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Core Values

When it comes to transferring ownership during a time of rapid growth, a family business that aligns key principles not only survives but thrives

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It's an unjust paradox that the very same values that make family businesses so successful—trust, goodwill, and tolerance—can also serve to undermine it.

Experts will tell you the 30% of family businesses that survive into the second generation manage the task because they've skillfully, arduously, and lovingly leveraged the core values that blur across business and family. And they've often done this amidst a transfer of ownership while never taking their sights off growing the bottom line.

Worry over combustion at the boardroom table and the dinner table has goaded Kim Nelson, of Royal Containers Ltd., since she began to take a real interest in the family business 10 years ago.

"I knew the dismal statistics on second-generation success, and I believed one of the major reasons was lack of a succession plan. I was the one who said we've got to make one," says the 41-year-old mother of three.

That was in 2007: after four years of preparation, consultations, conversations, meetings, and more conversations, she and her father, Royal Containers' founder Ross Nelson, are about to sign the paperwork transferring 25% of the company to her.

While those negotiations take place, the father-daughter duo are pursuing aggressive growth as part of Kim's 10-year strategic plan for the corrugate converter company, which chalks up more than $35 million in annual sales. Just like it sounds, Royal Containers' two plants transform corrugate fluted cardboard sheets, into various end products from grocery store displays to shipping materials.

Since Ross started the company in 1980, the industry has experienced massive consolidation (from 65

Heir apparent, Kim Nelson on the shop floor of Royal Containers' Brampton, Ont., location competitors down to 15). And in order to grow profits, Royal Containers bought 12.1% of a new lightweight recycled-paper mill with two other partners.

"This kind of vertical acquisition is important because 70% of our cost is paper," says Kim. Ross, who turned 65 this year, admits he probably won't see any money out of the deal, but "Kim will and when she does, it is going to be huge."

The new mill is critical to Kim's long-term plan because using lightweight recycled liner is more cost-effective. The company is also investing $15 million dollars in a piece of equipment that can run the lightweight liner, which will be produced at the new mill.

In their own bit of industry consolidation, Kim saw an opportunity in a competing London corrugator and scooped it up two years earlier. By launching Royal Containers London, Ross and Kim gained clients and turned the failing London enterprise into one that makes $15 million in sales a year. The operation is profitable now, and expected to improve.

"Acquisition is the only way to grow and growth is the crux of my plan for the future of the company," says Kim.

Seat of the pants succession

Impressive results, but Ross is the first to say he hasn't followed the best-laid plans for passing on the firm.

While he encouraged his son and daughter to get university educations and pursue their own dreams, they were involved in the business at an early age; helping out in the plant on weekends in their early teens. Both would eventually end up in managerial roles, his son in charge of production, but only Kim would stay on as manager of the office and transition into leadership.

"I kind of expected them to take over, but I wasn't sure how," says Ross. Even now, he has no formal retirement plans, coming in most days expect for a few winter months when he and his wife enjoy balmy days in Florida. "Kim will take over," he says, "when I die."

So how do these two make what is, despite the recent change in ownership on paper, still an incredibly informal governance structure work? Simple: they share the same fundamental business principles.

While Kim has brought changes to the table in the form of acquisitions and expansion, she still "relies on the values that my dad built the company on: trustworthiness, honesty, hard work and loyalty, open-mindedness, and top-line customer service. Holding on to those allows me to maintain the respect of employees who have been there a whole lot longer than me."

For example, in 2005 Kim introduced a then precedent-setting change in her industry. She put the entire operating system online and trained her customers to use it. This empowered her customers to submit or cancel orders and check on shipments whenever they

Carving Out Your Own Niche

KIM NELSON'S TIPS FOR SUCCEEDING A FOUNDER

1 The sooner the better and plan continuously

Allow succession planning to become a part of the company culture. Similar to a mentoring program, for example, succession planning should become a normal part of business to both the founder and the successor.

2 Be prepared for the emotional roller-coaster

Succession is emotional for all parties, and family members in particular expect that the worst can happen; it can tear families apart even when the intentions are to bring them closer together.

3 Respect each other's positions

It takes character for the incoming generation to consistently display respect for the founder, but doing that will generate more open decision-making. The founder has spent a lifetime building the company and has a well-deserved entitlement to all decisions, big or small - it is his or her legacy.

4 Succession planning never ends

By the time you (the successor) have finally agreed on a path and legally executed the succession process with all the appropriate documents—corporate re-structuring, setting up holding companies, trust funds, wills, etc.—it will be your turn to start succession planning! So think about what you would want to happen tomorrow if you were gone. Identifying and relaying the strategic long-term direction of the company to a board of advisors (even if it's an unofficial body) provides peace of mind that others know your intentions in the unlikely event you're suddenly unable to lead the company.

5 Communicate and seek counsel

If both parties communicate on a regular basis, and in a structured way, it can really help the process move forward. But it's sometimes difficult to recognize when an outside opinion is needed. Consideration of the issues by experts in the field (accountants, lawyers, and other business contacts) can be very helpful as they don't have any emotional attachment. Surround yourself with people who can help both of you without prejudice.

wanted, which made Royal Containers both easy to work with and efficient. It was also totally transparent and helped the company maintain what was then most at risk, customer service.

Family business succession expert Francine Z. Carlin of the Business Harmonizer Group in Vancouver, says successful transitions rest in revisiting the values that drive the family-owned enterprise. "You don't need to replace core tenets so much as update them. If teamwork was one of your founding principles 30 years ago, today that might translate to a focus on collaboration and result in establishing a flatter organizational structure. The key is to align business family values with your current business strategy."

