Foundation Ownership at Kavli[1][2]

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Overview

Kavli is one of Norway's largest food producers and a multinational corporation with production in all the Nordic countries and the UK. It has shown impressive and generally profitable growth over more than 120 years. Kavli is 100% owned by the charitable Kavli Trust. In this case study I discuss to what extent foundation ownership and governance has contributed to the company's success.

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[2] I am grateful to the Kavli Trust for its kind-hearted cooperation in this project, including interviews and comments. Special thanks to the chairman of the foundation board, Associate Professor Aksel Mjøs, Manager of the Kavli Trust Inger-Elise Iversen, chairman of the Kavli company board Finn Jebsen, Kavli's CEO Erik Volden and former chairman of both boards, Reidar Lorentzen. I am also deeply grateful to Professor Ola Grytten from the Norwegian School of Economics for sharing his data with me.
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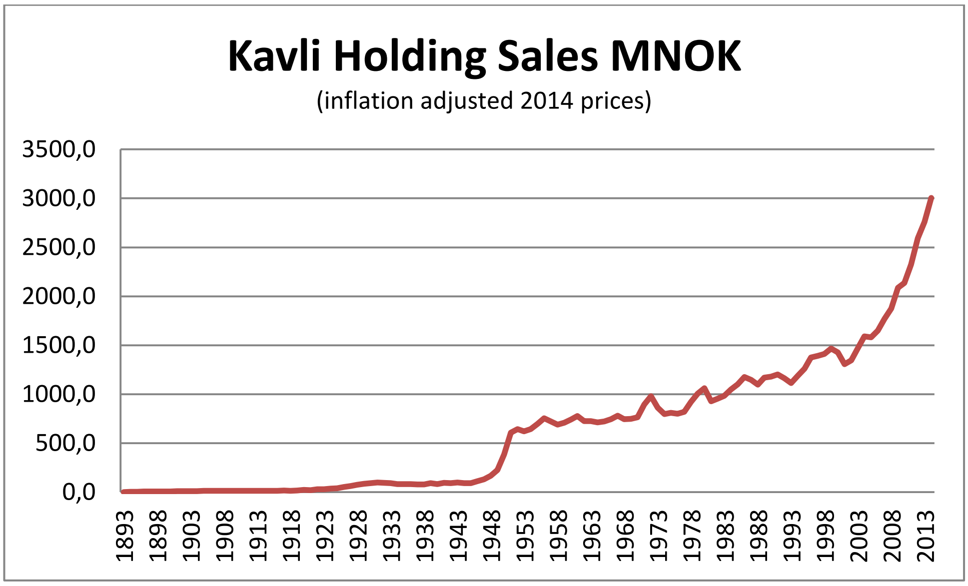
Introduction

Kavli is one of the largest Norwegian food producers with sales of3 bill NOK (app. 2.4 bill DKK / 375 mill USD) and 800 employees. It produces cheese, milk and various other processed foods. It is a multinational company with production in the Nordic countries and the UK. It is 100% owned by the Kavli Trust[4] which donated 43,6 mill NOK to charity in 2014.

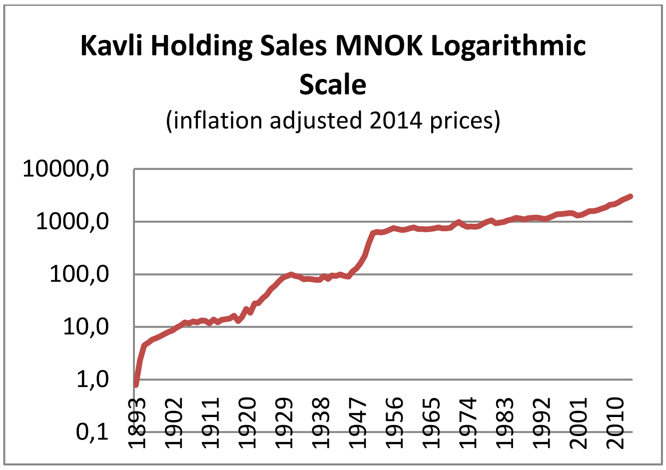
Figure 1 provides a snapshot of the Kavli's evolution, which is shown below in terms of sales. The company started out as a cheese manufacturer, but from early on diversified into fish and dairy products, condiments, crackers, bread, squashes, sauces and so on.



Source: Grytten and Minde (2013)

We observe impressive long run growth with accelerations after the Second World War and after 2003, when sales doubled from 1.5 bill to 3 bill NOK. These developments are also visible in the logarithmic diagram below, which also reveals fast early growth and an acceleration period in the 1920s. In logarithms a straight line indicates a constant growth rate.

