Family Business Magazine
The guide for building and managing family companies

Bouncing back from bankruptcy

When business families rebound from a brush with failure,they wind up closer and stronger than ever—if they survive the ordeal.

By Barbara Spector

One summer Friday morning in 1995, Allison Felstein was waiting for a table at a Bob Evans family restaurant in Terre Haute, Ind. She had come there to escape a family crisis for an hour and share a quiet breakfast with her parents, who were visiting from their home in Wisconsin. The hostess asked for a name so the family could be notified when their table was ready.

Felstein generally isn't shy about speaking up for herself. But as her eyes scanned the crowded dining room, she saw table after table of patrons reading that morning's Terre Haute Star-Tribune, with its dreaded front-page headline: "Hillman's Files Bankruptcy."

Hillman Jewelers was the five-store chain co-founded by Felstein's husband's grandfather in 1934. The store and family alike had been prominent Terre Haute institutions ever since. In the 1990s Felstein's husband, David, ran the stores along with Arnold Kosofsky, husband of David's sister Jane. Kosofsky had been installed as president of the Terre Haute Chamber of Commerce only a week earlier.

But the chain, overextended and saddled with onerous long-term leases, was $1.6 million in debt. On August 9, 1995, the Felsteins and Kosofskys filed for a bankruptcy reorganization, determined to use that breathing space to work through their difficulties and eventually repay their creditors 100% on the dollar. Yet as Allison Felstein waited in the restaurant, she felt as if her dirty laundry were on display before all 60,000 of her neighbors.

"I knew it would be big, big, big news," she recalls. "Everybody likes to see the mighty fall."

Allison, now 41, thought she'd steeled herself for the inevitable local gossip. But that morning in the restaurant she just wasn't prepared to face the stares she knew she'd get if the hostess called the Felstein party. "So I told them my last name was Allison," she recalls.

Bankruptcy—a public confession that you can't pay your debts—can be a traumatic experience for any business. When the firm is a family company to boot, the strain on the family can be devastating. In a town or small city, a family company's financial troubles can affect virtually everyone in the community, either because they work there or because their jobs involve serving the company's employees. "The resolution of business issues can be measured in weeks and months," says Gary Brooks, co-founder and CEO of Allomet Partners, New York, and a founding member of the Turnaround Management Association. "The resolution of personal issues can take a lot longer."

Even last year, before the economic downturn was in full force, more than 35,400 business bankruptcies were filed in the U.S., according to the Alexandria, Va.-based American Bankruptcy Institute. And

experts expect that figure to rise significantly in 2001. Indeed, the number of business filings increased during the first quarter of this year compared with the same period a year ago.

Bankruptcy is no longer the permanent disgrace that it was back in the days when Robert Morris, who signed the Declaration of Independence and helped finance the American Revolution, spent three years in a Philadelphia jail for failure to pay some $12 million in debts. “People have short memories,” Brooks notes. And bankruptcy filing doesn’t necessarily mean failure. When bankruptcy works as it’s intended, it offers sick companies a chance to “restructure and establish a new foundation on which to build a healthy business,” Brooks says. Business families who come through a bankruptcy intact often find themselves closer and stronger for having endured this test together—if they survive it. “If they can successfully pull through,” says Chicago business psychologist Bernard Liebowitz, “they can brag about how they’ve recovered.”

“Loyalty is a very big deal” in family companies, notes Dan Dooley, a principal at Morris-Anderson & Associates Ltd., turnaround consultants in Chicago. “That often causes people to make very bad decisions.” In the case of Hillman Jewelers, the chain’s troubles stemmed from Jane and David’s desire to maintain the multi-store chain that their father, Allen Felstein, had expanded in the 1960s and ’70s. The siblings, who bought the stores from their father when he retired in 1987, felt pressure to keep them all open. “We were making decisions based on what the family would think of us, not what was good for the business,” recalls David, now 53. “My father’s idea was that you can’t go backward.”

In 1993, the couples agreed to a ten-year lease renewal at the Cross County Mall in nearby Mattoon, Ill., that mandated construction of a new store. But customers abandoned the mall, which had lost one of its anchor stores. “I should have just let the lease lapse and walk away,” David says ruefully.

Meanwhile, a new landlord at the Honey Creek Square Mall in Terre Haute demanded that Hillman relocate and rebuild. Another mall—the Danville Mall in Danville, Ill.—had been unsuccessful from the beginning. And changing demographics caused the Hillman store in downtown Terre Haute and another in Vincennes, Ind., to founder.

High overhead hampered Hillman’s ability to compete with national chains. Other problems compounded the woes. In June 1995, $16,000 of consigned merchandise went missing. One month later, a con artist scammed the store by switching $26,000 worth of diamonds with cubic zirconia, a lookalike mineral commonly used in imitation diamond jewelry. Jane and David’s cost of buying the business from their father caused another financial burden. “We did not get a sweetheart deal,” David says. “We paid market.”