Kim Nelson is paying market value for her shares in the family's corrugate converter company

While Kim drove the succession planning process, father and daughter also hired an outside consultant who, over the course of two years, helped identify and articulate the company's core tenets.

"During these discussions a whole bunch of issues came up. But at the heart of the conversations was the question, 'Do you believe this is a family business or a business to benefit the family?'" says Kim. "It was instructive because my brother, my father, and myself had three different ideas. After that realization, we were better able to understand what each of us was thinking and the decisions that were made."

Skin in the game

Tom Deans a speaker and author of *Every Family's Business*, is pretty vocal about his tough love theories on successful family businesses.

He thinks families often make one big mistake, "They mix up management with ownership. You can have a pretty terrific son, daughter, or nephew, or cousin as managers. But managers are not owners. Owners' risk capital and they have a different personality. When there is no skin in the game, the next generation is wired to pursue perpetuity."

Kim's acutely aware of this theory, and thoroughly believes in it. The company has frozen its assets while Kim plugs away at paying market value for her shares [see "Estate Freeze," page 46]. Her entrepreneurial drive and capacity for advancing her education explains in part why she's an exception to Deans' widely shared theory.

Kim notes her preference for consultative decision-making also helps manage the unique leadership role that comes with having her father at the office day-to-day. "I believe a better decision is made when there are more people involved in it," she says. "It's silly for me to think I would know everything."

The fact that Kim doesn't need a title on paper—when forced, she describes herself as vice-president even though she makes all the company's day-to-day decisions, only running really big ones past Ross—shows she's confident in herself and in her father's

Growth in Transition

According to David Shlagbaum, a lawyer with Robins Appleby & Taub in Toronto, the issues to consider aren't "so much legal as they are strategic" when going through all the due diligence steps in the negotiation of an acquisition or investment.

Here are things to consider:

❯❯ Hire an interim senior manager for the sole function of overseeing an acquisition.

❯❯ Nail down your succession plan. "You can't really make proper decisions about growth strategy until you know the future of the company," says Shlagbaum.

❯❯ If you are selling your business to the next generation, you need to carefully assess the strains this could place on the business, your offspring, and yourself.

❯❯ Don't be surprised if the next generation takes a pass when asked to financially invest in the business. "When kids won't risk capital this actually provides valuable information to the parent about what they think of the business's potential and where the business may be in its natural life cycle," says Tom Deans, a speaker and author of *Every Family's Business.*

confidence in her. "Titles have never been a part of the culture," she says. "Ross is still the president officially. He built the company. That was the title he had from the beginning."

Most family-owned companies can't rely on such natural gelling, according to Anna Stuart, vice-president of human capital firm Knightsbridge Robertson Surette in Halifax. She says development of the transition strategy and governance structure should start early, be inclusive and be explicitly spelled out.

"The sooner the better, because children get an appreciation for the fact that this is an asset they need to acquire. It also gives them time to grow a sense of the values that will ultimately drive the business forward."

Transfer before growth

"A company needs to have a handle on succession before any growth strategy can be decided on," says David Shlagbaum, a lawyer with Robins Appleby & Taub in Toronto.

There are a host of financial and legal concerns, especially when the next generation is borrowing money to buy out the founder and the founder is taking a vendor-take-back security position behind the lender for the balance of the purchase price. In these circumstances, the founder relies heavily on his confidence in the next generation and also risks giving up some or all control over his own security to the lender. But there are also the personal reasons, such as potentially competing values and expectations that can get in the way of business strategy.

In this respect Kim describes herself as all business. "I compartmentalize everything in my head. I find I work best when I do that instead of letting the personal and professional overlap." This even extends to a father-daughter relationship. "I would say ours is not a typical relationship. I don't want that to sound negative because it's not. We see each other and have family dinners and all that. But our situation is really mostly professional."

Even when it's all worked out, the hand-over comes down to two factors, according to Shlagbaum: how much does the founder really want to give up, and can the founder walk away?

"A lot of groundwork needs to be accomplished at a strategic level in a company before the founder has the confidence to hand over the reigns," says Shlagbaum.

Ross has plenty of confidence in Kim. "She is totally amazing and not just because she is my daughter. I have been told by so many people how fortunate I am to have to somebody like her taking over the company," he says.

The thing is, he never wants to stop working entirely. Even now he headed up their latest acquisition and still visits key clients. And that's okay with his eventual successor. "Retire? He will never retire," says Kim. "He built this company with his bare hands. There was a lot of blood, sweat, and tears. It is his company. And all of us here know that."

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Estate Freeze

A tax-efficient method for passing on ownership of a company to children BY PAUL MCLAUGHLIN AND LESLEY YOUNG

An estate freeze—exchanging the value of your business interests at their current value for property having a static value—is a method of passing along future growth to others while maintaining some control (ideal if you want to keep a hand in a new business strategy) and reduce your tax burden.

It usually takes place when an owner recognizes he or she will have kids or other relatives take over the business. A freeze is particularly attractive if it's clear a business will keep growing.

Take the example of a family manufacturing business worth $10 million. The two adult children can't afford to buy out their parents, so the parents perform an estate freeze. The parents receive preferred shares worth $10 million and new common shares are issued to children for a nominal amount, say $100, in a 50-50 split. From that point on the two children participate in the growth of the business and use its profits to pay their parents back over time.

Entitlement to future growth then passes to holders of new shares issued as part of the estate freeze. These shares have low value initially because the corporation's entire value is reflected in the freeze shares that are owned by the parents. But the move lets new people become partners in the corporation at a minimal cost.

For the parents, the corporation's tax bill is frozen at the value of the preferred shares at the time of sale. So the parents only pay tax on that sum, regardless of how much growth the new owners (their kids) coax out of the business.