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Control and growth: the taramosalada kings

By opening up to external finance and management, Katsouris Fresh Foods Limited has become a force in ready meals. Dr Panikkos Poutziouris of Science Enterprise Centre (previously at Manchester Business School) reports on how the Katsouris family resolved the classic dilemma between growth and control that arrests the development of so many private businesses.

This is the story of the transformation of an ethnic small business from an introvert struggling family venture into a professional, market-oriented medium-sized growth star. At the cost of relinquishing 20 per cent of ownership control and opening the board to non-executive directors, the Katsouris family reached a profitable resolution of the growth versus control dilemma that owner-managing directors of family firms often find insurmountable and which can result in arrested development. Instead, Katsouris Fresh Foods Limited (KFF) has evolved into a champion business family that has activated a line of ventures across the industrial spectrum: trading ethnic delicatessens and fresh vegetables, launching a chain of restaurants serving Mediterranean/Greek mezedes and wineries and setting up a state-of-the-art food-processing plant. The family stake in the business had also increased over the last 15 years.

KFF's founder was the uncle of the current generation, Theodosis Katsouris, who arrived in the United Kingdom in the mid-1950s as an immigrant from Cyprus. He opened an office in London's Strand to market fresh produce supplied by the family partnership and other suppliers in Cyprus. In 1964, Katsouris Brothers Limited was formed. The company began to import high-quality food, predominantly from Greece and other Mediterranean countries, and sold them under the company's Cypressa brand name. In

1976, the wine and mousaka business was set up with three restaurants selling Greek food and wines at affordable prices.

Following the success of the restaurants (and the prospect for chaining out), the family decided to open a large central kitchen with the aim of improving control over both the quality and stock levels of food used in the businesses. This enabled more restaurants to be opened and a start to be made on the manufacturing of ready meals for the retail trade. In 1982, the central kitchen was set up and operated under the name Katsouris (Fresh Foods) Limited.

In 1983, the company began operating from four locations close to the North Circular Road in Wembley. It is a leading supplier of ethnic – not only Greek and Mediterranean but also Indian delicatessen – recipe dishes to the major supermarket chains for sale under their own brands. The launch and early development of KFF was financed by pooling family capital. In essence, the company was owned and managed by a consortium of five cousins, drawing further managerial support from the extended family.

The ethnic ready meals sector has been one of the most dynamic sectors of the UK food market in recent years. In 1999, the market was valued at £1.22 billion and consumer spending on ready meals accounted for 2.2 per cent of all consumer expenditure on food. Between 1995 and 1999, retail sales of ready meals increased by 21 per cent, outperforming growth in the food sector overall. Demand for convenience foods has been driven by factors such as busier lifestyles, shrinking household sizes and less time being devoted to cooking – particularly during the week. As consumers' tastes become more sophisticated, so they have come to expect more authentic flavours and textures in ready meals. Armed with higher incomes, they are prepared to pay a premium for authenticity. However, as part of the food sector, the industry is subject to stringent legislative controls under the close scrutiny of the Foods Standards Agency.

The ethnic ready meals market is very fragmented in terms of supply. It is characterised by a large number of small specialist suppliers and the major supermarket chains supplying their own-label ethnic ranges, together with a handful of companies accounting for mass-market brand leaders such as Sharwood's & Patak's. The continuing segmentation of the marketplace, together with the growing demand for more authentic products, have provided increased opportunities for smaller, regional, often family-run, companies. In addition, the low barriers to entry also encourage the small independent specialists to carve out successful niches in the market. However, this may not continue indefinitely, as size is becoming an issue. Given that the majority of players in this market are small, increasing takeover activities are likely to be used as a form of growth to supplement organic development.

The ready meals market will continue to be driven by convenience and innovation, but future success depends on closer worker relationships between suppliers and retailers. The main challenges are, therefore, the widening of the consumer base and the raising of the purchasing and usage levels.

Although there was plenty of demand for ethnic ready meals, KFF incurred losses in the early years. This was because without considerable development work on the restaurant techniques that were being used the central kitchen could not produce large enough volumes of products or maintain satisfactory quality. As a result, in 1985, it was decided that if the business was to continue manufacturing for the retail trade and to grow, it would need a larger production plant base and it would have to employ automated and technologically advanced food technology. This investment programme was fundamental not only in developing the production side, but also in enabling the company to join the supplier chain of the supermarkets who are spearheading the ready meals market. However, in order to facilitate the techno-economic transformation and to enhance the growth potential of the company, additional, and external, funding was required.