A jewelry industry consultant recommended they file for a Chapter 11 reorganization, which enables a company to continue operating as it pays off creditors according to a court-supervised schedule. David was heartbroken by the decision. “He came home that night and crawled up into a ball,” Allison recalls. “He was really worried about telling other family members. I think it was devastating to David’s father and his mother.” The two couples won’t discuss the bankruptcy's effect on their relationship with Allen and Mildred Felstein, now both 81 and in poor health. “There have been some real hard feelings that came from misunderstandings,” says son-in-law Arnold Kosofsky, now 59, without elaborating.

On the other hand, the experience drew the two couples closer together. Both Allison, who had held “a pretty easy, well-paying banking job,” and Jane, a registered nurse, went to work at Hillman for $6 per hour. “We are here; we are part of this, and we’re not going to let you guys go down the river without

helping out," Allison says both women told their husbands.

For Allison, the healing began the day the bankruptcy papers were signed. "It was like finally going to an attorney and saying, 'It's time to get a divorce.' The worst part is building up to it, when you just can't imagine taking that step. Once you take it, it's a great relief." Consultant Dan Dooley says family business owners who file for bankruptcy needn't fear losing status among vendors or customers. Because these stakeholders are keen observers of your operations, they're already aware of your problems, Dooley says. "You do yourself a disservice by lying to people."

Still, it was hard for the Felsteins and Kosofskys to keep a positive attitude or a low profile with "Bankruptcy Sale" signs strewn across the storefronts, the relatives say. Following a consultant's advice, Hillman returned consigned goods to its suppliers and ran bankruptcy sales with the consultant's help. All stores except the one at the Honey Creek Square Mall were to be closed. "Everything we did was public knowledge—everything," says Arnold. "And our competition used it against us. We fought back, and we continue to fight back."

The repayment plan offered creditors two alternatives: receive 40 cents on the dollar immediately or the full amount in annual installments over five years. All but three vendors opted for full repayment—"a vote of confidence," David says. The banks agreed to a five-year repayment schedule, as well.

The Danville Mall landlord accepted 40 cents on the dollar until the lease expiration date of April 1996. The Vincennes lease was month-to-month, and the Mattoon landlord didn't petition Hillman for the remaining lease payment. In April 1996, Hillman sold its downtown Terrre Haute building and used the proceeds to repay a portion of the company's bank debt.

The relatives made the final Chapter 11 payment in January 2001. "We have not borrowed a dime since 1994," David stresses.

Today, Hillman's single store generates about $1.6 million in annual revenues. Personally and professionally, the couples have cut back on luxuries. The store has no travel-and-entertainment account, David says. The families have sacrificed vacations and remodeling of their homes. And the temporary jobs that Allison Felstein and Jane Kosofsky took at Hillman have become permanent. (Jane has kept her hospital job and juggles the two positions while also caring for her ill parents.)

"We all stuck together and made it work," Arnold Kosofsky says proudly. And they discovered they had many friends in the industry, he adds. "The people who stuck with us are the ones we will continue to do business with."

Tom Peterson, who owned a chain of eponymous appliance and furniture stores in Portland, Ore., in the early '90s, would have found it impossible to conceal his company's troubles from the public. Sporting a legendary crewcut, Peterson starred in a series of late-night local TV commercials for his stores and had become a cult figure in the region. At their peak Peterson's stores were generating $30 million a year in revenues.

So when the unwise acquisition of a chain of failing stereo superstores dragged the nine-store Tom Peterson's chain into Chapter 11 bankruptcy in 1991, the proprietor and his flat-top hairstyle were all over the local news. "It hurt like hell," acknowledges Peterson, now 72.

The acquisition was doomed from the start. "Everyone realized we were stretched the day after the sale,"

says Peterson's son-in-law and successor, Robert Condon, 46.

Peterson says it didn't take long to get over the injury to his pride. "I was despondent for two days—then I bounced back again," he says. "It's not the end of the world." His customers' fierce loyalty helped. "They were sending in money in envelopes," Condon recalls. "It was something to see."

Their employees' reaction was a different story. "They were jumping ship," Condon recalls. "When times got tough, they walked pretty fast."

Peterson and his family spent the next six years reorganizing and raising seed money for a new business. Condon liquidated some of his assets to help form the new company, called R.C. Condon Corp., which began operating in 1998. The company conducts business under the name "Tom Peterson & Gloria's Too," an acknowledgment of the contributions of Tom's wife, Gloria, 71, who's worked by her husband's side since the opening of their first store in 1964. They now own a single store that generates about $5 million in sales—an appropriate scale for a couple their age, notes Condon.

Watching his in-laws battle back from bankruptcy helped move Condon closer to them. "Over the last 16 years of being a member of this family, I've found their philosophy to be that tough times don't last; tough people do," he observes. "I've studied under Tom's tutelage, and I know a winner when I see one. He's always optimistic, upbeat and positive."

Today, Condon serves as company president and general manager. His wife, Kathy, 45—the Petersons' daughter—supervises payroll and legal matters. "Tom still is the boss; he makes the decisions," Robert Condon says.