[4] The words trust and foundation are synonymous in this context. We use the name "Kavli Trust" to avoid confusion with another charitable (non-industrial) foundation, The Kavli Foundation.



Source: Data by Grytten and Minde (2013)

Generally, Kavli's growth has been profitable with ROS (Return on Sales) fluctuating around 5%, but with deficits in the beginning of the 1920's, the 1930's and during the first phase of dairy production after 2000. The losses in the 1920's were particularly serious and partially attributable to financial speculation that caused the company to go temporarily bankrupt (Grytten and Minde 2013).

Some of the most important events are outlined below. We can identify the growth period in the 1920's with the introduction of the spread cheese Primula, Kavli's first major innovation. The after-war acceleration may be related to pent-up demand and relaxation of trade barriers, while the post 2000 growth surge was caused by the launch of the company's dairy division and a series of international acquisitions.

At first glance it may be difficult to understand the advantages of foundation ownership for a company like Kavli, which neither has the luxury of high profit margins, nor is shielded from competition by capital intensity or patents. However, within its industry Kavli has a tradition for product innovation and experimentation by entering new businesses. The company's signature product, the spread cheese Primula, was developed by a focused research effort, which continues in the company's laboratories. Moreover, the company's brands are valuable immaterial assets which benefit from longtermism.

A recent example of stubborn longtermism may be Kavli's entry into the Norwegian diary industry by what came to be the so-called Q dairies (Grytten and Minde 2013 p. 231-248). As a cheese producer, Kavli always been relying on a supply of milk, which had become highly regulated and controlled by a monopoly cooperative, Tine. Kavli decided to enter the market, when the Norwegian parliament liberalized the milk market, but encountered unexpectedly fierce resistance from the incumbent cooperative monopoly (Tine), farm organizations and regulators. This led to 117 months of deficits, which was a drain on financial and management resources that would have been difficult to sustain for a company with a shorter time horizon. Eventually, after much toil and after successfully filing a lawsuit against the Norwegian government, the Q dairies were able turn a profit in 2007 and to become one of the biggest subsidiaries in the Kavli Group. In the political and bureaucratic turmoil Kavli's foundation ownership proved to be an additional advantage against accusations of profiteering on Norwegian consumers. As a special bonus the company seized the opportunity to produce the Icelandic yoghurt Skyr which became an instant success.

Kavli Time Line
1893 Olav Kavli founds Kavli Cheese and Food Factory in Bergen, Norway 1905 First exports (to Denmark) 1912 Fish products (synthetic Kaviar based on cod roe) 1914 Dairy production started 1924 Bankruptcy after failed financial speculation, formation of a joint stock company 1924 Production of Primula, one of the first spread cheeses in the world 1924 Knut Kavli, Olav's son, joins the firm 1929 Production of the first tube cheese in the world 1933 First Sales Office in Stockholm 1934 Production in Vienna 1935 Factory in Denmark 1936 Factory in Newcastle, UK 1938 Production of mayonnaise 1940 Production in Sweden 1958 Olav Kavli dies 1962 The Kavli Trust is established by donation from Knut Kavli 1965 Knut Kavli dies 1968 Acquisition of a Danish mustard producer 1968 Production of dog food 1976 Production of "fruit juice" 1984 Acquisition of a bread factory 1997 Acquisition of pate producer Castle-MacLellan, Scotland 1997 Q Dairies established
Source: Grytten and Minde (2013)

Goals and Values[5]

Kavli has very clear statement of its goals and values summarized in the leaflet *"We in Kavli"*.

The company is in no doubt that the overall goal is economic value creation. *"The overall goal for Kavli is to create good economic results over time. To put it in another way – the goal is long term value creation"*.

Kavli recognizes that profitability drivers may be a challenge in the absence of outside owners, but maintains that its foundation ownership implies a special obligation for value creation.

"What makes our company different from most other firms is that Kavli is owned by a charitable Trust. This means that all value creation accrues to the Kavli Trust. Some is retained to strengthen and develop the firm, the rest is donated to humanitarian goals, research and culture. Put simply, you can say that we who work in Kavli work for a good cause."

"With Kavli's unique ownership form, there will always be a risk that the company is not faced with the same demands as companies with normal shareholders. On the contrary, we in Kavli see this unique ownership form as an obligation to value creation."

The goal is that Kavli shall be a leading food company – *"at least as profitable and dynamic as the best competitors in the industry".* The projected means are: recruiting the best employees, innovation/ being close to the market and corporate responsibility.

