All in the family

Following in Father's footsteps isn't always easy. Family business succession requires careful planning. In this article, several families share their experiences.

by Mickey Falcone*

My father had a business. It wasn't a plastics company, but it was a small business. A small grocery store, to be exact. The business was his baby, his dream and my mother's nightmare. My father died in 1966; the company never passed to a second generation. Instead creditors moved in and divided it amongst themselves.

Many entrepreneurs like to believe that times have changed. But, they haven't. Today, only 3 in every 10 North American businesses will ever be owned by the owner's children. The reason: most entrepreneurs do not prepare for the successful succession of their business.

According to experts in family business succession, many company owners blindly believe that their business, once willed to heirs, will continue. However, there are numerous personal conflicts to address and legal issues to resolve before the company can hope to survive into the second generation.

In today's plastics industry, the doors to the second generation are just beginning to open. Many entrepreneurs launched plastics firms during the 1950s and 1960s at a time when the plastics market first started to expand. Now, these owners range in age from 60 to 85.

"I'm an economist, not a psychiatrist," says Léon Danco, Ph.D., President of the Cleveland-based Centre for Family Business. "But, I can tell you that having to retire and leave the business is a very difficult subject for the aging male to deal with. As businessmen get older, the majority don't write wills or plan the succession of their company. It's as though by not doing these things, they think they can hold back time."

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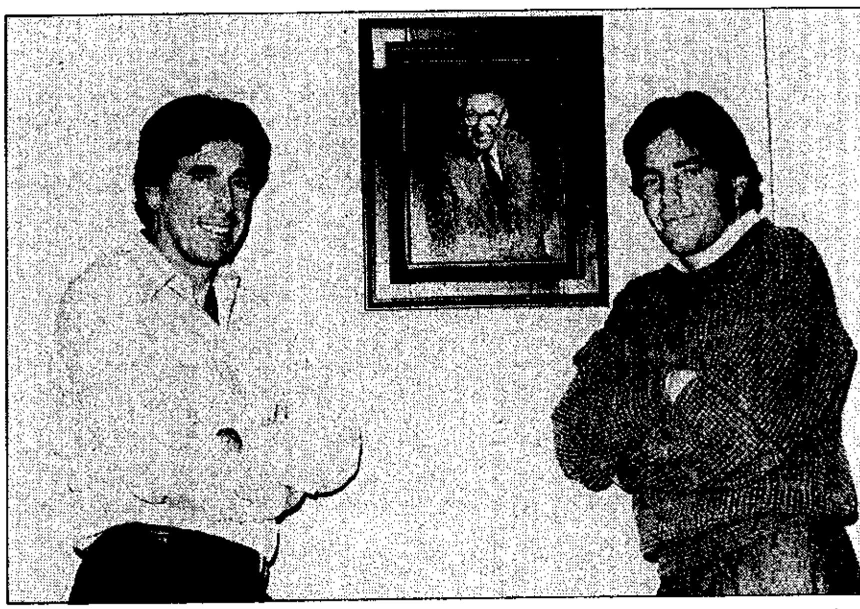


Alan and Ian Medad are actively involved in managing Tarxien, a custom molding firm founded by their father Arnold.

Some plastics business owners claim to be semi-retired, yet will not sell or pass their firms on to their children while they are still alive. Danco, author of several books, including *Inside the Family Business*, sums up the reason why fathers won't let go — it's fear.

Gradual succession

"When they were younger, having all the responsibility on their own would have been too much," says Arnold Medad, president of Tarxien Limited, a firm in Ajax, Ont. specializing in custom injection molding.

Medad is referring to his two sons, Alan, 37, and Ian, 35. Both are actively involved in managing the company and have been for several years since their father moved into semi-retirement.

Medad's experience in the plastics industry dates back to the 1950s. He left Israel with his family and settled in Montreal in 1961. In 1965, he accepted a job as technical director at G.S. Wooley in Toronto and later became general manager at this plastics firm.

