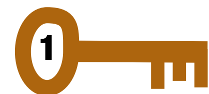
Many business owners face opportunities and challenges as they look to grow and expand their businesses. This growth may be accomplished through a merger or acquisition of a business or through organic growth, either in the company's existing market or expansion into a new market. In some cases, forming a joint venture (JV) with a strategic partner may be a good option.

Why form a JV? Companies have a variety of motives, including:

- Gaining access to a new market
- Reducing or sharing cost
- Mitigating up-front and operational risks
- Gaining access to additional resources and/or different core competencies
- Preserving cash and/or gaining additional financial resources

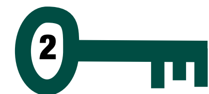
When a company determines the formation of a JV is an appropriate strategy to accomplish a goal for the business, it becomes critical to ensure that the JV is on a path to success. Businesses enter JV arrangements with the intention of meeting or exceeding their targeted objectives; however, many fail to meet those goals. Typically, these failures are a result of poor planning and a lack of commitment of sufficient resources during the launch phase of the joint venture.

So how do you position your JV for success? Here are four key elements to consider:



Set clear goals and define the strategy.

It is critical to understand the strategic objectives of the potential JV and how this fits with the current business strategy for each participant. Is the JV expected to be for a specific project or an ongoing alliance? What is the expected lifecycle of the JV and what are the exit strategies for both participants? Aligning the JV's goals with each partner is a very important component of the planning process.



Identify the right partner.

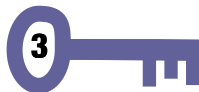
The compatibility of a partner is a key factor in determining the success of a JV. What assets and competencies will each partner

continued on following page

continued from previous page

bring to the table? What synergies will be achieved in the combined JV? For example, a small construction contractor may align with a larger contractor to obtain access to a deep, specialized labor force with financing resources and bonding capacity to assist in completing a project that the smaller contractor does not have the resources to complete on its own.

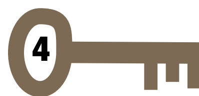
Also, performing due diligence is critical to determine if you are partnering with the right party, which can minimize risk for each partner. Ultimately, structuring a "win-win" relationship with your JV partner will contribute toward success for both sides.



Plan the JV and commit sufficient resources.

To clearly identify the structure of the JV, you need to establish management dedicated to the JV's operations, document the organizational and operating assumptions, define the governance and risk management protocols, and establish the accounting and financial reporting requirements. Putting the best team in place for the JV is a recipe for success; under-investing in the right people and resources is a formula for failure.

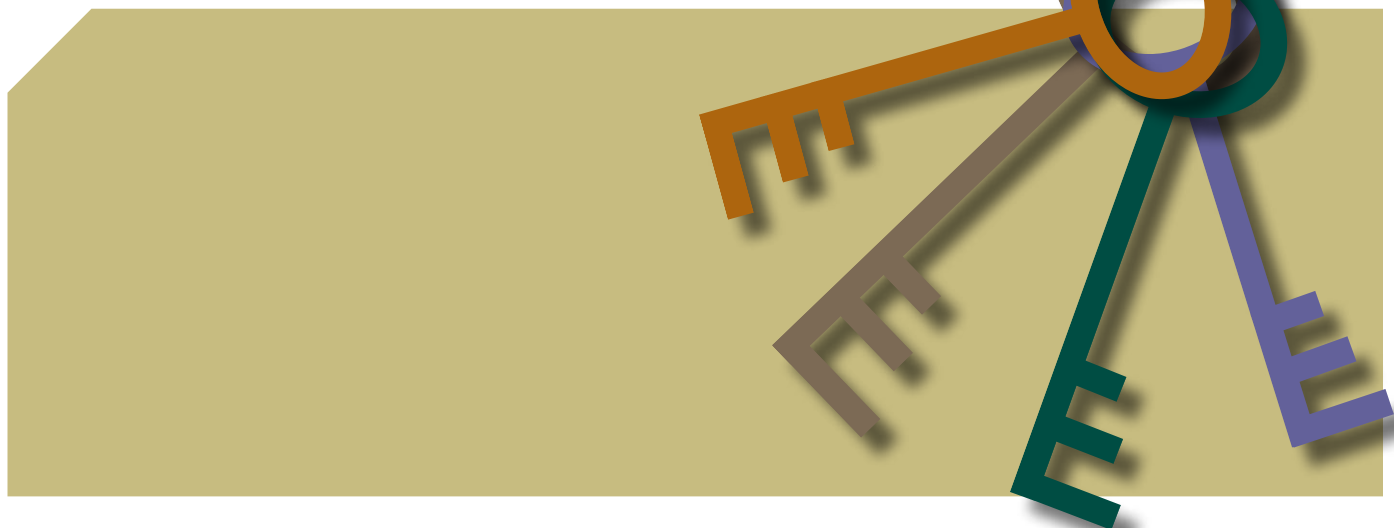
In addition, setting and communicating the financial goals should be part of the planning process. This would include identifying capital requirements and compensation arrangements up-front, and defining the framework for the sharing of costs and profits. Proper planning will increase your chances of success in a JV arrangement.