Kavli has also articulated a set of values in the spirit the founders (Olav and Knut Kavli):

- Ambition
- Longtermism
- Continuous Improvement
- Cooperation

Ambition signals a will to grow the company and develop new products. Statistical studies indicate that foundation-owned companies tend to be conservative and grow slower than other companies (Børsting et al. 2014a), so a conscious effort may be needed to maintain the company's drive.

Longtermism is a particular source of competitive advantage for foundation-owned companies (Børsting et al. 2014b). *"We in Kavli"* puts it this way:

"Many of our competitors are driven by pressure for short-term results. Shorttermism can often be destructive for good long-term results – and we know that quarterly results are not the best measure of value creation"

The company is conscious that longtermism should not lead to complacency:

"At the same time it is important that our longtermism does not become a pretext for complacency. We will look sufficiently far ahead and give the time necessary but at the same time require good progress in both planning, decisions and implementation. We want both longtermism, speed and activeness."

[5] The main source for Kavli's values is a leaflet "We in Kavli" prefaced by the company's CEO Erik Volden.

Continuous improvements are among other things regarded as an antidote to complacency which may otherwise come to rule in old company with patient ownership.

Cooperation and other common values are particularly important in a company that was traditionally very decentralized. The individual country subsidiaries were historically quite independently managed (Grytten and Minde 2013), and the company still aims to be *"a multi-local enterprise – with room for diversity and local differences in the markets which we serve"*. This makes it necessary to emphasize the benefits of synergies and cooperation.

The Kavli Trust

The Kavli Trust was established in 1962. Knut Kavli donated 2/3 of the company to the foundation along with an option (a right of first refusal) to buy back the remaining stock from the other heirs, which it subsequently did.

The foundation was first and foremost a solution to the succession problem (Grytten and Minde 2013). Knut and Karin Kavli had no children and wanted a secure future development for the company.

From the beginning the Trust had three objectives:

- Charitable donations
- Managing the financial endowment
- Ownership of the Kavli company.

According to the charter, which has been revised (with the approval of the foundation authority) since it was written by the founder, the foundation's purpose is to benefit humanitarian goals, research and culture (§1). The foundation cannot sell its basic endowment of Kavli shares, but the company may if necessary merge or issue new stock provided that the foundation retains *"considerable influence"* (§2).

The board shall consist of 3-5 members, of which two should be knowledgeable about the company's business areas, two should have work experience in culture, research or humanitarian projects, and one should have competencies in finance or investment. New members are appointed by the incumbents on the foundation board after consulting with the company board and company executives (§4).

The foundation board decides on donations and exercises the foundation's ownership interest in the company to ensure that *"the company is managed according to the principles which at any time apply to forward looking business management"* (§5).

Board members sit for 8 years with an age limit of 67 or (if the other members approve) 70 years. However, recently appointed board members (i.e. appointed within the last two years) must retire if the majority of the other members require it (§8).

Historically, the Kavli Trust donated relatively little and focused its donations on the Bergen region. But in recent years, donations have grown to more than 40 mill NOK, and the foundation has employed a daily manager. The foundation seeks to donate to each its 3 main purposes (humanitarian aid, research and culture), but it is not required to spend equally on the 3 goals (current target ratios are 50:30:20). Somewhat unusually, the Foundation has sought to be more visible by advertising and other means in recent years. The company has also sought to raise awareness that it is owned by a charity and that profits are ultimately donated to charity. It other words, company management has come to regard foundation ownership as a reputational asset.

Governance

The key constituents of Kavli's governance are the two boards – the foundation board and the company board.

As was the case in the past the board of the Kavli Trust is relatively small (3 members). It comprises a mix of competencies in research, nonprofit management and business experience.

Kavli Trust Board 2015	
Aksel Mjøs	Chairman of the Kavli Trust, Associate Professor at the Norwegian School of Economics (NHH), formerly CEO of DnB Asset Management and Vice President in Morgan Stanley Investment Banking
Solfrid Lind	CEO at Campus Kristiania (a foundation-owned college). Several board positions in nonprofit companies.
Dag J.Opedal	Professional board member, former CEO of Orkla.

The Kavli Trust has appointed Inger Elise Iversen, with broad professional experience and most recently a manager in Hansa Borg Breweries, as "daily manager" in charge of philanthropic and administrative activities.

