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TLA's Ray Murray still live on tape

HOOPS & DREAMS

When it comes to Allen Iverson, Reebok isn't playing games

How to prepare for catastrophe

Valentine's Day special: When Cupid strikes at the office

EXTRA! SMALL BUSINESS GROWTH GUIDE!

february

BUSINESS PHILADELPHIA • 1997 • VOLUME EIGHT • NUMBER TWO

31

32 INSIDE STORY
Hoops and dreams are riding on the skinny shoulders of electrifying 76ers rookie Allen Iverson. ......By KERRY PECHTER

36 TALE OF THE TAPE
The video rental business ain't what it used to be. But along with the major chains, some local movie-buff entrepreneurs are still doing boffo box office. ......By EILEEN SMITH

40 SMOKIN'!
They're low-fat and high-end. No wonder Fabulous Foods' exotic fish are just reeling in the customers. ......By JULIE LIEDMAN

31 CLOSE UP
Ramona Riscoe is jazzing up business at the Multicultural Affairs Congress.By LAURA MUNICH

6 LETTERS
On our watch and up with superwoman!

9 INBOX
Heart-stoppers for executive shoppers and trashy business.

21 TECHNOLOGY
Whether by LAN or intranet, networking isn't just about business contacts anymore. ...By JOSHUA PIVEN

24 EDUCATION
Still deemed vital to career success, the range of continuing-education options is exploding. ..By JAY APT

28 INSURANCE
Catastrophe happens. Expect the rarely expected. ......By MAURA CICCARELLI

30 NET INDEX
How to find the folks we feature.

49 SMALL BUSINESS GROWTH GUIDE
Growing your business by taking the right steps...............By PAUL EISENBERG and LILA BOOTH

59 EXECUTIVE LIFE
The scoop on *BP*'s Family Business Seminar and lots of Women to Watch.

62 EXECUTIVE SERVICES DIRECTORY UPDATE
Clip and save: a periodic update of the 1997 *BP* Executive Services Directory.

63 YOUR BUSINESS HOROSCOPE ......By L.B.GWYNN

64 PUNCHLINES ......By LARRY WEXLER

40

Small Business Advisor

Ideas you can use from people you trust.

13 Executive Briefing
US law schools need to broaden their horizons to train for a shrinking world.

13 Finance
Tax tips for the Golden years to come.

14 Small Business
What the new law means for S Corporations.

16 Law
The Family and Medical Leave Act: Violations and how to prevent them.

17 Web Sightings
Expert financial and investment talk is more than cheap on the Web.

19 The Consultants
On Valentine's Day, an employer's fancy turns to romantic liabilities.

49

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legal systems of other countries. Our Tokyo program was created so that students could intensively study Japanese, Asian and international law and learn to recognize the cultural issues that are inextricably intertwined in every cross-border transaction. I think Japan, with its powerful economy and vastly different culture, is the ideal training ground for lawyers who will practice in the 21st century.

In providing this opportunity for our law students to study abroad, we are following the lead of other countries. Each year, many foreign lawyers are sent to American law schools by their governments, companies or law firms to study our legal system and better understand our culture. This year, we have 35 foreign attorneys studying full-time at Temple for an LLM degree. Other countries understand the necessity of developing a corps of lawyers who are conversant with our legal system. Similarly, our country, to preserve its competitive position in world markets, must develop a corps of attorneys who are conversant with the legal systems of other countries.

In my most recent negotiation in Tokyo, for the first time in my experience, the opposing party was represented by a Japanese lawyer who studied in the US for a year, which gave the opposition a significant advantage because the lawyer understood some nuances—legal and cultural—which would not have been apparent to those who had not been exposed to both legal systems and cultures. Our Tokyo program trains American law students to recognize cultural issues and to integrate concepts from different legal systems so a deal can successfully move ahead, tools which can be applied anywhere in the world. Any company that manufactures, purchases or sells products or services from a foreign company can benefit from the insights of a lawyer who has attended a program like Temple's. These graduates are being hired by American and foreign companies and law firms to guide clients through cross-border transactions or to develop clients doing business outside their home countries. Such transactions are becoming more common every day, and I see no end in sight.

Although I have taken 18 business trips to Japan, I have actually seen very little of the country outside the boardroom, so I look forward to spending January to June living in Tokyo, seeing Japan and absorbing the Japanese culture with my wife, Assistant US Attorney Taylor Aspinwall, whose office has graciously permitted her to take a leave, and our 11-year-old son, Tommy, who will be studying at an international school in Tokyo. Preparing to go away for six months was exhausting, but, I am sure, worth the effort. As rewarding as the time in Japan will be for me personally and professionally, I expect it to be a defining experience for my son. It will be a special pleasure to see Japan through his eyes. □

COMPENSATION

Should you share the wealth?

A company can improve its odds of survival from 34 to 92 percent by valuing its employees and sharing the wealth, according to a recent Cornell University study. The critical challenge, the study says, is to make the connection between profitability, productivity and employee compensation.

