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Member of the  
Wolf Financial Group

# Manufacturing & Distribution

*Better Ways ▲ Better Results*

A NEWSLETTER FOR THE MANUFACTURING & DISTRIBUTION INDUSTRIES

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## THE BEST, THE WORST, THE IN-BETWEEN

### Can Your Customer Base Pull You Through?

**A**fter more than a year of recession, marked by an unrelenting contraction of manufacturing activity, many hope the U.S. economy will improve this year. But most experts predict a longer and deeper downturn than any since the 1930s.

Whatever its ultimate depth and duration, the recession is testing inventory-based companies severely, and greater tests lie ahead. Some companies will fail, while others will stagger through only to emerge too weak to ride the eventual recovery.

And, as happens in every downturn, some companies will adapt and come out stronger. Unfortunately, there's no "Ten-Minute Manager" for this situation. Virtually all manufacturers and distributors must figure out how to boost sales, drive down cost, find credit, plan tax strategy, conserve cash and make other necessary changes.

Beyond these steps, some companies succeed in a difficult economy with a strategy that focuses on their existing customers — and not just the good kind.

#### Customers, Profitable and Otherwise

An old saw says, "the upsell is the cheapest sell." Existing customers require no prospecting, qualifying, or advertising, so the ROI is automatically high.

Keith Friedlein, partner-in-charge of the Manufacturing & Distribution Group, Wolf & Company LLP says, "Especially



in hard times, some companies seek, and find, the keys to survival and profitability in their existing customer bases."

These customer-focused companies begin by developing detailed profitability reports on every customer and analyzing the data. They also seek input from employees, because every department has its own unwritten rankings for customers. They know the "perfect fits," whose transactions are always smooth, and the "crazy-makers," who create endless chaos.

With this knowledge, it's possible to identify which customers are golden, which are sure losers and which are somewhere between. Results vary widely, of course, but nearly every company is surprised by how much of its profit comes from the high-scorers and how little from the bottom ranks.

#### Golden Customers

The top priority is keeping the "best of the best." For initial clues on how to

## Employee or Independent Contractor

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Understanding the difference between two kinds of labor relationships becomes more important in a business environment like this one.

In a struggling economy, companies will try almost anything before they resort to laying off workers. Concern for employees and their families, as well as the need to minimize disruption, leads the company to raise prices, cut more waste, borrow money and take other measures before letting people go.

But in a deepening recession these steps may not be enough, and then companies are forced into a well-defined pattern. At first a hiring freeze and attrition may be enough to reduce the payroll, but when they're not, companies lay off. And they sometimes cut too deep.

In the economy as a whole, manufacturing activity may slow, but it never stops. Business and commerce go on, marketing efforts bear fruit and orders must be filled.

### Not Hiring. Help Wanted

When new orders come, a company may find itself in need of labor quickly. But no one knows initially whether those orders represent the start of a real recovery or merely a short-lived spike, so the company may be reluctant to hire (or rehire) regular full-time employees.

Under such circumstances companies often look to temporary contract workers, who are either employed by a temporary staffing agency or working, on their own, as independent contractors.

The latter category presents a unique set of problems, which Microsoft knows all too well. In 1993, the corporation's "permatemp" workers — independent contractors with long tenure — sued for the benefits, 401k contributions and

ESOP participation rights that regular employees enjoyed. The courts upheld the ESOP claim, saying the workers were "common law employees," and two years later Microsoft settled the benefits and 401k claims for \$97 million.

The IRS maintains a detailed and complex set of rules that determine a worker's relationship with an employer. The stakes can be substantial: The determination governs the employer's responsibility to furnish benefits, as well as to withhold and pay income, unemployment, Social Security and Medicare taxes. The employment relationship also establishes the employer's obligations under various labor laws, as well as its liability for a worker's negligence. And mistakes in categorizing can draw fines.

### What's the Difference?

The main principle that determines whether workers are employees or independent contractors is the "right of control" in three areas: behavioral, financial and type of relationship.

**Behavioral:** If an employer dictates when, where and how work is to be performed, the worker is most likely an employee. But if the employer controls only the result of the work, and not the means and methods of accomplishing it, that indicates the worker is an independent contractor.

**Financial:** Control also applies to the financial aspects of a job. Obviously, an employer controls all of these for its employees. But if a worker incurs unreimbursed expenses, invests in or maintains separate facilities, or has an opportunity for profit or loss, that worker is more likely an independent contractor.

**Type of relationship:** The "perceived relationship" is important, too. The job's permanency, the worker's availability for other work and how integral the worker is to the business

itself are some of the key factors that contribute to this perception.

### Why the Ambiguity

The reason these tests point to "likely" or "unlikely" conclusions is that the IRS considers multiple factors within each of the above categories. Some might assign an individual to employee status even while others indicate an independent contractor. The tax agency stresses that the "totality" of these various tests must be considered.

The rules cover many areas. Employees generally report at specified times and use the employer's tools. Independent contractors set their own schedules and usually have their own tools and a "significant investment" in the facilities where the work is performed. Employees sometimes receive paid training, but independent contractors rarely do. And while employees perform their own work, contractors are typically free to assign the work to their own employees or subcontractors.