During 1986, the family considered the strategic financial development of the company. Following a series of discussions, the family board took a decision that probably shook the tombstone of their predecessors: relinquish, albeit partially, ownership in exchange for capital to finance the development of the company's business strategy. The managing director reflected that occasionally the strategic planning process was disturbed by the echoes of the words of senior Theodosis Katsouris:

> '. . . and always remember to cherish our customers, capture them with service and quality . . . and more important enjoy your independence: Good business thrives only on "sweat and blood" fortified money; home-made profits. . . do not become servants of the financiers.'

However, the board of KFF felt that, while it was worthwhile to cherish old principles and traditions, it was imperative to water down their wine, symbolising family business control, in order to safeguard the survival, growth and long-term prosperity of the company. 1986 marked the beginning of the partnership with Durrington Corporation, a private finance company specialising in the provision of development equity finance. The strategic financial decision was taken: 2,500 ordinary shares, representing 20 per cent of the overall shareholding, were issued to Durrington. This diluted the five equal family shareholdings of 20 per cent to 16 per cent. In addition, Durrington obtained a seat on the board of directors. As a result of the transformation of ownership and management regime, family owner-directors did control 32 per cent while the other family members control 48 per cent of the shareholding, giving the family an overall controlling interest of 80 per cent.

With the additional equity capital, the company purchased a factory that was in a dilapidated state of repair and, over the years, spent in excess of £5 million on refurbishment and acquisition of modern equipment to satisfy the standards required by the major food retailers.

Following further growth, the company acquired another site nearby in 1995 with an injection of £1.1 million short-term finance from the shareholders. The site was equipped to become a new production unit for recipe dishes and snack foods. Approximately £4.5 million was spent on refurbishment and purchase of equipment including a state-of-the-art Stein oven specially developed for fast and efficient cooking for ready-made meals and snacks. Further investment was made during 1998 and 1999. In order to enhance the production facilities, the company spent £3.6 million on the acquisition and refurbishment of another factory nearby. Rather than raising the capital internally, the investment was financed by a £3 million long-term loan from the bank, secured over the company's assets.

With the additional finance, the business becomes known as the 'Taramosalada Kings'. As the leading supplier of Greek and Mediterranean ready-made meals, the fortunes of the company were enhanced, and building on the good reputation, product development enabled the broadening of the product line to include other ethnic delicatessens. Moreover, third-phase growth created additional spin-off companies to supply KFF and other providers with certain key production inputs, such as filo pastries. In 1991, the company was, for the first time, able to pay a dividend of £75 per share to its shareholders. This climbed to £320 per ordinary share in 2000.

Table 6.1.1 Financial structure and performance of KFF, 1986–2000

	1986	*1991*	*1996*	*2000*
Turnover	£2.2 million	£11.3 million	£26.1 million	£61.7 million
% growth in turnover		413.6%	131%	136.4%
Pre-tax profit	£0.3 million	£2 million	£3 million	£9.5 million
% turnover (profit margin)	13.6%	17.7%	11.5%	15.3%
% growth in profit margin		30.2%	–35%	33%
Interest charges			£16,000	£179,000
Fixed assets (net book value)	£0.5 million	£1.9 million	£5.9 million	£13.1 million
Short-term loans		£0.1 million	£2.4 million	£1.8 million
Long-term loans				£0.42 million
Shareholder funds	£0.5 million	£1.7 million	£3.1 million	£10.6 million
% growth in shareholder funds		240%	82.4%	241.9%
Return on capital employed	55.8%	96.2%	87.4%	83.5%
Gearing ratio	12.7%	17.6%	87.5%	23.8%

The increased activities brought a sharp rise in loan finances: short-term finances rose to £3.4 million in 1999 (down to £1.8 million in 2000), while a long-term loan of £2.5 million appeared for the first time in 1999 (down to £420,000 in 2000). Notably, the gearing ratio rose significantly in the 1990s from 12.7 per cent in 1986 to 87.5 per cent in 1996 (in fact it climbed as high as 117.6 per cent in 1991 and 1998), reflecting the increased risk-taking propensity of the family. It settled at 23.8 per cent in 2000.