Here are some guidelines to setting up organizational-based compensation:

- **Keep it simple. Make a direct link between performance and rewards.**
- **Communicate how employees are being measured. Most companies use multiple measures, such as basing a third of a bonus on individual performance, a third on team (or division) performance and a third on corporate performance.**
- **Show that everyone wins: You're not simply carving the pie into more slices; you're creating circumstances that will mean a bigger pie.**
- **Avoid complacency. Keep your strategy flexible and review it periodically. Once you think you've got it right, take another look.**

One more thing: Your wealth-sharing program needs to be tweaked as soon as you start to feel comfortable with it! □

(Source: John P. Doyle and Paul Ray Berndtson in LRP Publications' HR Reporter*)*

SMALL BUSINESS

What the new law means for S corps

LAST AUGUST, CONGRESS passed and President Clinton signed into law the Small Business Job Protection Act of 1996. Among the many important provisions of this bill was the easing of rules for S corporations.

Because setting up limited liability companies (LLCs) offers owners of non-publicly-traded businesses all of the benefits of S corporations (pass-through tax treatment and limited liability) without the burdensome restrictions, the LLC is the entity of choice when establishing a new business.

But for the millions of small businesses already operating as S corporations, the tax consequences of a conversion to an LLC often rules that out. So it was really for the existing S corporations that Congress eased the rules, which became effective January 1. The S corporation may still be headed for extinction. But in the meantime, the "new" Subchapter S corporation is a real improvement.

Here are some of the changes:

- The limit on the maximum number of shareholders was increased from 35 to 75. Shareholders still must be US citizens or resident, naturalized aliens. Corporations and partnerships still cannot own shares.
- Under prior law, an S corporation

By SHELDON POLLACK

could not own 80 percent or more of another corporation. Under the new law, an S corporation can now own 80 percent or more of a C corporation. An S corporation can also have a subsidiary that is an S corporation if it is a 100-percent-owned "qualified Subchapter S subsidiary" that meets certain requirements. The qualified Subchapter S corporation is not treated as a separate corporation for tax purposes, so transactions between the parent and subsidiary are not taken into account. But the subsidiary is a separate corporation under state corporate law. Where an S corporation needs to segregate liabilities arising out of two or more businesses, use of a qualified Subchapter S subsidiary may be advantageous.

- Under prior law, only grants or trusts, testamentary trusts, voting trusts and certain qualified Subchapter S trusts (QSSTs) were allowed to be shareholders of S corporations. The new law provides for a new trust that also is an eligible shareholder. This new "small-business trust" is a taxable entity that takes into account its share of the S corporation's income and deductions. It is taxed at the highest tax rates applicable to trusts and estates, unless the more favorable 28 percent maximum capital gains rate applies. The important benefits of this new small-business trust relate to its use in family financial planning. The small-business trust can have multiple beneficiaries (children and grandchildren of the small-business owner), and the trustee can exercise "spray" powers for the benefit of such beneficiaries, although it comes at the expense of higher tax rates.
- Under the old rules, a tax-exempt organization could not be an S corporation shareholder. The new law permits certain tax-exempt organizations such as retirement plan trusts, Section 503(c)(3) charitable organizations and universities to be shareholders. But for tax-exempt organizations that hold S-corporation shares, distributions of profit will be treated as income from an unrelated trade or business, and therefore will be subject to income taxes as unrelated business taxable income (UBTI).
- The rules for Subchapter S contain a safe harbor from the prohibition against having more than one class of stock. This is for "straight debt" issued by the business. However, only individuals, trusts or estates were eligible to be lenders under the safe harbor. The new law includes financial institutions among those eligible under the safe harbor to hold straight debt of an S corporation borrower.
- Upon termination of a shareholder's interest in an S corporation, the corporation and all its shareholders could elect to "close the books" of the corporation for tax purposes. However, in many cases it may prove difficult to obtain all of the required consents. Under the new law, only the corporation and the "affected" shareholders—the selling and buying shareholders—need consent.
- Under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), items of Subchapter S income, loss or deduction were required to be determined and audited at the corporate level, as with partnerships. In August, Congress repealed the unified audit rules for S corporations. Now audits will be conducted on a shareholder-by-shareholder basis. However, there are new requirements for consistency between the S corporation returns and the shareholders' returns. Any inconsistency must be "flagged" for the IRS on the shareholder's tax return.
- S corporations can have accumulated earnings and profits from prior years as a C corporation or from pre-1983 S corporation years (when S corporations could accumulate E&P). Under current law, S corporations no longer can accumulate E&P. Hence, the new law provided that any S corporation with E&P from pre-1983 S corporation years can reduce its accumulated earnings and profits by that amount. This wipes the entry off the corporation's books and simplifies recordkeeping.
- Corporations whose S election is terminated or revoked are required to wait five years before making a new Subchapter S election. Under the new legislation, this five-year waiting period was waived for corporations whose S election was terminated or revoked during the five-year period prior to January 1. This rule was provided to allow S corporations that terminated their election under the old rules (perhaps because they were too inflexible) to make a new election under new, more flexible rules. The five-year waiting period still applies when an S election is terminated or revoked after January 1. □

Sheldon D. Pollack is an attorney, an assistant professor at the University of Delaware and author of The Failure of U.S. Tax Policy.

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