The company board in turn consists of 8 members, two of which are employee representatives (see below)

Kavli Holding Board of Directors	
Finn Jebsen	Chairman of the Board, former CEO of Orkla, self-employed with several board positions.
Frank Mohn	Managing Partner of the financial consultancy firm Momentum Partners, former CEO of Rieber & Son, an international branded food company.
Lise Hammergren	Executive Vice President at BI Norwegian Business School, formerly Marketing Director at Lilleborg.
Stefan Granlund	Independent consultant and CEO of Nordic Lunch AB, formerly CEO of Kraft Foods Norway.
Eli Kverneland	Employee representative, Administrative Assistant (Q-Meieriene AS)
Aksel Mjøs	Chairman of the Kavli Trust, Associate Professor at the Norwegian School of Economics (NHH), formerly CEO of DnB Asset Management and Vice President in Morgan Stanley Investment Banking
Rune Nyheim	Employee representative, TPM manager (O. Kavli AS)
Dag J.Opedal	Professional board member, former CEO of Orkla.

Erik Volden has been employed as CEO of Kavli Holding since 2005[6].

Two members sit on both the foundation and the company board, which happens to be the optimum overlap between the two boards suggested by Hansmann and Thomsen (2003). The idea is that both boards need to act independently but that some overlap can facilitate information flows so an intermediate solution with a mostly independent company board is warranted.

The company board members have extensive business experience in food and branded consumer goods (with executive experience from Kraft, Orkla and Rieber).

The key governance principles for the Kavli Trust are laid down in an internal memorandum "Governance and Development of the Kavli Trust" (hereafter "The Memorandum") approved by the Kavli Trust board.

The document emphasizes the need to keep foundation statutes and practices up to date in accordance with contemporary challenges and general professional standards. While the foundation charter (the Trust deed) and founder's intentions are regarded as the foundation also in this respect, the document emphasis governance of the foundation as a *"relay of trust"* from the founder to the foundation board and to successive "generations" of board members. *"Nobody fully knows what views Knut Kavli had upon founding the foundation. And perhaps even more importantly, nobody fully knows how he would have viewed situations that arose after his departure."* Thus the foundation charter needs to be interpreted with flexibility, particularly since it historically contained clauses that were deemed inappropriate or inconsistent and inappropriate in a contemporary context (see "Governance Issues" below).

The Memorandum recognizes that this puts a heavy responsibility on the foundation board, particularly with regard to self-appointed board members. "*It is not difficult to imagine significant negative consequences of relaying trust to the wrong persons. Or that that the "right" persons develop in the wrong direction over time. In the worst case this can lead to great value losses both economically and in terms of reputation".*

The Memorandum addresses governance issues and contains precise guidelines and principles for the foundation's philanthropic activities as well as for administration of its growing financial portfolio. It also addresses the relationship between the foundation and the company.

The foundation recognizes the close connections with the company, which may have become even stronger as the company has decided to emphasize its foundation ownership as part of its value statement. "*The Foundation and the Company share a common destiny with regard to value creation and values related to corporate culture, brands and financial matters".* The Foundation is conscious of spill-over effects which the foundation's activities and behavior may have on the company and maintains that this calls for *"close interaction with the Company with regard to value creation in an extended sense".* That said, the Memorandum clearly states that the foundation should *"leave no doubt that it pursues its own interest only"* (and not the interests of the company or any third party unless they are consonant with its own).

As for governance of the company, the Foundation aims for a proper balance between owner involvement and autonomy of the company.

[6] Such long tenure may be regarded as evidence of longtermism but previous CEOs did not sit for that long (Grytten and Minde 2013 p. 318).

"There is no doubt that the Kavli Trust is charged with serving the Kavli Company in the best possible way by exercising competent ownership. Neither is there any doubt that this assumes close proximity between the Foundation and the Company. At the same time it is a formal condition that the Foundation is independent. Therefore it is necessary to design and exercise a proper balance between proximity and independence. Independence of the Kavli Trust implies that it has the sole decision making authority matters set by the foundation statutes and prevailing laws and rules ". Having the foundation be represented with two board members (no more, no less) appears to reflect just such a balancing of considerations.

As a rule, the company is governed by the company board and managed by the company executives. However, appointment of a new company CEO and company chairman also require formal approval by the foundation board. The company board is elected at the company's annual general meeting and thereby effectively decided by the foundation (board), which is the only shareholder. Moreover, the foundation board must be informed of investments/ acquisitions/transactions of more than 50 MNOK and must actively approve investments/transactions exceeding 200 MNOK.

The foundation board ensures that it is up to date with company affairs. Erik Volden, the company CEO, provides a one-hour update on the company at all regular foundation board meetings. The updates include changes in company strategy and other important topics.

Board fees are fixed and set somewhat below market rates for large companies. Regular board members in the foundation and the company get the same fee.