Manage the relationship. JV partners should treat the relationship like a marriage; it should be built on communication, trust, and understanding. Ongoing communication is critical during both the planning and the operational phases of the JV. It is important to be clear about strategies, including exit mechanisms. Solid interaction between colleagues will enhance productivity and may avoid clashes in culture as well.

Trust between partners may be one of the most integral success factors in a JV arrangement. A lack of trust could be blamed for any unexpected issues or problems that arise during the relationship. Establishing and building trust from the onset will lead to solid collaboration throughout the duration of the relationship.

There are many factors that determine the success of a JV. If a JV structure is right for you, focus on setting the proper goals and strategy, identifying the proper JV partner, planning and dedicating sufficient resources, and managing the relationship with your JV partner. Proper attention to these key elements will likely improve the success rate of your JV and may contribute to the long-term strategic goals of your business. **LE**



leading **edge** alliance

innovation • quality • excellence

Kreischer Miller is a member of the Leading Edge Alliance. Members are leaders in many key markets, including:

Alabama
Albania
Afghanistan
Argentina
Atlanta
Australia
Azerbaijan
Bahrain
Baltimore
Bangladesh
Belgium
Bolivia
Boston
Brazil
British Virgin Islands
Buffalo
Bulgaria
Cayman Islands
Chattanooga
Chicago
Chile
China
Cincinnati
Cleveland
Colombia
Croatia
Cyprus
Czech Republic
Dallas
Dayton
Denver
Dominican Republic
Ecuador
Egypt
El Salvador
Finland
Fort Lauderdale
Ghana
Germany
Greece
Guatemala
Harrisburg, PA
Hartford
Hong Kong
Honolulu
Houston
Hungary
India
Indiana
Indonesia
Iowa
Ireland
Israel
Italy
Jordan
Kansas
Kazakhstan
Kenya
Knoxville
Korea
Kuwait
Las Vegas
Latvia
Lebanon
Lexington
London
Los Angeles
Luxembourg
Macedonia
Madison, WI
Malaysia
Malta
Mauritius
Memphis
Mexico
Miami
Michigan
Minneapolis/St. Paul
Missouri
Moldova
Montenegro
Montreal
Morocco
Nashville
Nebraska
Netherlands
New Orleans
New Jersey
New York
New Zealand
North Carolina
Norway
Orange County, CA
Oregon
Pakistan
Palestine
Panama
Paraguay
Paris
Peru
Philadelphia
Phoenix
Philippines
Pittsburgh
Poland
Providence
Puerto Rico
Richmond
Reno
Romania
Russian Federation
San Francisco
Saudi Arabia
Scotland
Seattle
Senegal
Serbia
Singapore
Slovakia
Slovenia
South Carolina
Spain
Sweden
Switzerland
Taiwan
Thailand
Tokyo
Toronto
Tucson
Tunisia
Turkey
Ukraine
United Arab Emirates
Uganda
Uruguay
U.S. Virgin Islands
Venezuela
Washington, D.C.
Vietnam
Virginia
West Virginia

The Leading Edge Alliance is an international network of independently-owned accounting and consulting firms. Membership in The LEA gives us access to the resources of a multibillion dollar global professional services organization that provides technical resources, industry specialization, professional training and education, and peer-to-peer networking opportunities—nationally and globally, around the corner and around the world.

Our affiliation with The LEA enables us to expand our capabilities and provide a greater depth and breadth of advice and services to our clients. The bottom line? Our clients benefit from the size and scope of a large multinational firm with the high-touch, high-quality service of a local firm.

Leading Edge Alliance Fast Facts

- 190+ leading accounting and consulting firms
- 100+ countries
- 460 offices worldwide
- 2,175+ partners
- 18,800+ professional staff
- $2.7 billion in total revenues

100 WITMER ROAD, STE. 350
HORSHAM, PA 19044

ADDRESS SERVICE REQUESTED

WHAT WOULD HAPPEN IF MY ACCOUNTING FIRM ACTUALLY CALLED WITH A BIG IDEA OFFERED BIG-4-LEVEL EXPERTISE WASN'T RUN BY A BIGGER OUT-OF-TOWN FIRM INVESTED TIME TO UNDERSTAND MY COMPANY ON ITS OWN DIME FOR ONCE?

Here's an idea: Call us for the names and numbers of Kreischer Miller clients in your industry and ask them yourself. Discover how a proactive, decisive, and forward-thinking accounting firm can help you get ahead—and stay ahead.

Kreischer Miller

PEOPLE | IDEAS | SOLUTIONS

100 WITMER RD., STE. 350, HORSHAM, PA 19044 | 215-441-4600 | WWW.KMCO.COM

AUDIT & ACCOUNTING | TAX STRATEGIES | BUSINESS ADVISORY | TECHNOLOGY SOLUTIONS | HUMAN CAPITAL RESOURCES