While an employee receives compensation at regular intervals, via paycheck, independent contractors are usually paid by the job. Employees generally work for one employer at a time, and aren't available to the general public, but a contractor might serve several companies at once.

Even brief upturns call for more labor in manufacturing and distribution industries. When that happens, hiring or contracting decisions are posed quickly, because a company's agility is a critical competitive advantage in these times. To avoid the consequences described above, make sure you address these decisions with all the facts. ■

*Employment relationships can be tricky, and mistakes costly. To learn more about your company's options call Phil Czajkowski at 630-545-4580.*

keep these clients, review their record of past complaints and returns. How can you make sure these mistakes are never repeated? Every employee must know exactly who these golden customers are because such facts can be less obvious on the shop floor than on the top floor. Clear instructions and meaningful rewards can align the entire workforce to deliver stellar customer service.

The task then becomes finding new ways to deliver value to these top customers, and this means more than sales reps making more calls to more purchasing offices. Instead, set up a high-level meeting where you go not to sell but to learn. It's a time for big ears and plenty of questions about their processes, challenges and plans.

A company should also take a close look at its relationship with the customer and explore ways to strengthen it. This type of review will strengthen customer service, and help protect the manufacturer itself — because business owners find out too frequently that an employee or sales rep has left for a competitor, and taken a key customer along.

To broaden out the relationship, a smart supplier will begin engaging more fully with its customer's employees at different levels — offering more consultation on the shop floor, for example, or working through price quotes together. That's also the best way to learn just how much confidence the customer really has. Does it take for granted that the supplier will fill its orders in full and on time, helping it minimize downtime, deliver on time and remain profitable itself?

A proactive supplier seeks out its customer's pain points. For example, you probably already know a lot about red tape or inefficiencies in the sourcing process. Both parties might save significantly by discussing these issues openly and making improvements. Plus, a competing

supplier might be about to walk in with the very same "great new idea" for improving processes.

Meeting every challenge is impossible, of course, because it could demand too much change in the manufacturing or distribution process. But a recession demands a new look at what's possible and what's not.

### Less-Than-Golden Customers

For suppliers and distributors, loser-customers come in many varieties, from the never-loyal to the too-loyal. Certain customers, for example, are extremely loyal to the overly generous deal the supplier offered in hopes of winning more business — which it won, but only at the same lowball price.

Some customers buy only low-margin products. Others create busy work — for both sides — by limiting purchase orders absurdly or demanding separate invoices for every item. Still others generate a flood of returns or demand constant stroking. On the profitability scale, only a few of these problem customers are likely to rank at the very bottom. Most will stand somewhere in the middle.

It may be possible to make these accounts vastly more profitable, and even turn some of them to gold. The process to do so is similar to that of enhancing partnerships with golden customers, with two differences. First, analyze the golden customers: How did they come to be golden? How did we get in so good with them? How can we replicate that? Second, the supplier can afford to ask more from the customer.

For the customers unwilling to change, the time has come for a decision. A new proposal on pricing is usually the next-to-last step; the last step is either acceptance of higher prices or a gentle farewell. A good end to a bad fit either saves money on

resources or frees them to take better care of golden customers.

After implementing this customer-focused strategy, the next step for many companies is to repeat the process to achieve the same goals of retention, transformation or separation — this time with their next-to-golden customers and their almost-zeroes. As these efforts bear fruit, the overall profitability of the customer base will rise. ■

*For more information contact Keith Friedlein at 630-545-4505.*



### Is There a Clone Out There?

A thorough analysis of existing customers' profitability can benefit manufacturers and distributors in another way, particularly if they have one or more single-customer niches.

Typically, these customers are intrinsically lower-margin because they demand unique configurations and processes, so it can be tempting to consign them to the loser pile automatically with little hope of change.

But before giving up, it's worth noting that one move can change matters dramatically: finding a similar customer. That alone can lead to immediate production efficiencies, and deliver decent ROI from both customers.

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## Estate Tax: On, Off, On Again

After a short break to rescue banks, automakers and a plummeting economy, the Obama administration proposed a budget in February that signaled its intention to press ahead with higher taxes on higher incomes. And one of the quickest moves the president proposed is a change in the estate tax.

In 2009 – under current law – the portion of an estate over \$3.5 million would be taxed at 45 percent. That exempted amount is

the highest ever, and the 45 percent tax, while high, is still lower than what the current law holds for the future.

The entire tax is scheduled to disappear for a year in 2010, and then roar back in 2011 with a much lower exclusion of \$1 million and a sharp hike in the tax rate to 55 percent. If the current law were to remain in force, that year would doubtless pose a serious cash crisis for some bereaved families.

The Obama budget, however, proposes to make the current tax permanent – and take away the “free year” of 2010.

Compared with the existing schedule, Obama’s call for a higher exemption and lower rate is welcome. And while the proposal to take away the free year hurts estates created by a death in 2010, the overall combination is probably favorable for most.

The impetus is clear: The government needs to raise cash, and taxable estates are a potential source of billions of dollars. ■

*Estate taxes are more complex than exemptions and tax rates; rules for valuation, basis and capital gains must also be considered. For more information contact Jodi Mersinger at 630-545-4574.*