The foundation's financial administration is also influenced by its ownership of Kavli. In recent years the foundation has accumulated financial reserves of its own (rather than letting the funds remain in the company). This is motivated by risk management concerns, for example to build reserves for subsequent investment in Kavli, to make foundation donations less dependent on fluctuations in company earnings and to make the Foundation's total assets less dependent on the company overall. The financial reserves are invested in a liquid fund portfolio with external advice and reporting.

The foundation's philanthropic activities are also influenced by its ownership of Kavli. For example, positive spill-overs of foundation activities depend not just on their charitable nature and social utility, but also whether they are perceived as such by the public, including Kavli employees and other stakeholders. For the same reason the Foundation desires to communicate more about its philanthropy in the years to come.

To be effective the Foundation's philanthropic activities must play an independent role. But the foundation maintains that *"It must both be legitimate and a goal in itself for the Foundation as owner that they benefit the company."* This applies particularly to the level of donations which should not place an undue financial burden on the company by an imprudent level of dividends. Currently a distribution ratio of donating up to 40% of Foundation profits is deemed appropriate by the Foundation board.

The same applies to issues such geographical diversification where a previous focus on the Bergen area has now been abandoned in favor of more international projects. A continued narrow-minded focus on Bergen could create bad will among the majority of Kavli employees and stakeholders outside Norway. A minor part of the Kavli Trust's donations are even allocated as open for suggestions by employees of all Kavli subsidiaries inside and outside of Norway. Similar concerns influence the risk management of the Foundation's philanthropic activities which try to avoid reputational risk that could spill over to the company. However, most of the donations now go outside Kavli-land (i.e. the Nordics and the UK where the company has production activity).

Finally, the Foundation hopes to be a positive role model for the formation of Norwegian industrial foundations in the future since this structure has hitherto been uncommon in Norway

Governance issues. The Kavli Trust is currently satisfied with its governance, but this was not always so. In several respects, it has been on a journey (or learning process) during the five decades since its formation.

Most prominently, the original charter stipulated that leading company executive should sit on the foundation board. This would seem at odds with modern governance principles regarding independence as well as the above mentioned empirical research (Hansmann and Thomsen 2013), which emphasize the value of managerial distance between industrial foundations and their companies. Predominance of current company executives on the foundation board would seem to short circuit the ownership function which can help remove inefficient directors or executives and change misguided strategies. Such executives are not independent foundation or company board members since they have a clear vested interest in preserving their own jobs and sticking to their own ideas.

Kavli's governance evolution was also advanced by the establishment in 1994 of a holding company between the foundation and the business units. Prior to that the foundation had for a long period acted as headquarters and holding company for the company's many businesses (Grytten and Minde 2013). Moreover, there had been tensions between Kavli Norway and foreign subsidiaries. The new structure put all subsidiaries on the footing and avoided the looming prospect of taxation which might be levied if the foundation was perceived as a business rather than a charity.

A third example of governance change is the increased emphasis on both the quantity and quality of the foundation's philanthropic activities mentioned above.

One of the biggest challenges for Kavli's foundation ownership has been a latent skepticism in the Norwegian business community which is not familiar with this ownership structure. In principle, this might have made it more difficult to recruit talented leaders and board members, but in practice it has been possible to recruit people that were not discouraged (or even positively motivated) by the idea of philanthropic ownership. However, in this connection it was very important for the foundation and the company to demonstrate a professional organization with a clear division of labor between business and philanthropy and chain of command from corporate headquarters in the holding company to the international and Norwegian subsidiaries.

Orkla, a large Norwegian conglomerate, appears to have been a role model for Kavli management and a source of experienced board members and managers.

So far, the foundation remains the sole owner of the Kavli Group. The foundation board has discussed whether partial listing or equity investment might be a possibility, but the board has chosen to retain its ownership. One argument is that the company can now claim that all profits ultimately go to charity, which would not be the case with outside owners.

Discussion

Kavli appears to thrive under foundation ownership, which has increasingly come to be seen as an asset rather than a liability for the company. The longtermism of foundation ownership enables Kavli to be innovative in product and business development. The foundation's philanthropy is emphasized as a source of reputation and employee motivation in the company.

However, good governance and management have been found to be essential to reap the benefits. A conscious management effort is needed to avoid that longtermism slips into complacency. Checks and balances, synergies and a clear division of labor have been implemented by the creation of a holding company between the foundation and its businesses. The foundation exercises ownership, manages its financial endowment and handles the philanthropy. The holding company takes charge of overall corporate strategy and related projects, while the subsidiaries manage their businesses locally.

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