Table 6.1.2 Wealth of the Katsouris family, 1986–2000

	1986	*1991*	*1996*	*2000*
% family control	100%	80%	80%	80%
Shareholder funds	£0.5 million	£1.7 million	£3.1 million	£10.6 million
Family share	£0.5 million	£1.4 million	£2.9 million	£8.5 million
% growth in family's wealth		180%	107%	193%
Market value of company	£1 million	£3.4 million	£6.2 million	£21.2 million
Family share	£1 million	£2.7 million	£5 million	£16.9 million
Market value per share	£80	£216	£400	£1352
Growth in family's wealth		170%	85%	239%

When the business issued 2,500 ordinary shares to Durrington in 1986, the shares were valued at £80 each, giving rise to a market value for the company of £1 million. Based on a net worth of £0.5 million, this gave rise to a multiple of 2 of market value over the net worth of the company. Using the same calculation and assuming that there is no further increase in goodwill, the valuation of the share in 2000 will have increased to £1,352. This extremely conservative calculation represents an increase in the share value of nearly 17 times over the period 1986–2000.

Despite the growth of the business, the Katsouris family continues to be closely involved with, and the family members keep a significant influence over, the management of the company's affairs. In order to remain competitive, the company has maintained its investment programme to upgrade and expand the production facilities so as to improve quality, efficiency and hygiene. New projects and activities are constantly under review. In all that is done, the consistent and reliable provision of top-quality products at reasonable prices, which has stood the family in good stead over the years, continues to be the guiding principle of the Katsouris family business.

The increasing dominance of retailers' own-labels in the ethnic ready meals market provided KFF with a number of opportunities. It could expand its business further to meet the demand of the major supermarkets or, alternatively, the business might be sold off to larger food conglomerates dominating the supply chain. With a net worth of over £10.6 million (based on very conservative book valuation), the return to the shareholders is not insignificant.

If the family was to choose the expansion route, it would involve a significant increase in the current operation, which will, in turn, demand further factory space and an increase in staff. Such an expansion programme inevitably means additional finance. Finance can be raised internally among the family, through Durrington Corporation with which the company has built up a long-term 'partnership' relationship, or externally through, for example, the Alternative Investment Market (AIM), but probably at the expense of family ownership. AIM is a public market that enables small, young and growing companies to raise capital. It also improves the marketability of their shares.

Over the last two decades, the company has developed from a closed family business into a successful enterprise, open, to a certain extent, to external finance and influence. The climate in the ethnic ready meals industry is encouraging it to expand, but the family still needs to strike a balance between growth and control.

The latest development: Exit?

Just before Christmas 2002, the Katsouris family took the decision to sell KFF Ltd – together with Fillo Pastry, a subsidiary that makes pastry casings for snacks, (both employing 1,500 staff and turning £85m sales) to the Icelandic food group Bakkavor for £102 million. Tony Yerolemou, his two sisters and two cousins owned 80 per cent of the business, so they have made £16 million each. Some of the money was being used to buy a 19 per cent stake in Bakkavor, but that still left them nearly £70 million between them.

According to Tony Yerolemou (Katsouris was his mother's maiden name), the entrepreneurial leader of the cousin consortium who started the venture in 1982 with a £75,000 bank loan, 'we love food and we understand it... this exit strategy is an inexpensive vehicle to broaden our corporate platform'. Katsouris Fresh Foods, now part of part of Bakkavor – another quoted family business, will continue to be led by Yerolemou (who also joined the board at Bakkavor). They aim to grow further via product (as they have widened the Katsouris range to include samosas, spring rolls and other Indian, Thai and Chinese dishes) and market diversification, as a new factory is being built in Wembley that will create another 300 jobs. The Katsouris entrepreneurial odyssey goes on.

In a nutshell, this case study demonstrates how a family business mastered profitably the growth versus control dilemma and thus their business family can now continue to prosper in a broader entrepreneurial horizon. That infusion of private equity capital (financial and human capital, plus business advice and networking opportunities) in the mid-1980s played a catalyst role in the transformation of the family fortune. The Taramosalada Kings is a success story from which owner-managers of private companies – with the growth potential, but perhaps with restrained growth aspirations and financial philosophy – can draw lessons from, about open-minded strategic financial development.

Reference

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