Medad started his own company, Tarxien, in 1970. "We had four machines then and 32 now," he says proudly. But, no one doubts that it took a lot of hard work to make the company successful.

Medad's wife, Ruth, has been involved from day one. She serves as company controller, and handles financial affairs and office management.

While relaxing in Arizona, Medad, now 76 years old, says it's too early for him to think about selling or passing his interest in the firm on to his children. Although he will not reveal details, he maintains that he has planned for the company's future once he has passed away. Until then, he continues to visit the plant to check on day-to-day operations.

Medad's actions are not unusual. In fact, they are quite common. Plastics business owners today may have 30 to 50 years industry experience behind them that they are willing to share.

However, they should also remember to work together with their children who are most often aware of the latest changes in technology and the newest techniques in business administration. If owners remain unwilling to accept any of the fresh ideas offered, they will never see the business survive a second generation.

New ideas

Ian Medad can understand his father's uncertainty about letting go. "What makes the situation difficult is that, on the one hand, your parent wants to give you as much responsibility as possible. On the other hand, the company is his baby. They think they know how best to handle everything and you're the child no matter how old you are."

Ian, like most children of entrepreneurs, spent many summers working for his father's firms while attending high school, and later as he was earning a B.A. in Political Science and Economics.

He had just begun working full-time at Tarxien when his father sold the electro-plating division of the business. "I was managing that section at the time, so I was part of the package that got sold. I left Tarxien for three years," Ian explains. "After a year, I left that electro-plating company and did some importing before I returned to Tarxien in 1976."

Ian had not considered returning to work with his father. He did so only because Arnold told the family that he was planning to slow down, and with no continuity, would possibly sell the business. Although Ian felt a certain obligation to return to the firm, he would not return without laying out some conditions.

"Ian said to me, 'I will not be married to the company like you,'" remembers his father. "I didn't know what he meant by that. Then, he reminded me of the times I would work all day, and then take my wife, Ruth, to the theatre at night. After the show, I'd drive back to the company to work some more."

Bob Ritchie now owns the profile extrusion business started by his father Thomas.

Differing opinions

Ian, as vice-president of operations, has brought several new changes to the company, many of them resulting from the fact that some of his philosophies differ from those of his father's.

"I know that my father ate, slept and dreamt the company. But, I don't. I believe that work is only a part of your life.

"I try to convey this same philosophy to the people that work here. I don't want them to put in overly long hours because they have families, they have private lives. To me, that is just as important, if not more so, than work."

Ian's business philosophies also differ regarding company growth. He has a young and aggressive management team behind him that is continuously looking for ways to improve and expand production. An offshoot business to spray paint plastic components was launched; and, plans for a large automotive program are being undertaken.

"Over the last few years, my father has not been against growth, but he certainly would have accepted the size we were five years ago," he says.

Ian's older brother, Alan, joined Tarxien four years ago, when the business grew large enough to need more managers. He serves as vice president administration.

Ian and Alan have brought in a new management philosophy: "My father used to run this company in a fashion where he knew where everything was at any given time. He knew where every bag of material was, and so on, because everything was funnelled through his office," Ian says.

"Today, because of our schooling and industry experience, our management style has changed. Now, my brother and I let the managers manage. We don't get involved with all the details. We don't know everything."

Open to change

Despite all their fresh ideas, the Medad brothers will not make major moves without their father's input. He is their personal mentor, the company consultant, and, above all, still the president.

Arnold Medad's plastic firm is moving slowly, but safely, into the hands of its heirs, because he has remained open to change and has always allowed his children to aid in company decision-making, even when he was actively involved in the business.

Too many business owners aren't willing to take this chance, according to Danco.

"If there is a business decision to be made, the owner should call in the successor and ask him or her to help work on a solution. Of course, doing this will be damn hard for most owners because they aren't accustomed to asking anyone for help," explains Danco.

