Family Business
THE GUIDE FOR FAMILY COMPANIES
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The current credit crunch: An equal-opportunity crisis

Even if your family business is thriving, today's economic woes can still drag you down. You must be proactive.

A CREDIT CRISIS affects businesses and households in two ways: the cost of credit as well as the availability of credit.

Lenders that have incurred significant losses are tightening their loan standards. In some cases, they are cutting off lines of credit—even to some healthy companies. After a long stretch of leniency, financial institutions are now readjusting their lending policies to reduce their risk. For instance, although the prime interest rate has come down, banks have inflated their spread. So when the government decreased the federal funds rate (the rate that institutions charge each other for extremely short-term loans) by half a point, many banks increased their credit premium by 200 basis points. That's why mortgage and other consumer and commercial interest rates have been going up, not down.

Without affordable credit, businesses cannot grow and consumer spending decreases. Increases in the cost of credit squeeze businesses' profit margins and eat into household cash flow. In some cases, when businesses or households are overextended, the lack of additional credit can put them at risk of bankruptcy.

Financial institutions will reward their better customers. In fact, one of our clients told us that ever since the crunch began, numerous bankers have been calling them to offer them credit. But that doesn't mean they are not at risk. Even if your family business is thriving—even if you have credit available and your balance sheet is healthy—a credit crunch still can drag you down.

Problems experienced by your customers, suppliers, bankers, shareholders and employees can quickly become your problems. For instance, if your customers run out of credit, they may stop or slow down their payments, which will erode your receivables. This may deplete a source of your cash and increase your need for additional borrowing. If suppliers become strapped for cash, they may not be able to produce or deliver what you need to conduct your business.

No matter how sterling your credit rating may be, during a credit crisis banks may receive dictates from headquarters limiting the availability and terms of your line of credit. This happened to one of our clients who had an excellent credit record with his bank. Nonetheless, he received a call from his banker, saying, "We love your business, but because of a new policy, we can no longer extend your lines of credit to the levels we had before."

It's also possible that if the value of your business property dips below thresholds specified in your loan covenants, your banker may be forced to call your loan—even if you have consistently paid on time.

If some of your key employees are experiencing financial difficulties, their productivity and morale may plummet. Such personal pressures are bound to increase stress, which can lead to substance abuse or other destructive behavior.

Trouble could also arise with family shareholders. Whether they work in the family business or not, their financial crisis could affect your business, eroding the company's "patient capital."

It's wise to prepare for the possibility that some of your shareholders may run into problems.

Protecting your business

Here are some steps you can take to ease the impact of today's tough economic climate on your company:

- **Research your customers and your suppliers.** It's critical to track the credit standing of your largest customers and suppliers. For example, at the moment your customers may be keeping current on their accounts with you, but that does not mean they are paying other creditors on time. You also want to know if they are in good standing with their banks. Their credit standing can change quickly, so you want to track this regularly.
- **Offer incentives, such as discounts or extra features, to customers who pay earlier or who pay cash.** This can reduce your exposure and even increase sales.

• **Diversify your group of customers, suppliers and bankers** so one large account, or one dried-up bank line of credit, will not be able to drag you down. Instead of shrinking your marketing budget, this is a good time to intensify your marketing effort to develop new customers. It's also a good idea to shop around for fallback suppliers and bankers.

• **Double your communication with employees.** Make them understand there's an open door if they need to talk about any financial difficulties they are experiencing. Consider offering personal finance workshops to employees as well as shareholders.

Protecting your family

During a credit crisis, it's wise to prepare for the possibility that some of your shareholders may run into problems. Here are some steps you can take to ensure that your company's patient capital will be unaffected by any family member's fiscal woes:

• **Conduct a liquidity survey** to assess potential shareholder liquidity issues. Do any shareholders have mortgages that are about to adjust? Do any of them work in industries that are especially vulnerable in the current economic climate? Are any shareholders facing imminent transitions (college tuition, divorce, illness) that may increase their need for liquidity?

• **Review your family employment policy.** Consider under what circumstances the company might employ an inactive shareholder who loses a job. One of my clients has always had a policy that once his children are out of the house, they are on their own. But his 24-year-old son, who recently got married, just lost his job as a mortgage broker. The client wanted to help his son in a way that would not be unfair to other shareholders. Without changing the employment policy and with proper communication and transparency with the rest of the family, he hired his son as a consultant for short-term special projects.

• **Conduct educational workshops for shareholders** through your family office or family council. You can invite the company's financial advisers to demonstrate how to strengthen family members' personal balance sheets. Also consider permitting shareholders to avail themselves of any private advisory resources the company may have, such as your bank officer.

• **Institute a shareholder loan program.** If company credit is available, you can consider setting up a program with the bank to provide small loans to shareholders, using company stock as collateral. The bank would write loans to the shareholders with an agreement that if the shareholders were to default, the company would pay back the loan; the shareholders would pledge their stock as collateral.

• **Consider a stock redemption program.** Within the limits of cash availability, the company could set up a formal program for shareholders who face credit problems or have other liquidity needs. A sound redemption program requires broad notice to all the shareholders and a fair valuation formula. Such a program may also include a feature allowing buybacks within the shareholder group at the same valuation price.

Take charge of the situation

Most important, don't just sit there. Don't be fooled by your excellent credit record. Be proactive. Make a list of all the potential glitches you may encounter, and map out strategies that you can implement now to avoid problems later. You want your business to emerge healthy from this credit crisis—and that means you must pay attention to the financial circumstances of your shareholders, customers and suppliers. FB

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