The family doesn't dwell on the financial troubles of a decade ago, Condon says. "It's a taboo subject that we don't discuss any more. We're way too busy concentrating on rebuilding our new business."

The Meloon family of Orlando, Fla., by contrast, doesn't hesitate to discuss the 1959 Chapter 11 filing of Correct Craft, their boat manufacturing company. As the deeply religious Meloons see it, bankruptcy was one of those life tests they took and passed, learning a great deal in the process. "Our school colors were black and blue," quips Walter N. Meloon, 63, the company president.

Correct Craft, founded in 1925, built boats for the U.S. military during World War II and the Korean War. "The company and the family had a habit of living from one government contract to the next," Walter N. reflects. "There wasn't a policy of saving for a rainy day. When the rain came, it was just too much."

The Meloons say their troubles began when a government contract for 3,000 boats was pulled in 1959. According to the family, a government inspector began rejecting large numbers of Correct Craft boats after the company refused to carry an expense account for the inspector. (Family members say this represented an attempt at double-dipping, since expenses were covered by the government.)

After the contract was canceled, Correct Craft found itself $1 million in debt and reduced its workforce from 500 to about 25. With their distribution system dismantled, the relatives gathered together their meager assets and devised a way to sell their boats. Walter O. Meloon, now 85—the company's current treasurer/secretary and father of Walter N.—was appointed by the bankruptcy court to head the recovery effort. He asked his parents (his father, Walter C., was the company founder) to set up a facility in New England. Walter O. and a friend each contributed $5,000 (to finance his portion, Walter O. and his wife,

Betty, took out a third mortgage on their house) and began an outlet in New Jersey, staffed by the friend.

Walter O.'s brother Ralph C. Meloon, now 83 and the company chairman, obtained a second mortgage and traveled to Indiana with his wife (also named Betty), towing boats behind their car. The couple saved on expenses by living in a tent six months per year for more than five years while Ralph peddled the boats in the Midwest. Because Ralph didn't want dealers to know he was broke, he would leave Betty at a campsite 50 miles away while he demonstrated his products.

Alone in the tent, Betty often found herself lacking shelter when a heavy storm hit, Ralph recalls. "The only place on the campground where she could get security was the ladies' room, and she'd have to stay there until the storm got over." In the winter, Ralph would take Betty back to Florida, where she stayed home alone while he continued to travel with the boats.

"You don't know how much I appreciate this lady, because we've been through so much together," Ralph says. When the Meloons speak to other business families, the reticent Betty offers a simple explanation for how she endured during those years, according to Ralph: "You do what you have to do—that's all she ever tells them."

After six years of bankruptcy negotiations, the court became impatient and announced its intention to shut down Correct Craft and sell its assets to pay off the debt. (According to the family, the problem occurred because court officials had lost the original bankruptcy paperwork.) The Meloons obtained letters from their creditors agreeing that if Correct Craft continued to operate, the creditors would accept 10% of the debt owed them (in addition to 10% that the family had already paid).

But the family felt duty-bound to repay 100% of the principal on their original debt. "Whenever we had a few dollars left at the end of the week, we found a creditor," says Walter O. "A lot of times, it cost more to find them than to pay them." Following a Biblical precept, they began by paying off the widows of creditors who had died.

The Meloons had hoped to retire their debts in 1984—by which time they were making payments to some of their original creditors' grandchildren. In the 1980s, Correct Craft built a line of bass-fishing boats and sponsored a team of competitive bass fishermen in a promotional venture. Under the terms of the sponsorship, the company and the fishermen split the team's winnings. But by May the Meloons still had $47,000 in outstanding payables. Because the company needed to finance the launch of a new line of boats in July, they realized they probably would have to carry the debt into the following year. Amazingly, the fishing team—which had never won a major prize before—netted $100,000 in a May 1984 competition, enabling Correct Craft to settle its debt just as the Meloons had hoped.

Today, Correct Craft has fully recovered, with 300 employees and $67 million in sales for 2000. The bankruptcy is just a distant memory—that is, it would be if the Meloons didn't go out of their way to share the experience with other overextended Christian businesspeople through a series of weekend ministries, for which they pay participants' travel expenses.

"At first, I felt bankruptcy was more like a stigma than a legend," says W. Gary Meloon, 40, the company's director of marketing and the son of Walter N. "As I got older, I grew to appreciate what it really meant." The company's legacy, he claims, is a lesson about setting priorities, which he defines as "God, family and then business."

A helping hand for troubled family companies

The Turnaround Management Association is an international association of professionals who help companies manage and improve their performance during periods of dramatic change. Its members include financial and operating advisers, attorneys, debt and equity investors, asset-based lenders, venture capitalists, accountants, appraisers, auctioneers and liquidators, as well as judicial personnel like bankruptcy judges and government representatives who shape policies to support corporate recovery.

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Turnaround Management Association
541 N. Fairbanks Court, Suite 1880
Chicago, IL 60611
(312) 822-9700
Fax: (312) 822-9706
www.turnaround.org

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