"Each time the father and successor try to talk solutions out together, the process will become easier and both sides will benefit. An owner may even be surprised to discover just how smart the son or daughter really is."

Sibling rivalry

Communication is one key to a successful business succession, but it isn't the only key. David Gallagher, managing director of the Canadian Association of Family Enterprises (CAFE), helps firms deal with many succession problems. The most common of these — conflicts amongst business heirs.

Ironically, many business owners never even consider their family's ability to work together when planning the company's future. They automatically assume each child should have an equal share and job in the company whether they want to or not.

To ensure that the company survives, an owner should question each child to see if they want to be actively involved in the business and how well they feel they can work with their brothers or sisters. Those that enter the firm should have specific duties or, if particularly skilled, their own division to manage. Sometimes, this type of delegation among family members works well. Wentworth Mould & Die Company in Hamilton, Ont. is one of the luckier firms.

A lifetime in moldmaking

"This company has been our whole life. My brothers and sisters and I have never known anything else," says Raymond Chalkley, Wentworth's general manager.

Just after World War II, his father, Fred, left a career at Dominion Glass to join in starting the plastics moldmaking firm. Internal strife amongst the company's 10 partners led Chalkley to buy them out in the 1950s, at which time, the company received its name, Wentworth.

Now, in semi-retirement at age 82, Chalkley currently spends the winter months in Florida and the summer in Northern Ontario. He still maintains ownership of the company, and his wife is still the company's president.

"He may have started with a hole in the wall, but the company has never stopped expanding in size or product line," says Raymond. "Now, we have 105 staff members and annual sales in excess of $7-million."

Wentworth is the workplace for five of Chalkley's six children. Besides Raymond, there is Sandra, 40, and Cindy, 29, who both work in the office; and the 25-year-old twins, Jeff and Jay, one a controller and the other a purchasing manager. The oldest son, Jim, 36, recently left the company for personal reasons, but still maintains a vested interest in the firm.

Actually, Raymond replaced Jim as general manager. However, neither had ever intended to join their father's company at all. Both had pursued careers that didn't work out; Raymond in television communications and Jim in Physical Education. But Raymond says he is happy now working at his father's firm with other family members.

"I enjoy the plastics business because it provides a lot of challenges that we are working to meet, such as implementing some new computer technology into the plant," says Raymond.

Personality conflicts

Although business owners may not realize it, their successors face a series of personality-conflict hurdles. First, there are often the confrontations between father and successor; second, there may be conflicts between children successors having to share power; finally, a successor may even have to face conflicts with staff and customers who are only comfortable dealing with the original owner.

Experts in family business succession agree that a conflict with staff can be avoided if the successor is not "parachuted" into a management position overnight. Both Danco and Gallagher offer seminars helping business owners to teach the younger generation how to handle the plastics company.

However, both experts agree that company staff will usually respect the successor who has gained some full-time experience in another plastics firm before joining or replacing his father.

Gaining respect

Bob Ritchie, 35, is one successor who is very much respected. In 1974, Bob began working full-time for his father's company, R & M Plastics Limited in Brampton, Ont. However, he left R & M to work for Toronto Plastics in 1979. While there, Bob managed the extrusion division and later took over as sales manager.

Toronto Plastics provided Bob with access to high technology and a broader view of the plastics industry. It also taught him the management and personnel development techniques which are so valuable to any successful business.

"I didn't leave R & M to gather experience and then bring it back. That's just the way it worked out," Bob says. "When I left, I had no intention of coming back to R & M. I was very happy at Toronto Plastics."

But he always wanted to own his own business, so when the opportunity arose to purchase R & M, he took it.

The company was originally formed by Thomas Ritchie in 1966 in a little metal shack with one extruder and no business. Ritchie had been with Micro Plastics before deciding to take a stab at his own company.

"I can remember when we started out and I needed material for a job," Ritchie, now 62, recalls.

"I'd phone B.F. Goodrich in the morning, and tell them I needed material right away. Then, I'd get in my car, drive all the way to Kitchener, put 200 lbs. of material in my car and bring it back to the plant. I would put it in the machine, Herb Schubert (a tool and die maker still with the company) would run it, and I'd be in the customer's office that same afternoon. That's how we became known."

Son runs the show

R & M Plastics has grown to operate six extruders and a staff of 19. However, R & M is especially unique. It is one of the few plastics companies to be under the control of a second generation. In Ritchie's words: "Bob runs the show, not me. It wasn't easy to bow out, but I did. And, now, it's his business. If Bob needs me to come in and help him, I do."

Bob purchased R & M Plastics with a silent partner last summer. Now that he owns the company, he is following many of his father's business philosophies, complimented by his own. Like Thomas Ritchie, Bob will put in long hours and go the extra mile for a customer needing same-day production.

"It's rewarding to me to see that the company is already expanding," says Bob. "I've added new equipment and modernized the plant. Now, we're able to attract a different type of business, yet maintain the bulk of existing customers."

In purchasing R & M Plastics, Bob used the services of a lawyer and accountant. "I knew what was there in the company. I knew what it was worth to me," says Bob. "And I had a pretty good idea what the equipment was worth. It wasn't as though I was coming into a business that I didn't understand."

Estate planning

For Bob Ritchie, the process was easy. But, for entrepreneurs, the legalities surrounding business succession are complex and frightening. For this reason, many owners avoid planning their estate altogether.

"Perhaps, the most difficult part in planning for business succession is dealing with the capital gains tax of 25%," explains CAFE's Gallagher. "No companies I know have that kind of cash kicking around."

However, Toronto lawyer and chartered accountant David Rotfleisch maintains that several solutions do exist to reduce tax on capital gains when transferring a business to heirs, now that all provinces (except Quebec) have abolished succession duties and gift taxes.

"To begin with, the process is more complicated than simply making your heirs a gift of the shares. The Income Tax Act deems such gifts to be made at fair market value," says Rotfleisch. "Fortunately, there is an exemption for up to first $200,000 of capital gains on the small business shares left to your child or grandchild. This applies whether the shares are transferred during your life or willed.

"Of course, this only defers tax. If the children sell the shares later, they will realize the capital gain you would have incurred. But if they pass on the shares to their own children, the deferral will continue. The important point is you now are exempt from paying capital gains tax."

Another solution, which some plastics businesses have tried, is to freeze the estate. This way, the owner maintains voting preference shares. His successor will receive voting participating shares, and other children, not involved in the company, receive nonparticipating shares.

A third solution, proposed by Rotfleisch, is establishing a holding company to acquire the shares of the operating company through a tax-free rollover.

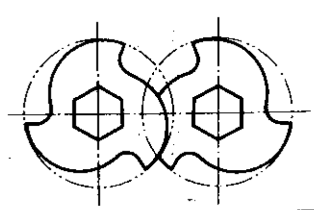
"This new company issues nonparticipating, voting shares to the parents and participating, nonvoting shares to the children," he details. "Alternatively, parents can exchange common shares of the operating company for nonparticipating preference shares and issue new participating shares to the children.

"In either case, the parents take back shares with a value equal to that of the company being frozen and ensure they have a voting majority. The children obtain shares which participate in future growth but carry no or fewer votes than those obtained by their parents. By transferring future corporate growth to children, the parents avoid the capital gains they would otherwise accrue."

No matter how business owners choose to deal with the tax blow, Danco urges that they deal with it and deal with it quickly.

Danco prescribes that plastics business owners who are in their 50s, develop an outside board of directors to help manage the changeover between father and successor. The board should, of course, be made of nonfamily members skilled in business administration, and not "old cronies, employees, or relatives whose only skill is rubber-stamping the owner's decisions."

Experts in business succession agree that there are too many legal and personal stumbling blocks for one owner to handle on his own. But, he must at least address these blocks, otherwise the business will be buried alongside him.



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