TITLE: The Ostankino Milk Processing Plant

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THE NATIONAL COUNCIL FOR SOVIET AND EAST EUROPEAN RESEARCH

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PROJECT INFORMATION:

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COUNCIL CONTRACT NUMBER: 807-06

DATE: April 12, 1993

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* The work leading to this report was supported by contract funds provided by the National Council for Soviet and East European Research. The analysis and interpretations contained in the report are those of the author.
THE OSTANKINO MILK PROCESSING PLANT

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ABSTRACT

This paper, written in December 1992, is a case study of economic reform and privatization at the Ostankino Dairy Combine, one of six plants in Moscow which repackage bulk milk for resale. It describes the plant and its organizational setting, how it obtains supplies and distributes to retailers, its subsidies and prices, the effects of privatization, and its expansion plans. In conclusion (page 8) the author notes that, given its subsidies, the Combine can pass through any cost increases to the city and operates under economic conditions much like the old command economy. Not only are such subsidy policies ruinously expensive but they contribute to the fragmentation of the market and so to the collapse of Russia's economy and political unity.

Because of chronic shortages the manager has little influence over his suppliers, nor can he do much to influence retailers. So instead of trying to improve the quality of milk supplied, or the subsequent handling of output, he seeks hard currency to buy a new processing line. He is used to working in an economy where particular plants monopolize particular products. He is unwilling to compete with his former colleagues in the Production Association and produce things others already produce. He clearly controls his enterprise and expects to benefit personally from its privatization to make his own future more secure. In a word, he is a good manager in a crazy economy, his actions are rational given the situation. Which means he can change as those circumstances do.

1Prepared by NCSEER staff.
Introduction

The Ostankino region of northern Moscow is mainly known as the site of Russia's first-program television station, now called simply "TV Ostankino." The same area is also home to the Ostankino Dairy Combine, one of six plants in the city that repackage bulk milk for resale in one section of Moscow. The Ostankino plant has the capacity to pasteurize and pack 600 tons of fluid or powdered milk a month into half- or one-liter cartons with varying butterfat contents. It also produces cottage cheese, sour cream, and a Velveeta-like process cheese (*plavlennyi syr*).

The six Moscow milk plants are not typical of food processing plants in the former Soviet Union because they have modern equipment. But like almost all other factories in the branch, their equipment largely came from abroad. Shevchenko estimates that 90% of his plant’s equipment was imported. The Pure-Pak Corporation manufactured the Ostankino Plant’s milk-packing line. Other city milk plants have equipment from Tetra-Pak.

The Ostankino Combine’s director, Aleksandr Shevchenko,1 was interviewed at length during a visit to Durham to participate in The Fuqua Program of Manager Development, CIS. Shevchenko described a situation that is common to most well-run processors in the Russian Federation. His obvious concern with the effect of privatization on his enterprise (his comments continually strayed back to that subject) clearly reflects a common concern among Russian enterprise managers at the moment. Although economic reform and privatization have already affected the plant’s formal organization—until last summer, the six milk plants formed a unified Moscow "Milk" Production Association under a single management—they have hardly touched its operations as yet.

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1Aleksandr Shevchenko was born in 1959 in Moscow. After his obligatory military service, his entire career has been in the dairy industry. He graduated from the Institute of the Meat and Dairy Industry (which, he commented with a laugh, has now been grandly renamed the Institute of Applied Biotechnologies). He began work in the Ministry of the Meat and Dairy Industry as a senior engineer. He then transferred to the Ostankino Milk Combine, where he moved up the ladder from deputy shop manager, to chief engineer, deputy director, and finally director of the Ostankino Milk Plant. He was concurrently a deputy general director of the Moscow "Milk" Combine until its dissolution in the summer of 1992. Shevchenko has travelled in Italy and Germany to study milk processing.
The Plant’s Milk Supplies

The Ostankino plant gets 90% of its milk under year-long delivery contracts from a network of ten to fifteen primary processing plants in Moscow oblast’. About 10% of its supply comes directly from Moscow-area kolkhozes and sovkhozes. Shevchenko did not report buying any milk directly from individual farmers—they almost certainly produce too little to justify the expense of hauling it into the city—although the local plants may. Some Moscow-oblast’ milk plant managers have complained about quality problems with milk bought from individual farmers and refuse to buy from them.

Shevchenko did not mention any particular shortage of milk supplies this year, although other sources report that sales of milk and dairy products to the state as of October 1 were only 78% of the 1991 level. (The fall-off does not necessarily mean that total production has fallen, since sales on kolkhoz markets were up by more than 350%.)

Prices paid to milk producers are supposed to be determined freely, but I was told by a kolkhoz deputy chairman for economics in mid-November in Moscow that although he could deliver his milk to any processing plant, the price difference would be too small to justify the expense. Primary plants were built to serve individual rural districts (raiony), normally one to a district. So each primary plant still basically draws its supplies from farms located in its district.

During the summer, when cows are lactating, there is enough fluid milk available for the Ostankino plant to work at full capacity. During the winter the plant processes about 400 tons of powdered milk each month as well as about 200 tons of fluid. Experiments with seasonal differentials to encourage dairy farmers to stagger their cows’ production to ensure a constant supply of fluid milk for the city are reportedly just beginning.

The primary processing plants’ trucks collect milk from the farms. These district plants then refrigerate and pasteurize the fluid milk, as well as the other bulk dairy items the

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Moscow city plants pack. The district plants apparently also dehydrate milk for storage and winter reconstitution (Shevchenko did not mention that his plant does so).

Bulk milk, cottage cheese and sour cream move from the local collection points/processors to the Moscow plants in trucks belonging to Moscow city Automotive Kombinat Number 6, a specialized enterprise which serves all six "Milk" Association plants under contract. Trucking operations are governed by monthly delivery plans and schedules. Formerly part of the Ministry of Motor Transport, this enterprise has already become an autonomous joint-stock company.

**Distribution to Retailers**

The Ostankino plant sells to about 500 retail outlets in the city of Moscow. Although the wholesale network was designed so that each plant served a specific part of the city as a monopoly supplier, retail stores are now free to conclude purchase contracts with any supplier they can find. Contracts between the Ostankino plant and retailers are annual. Delivery plans and schedules are worked out monthly. But actual daily delivery quantities can be changed by an individual store's manager or dairy-products merchandiser (torgoved) simply by calling the plant with a request for a change. (Shevchenko appeared not to understand when asked who paid for the surplus production if a store reduced its delivery order. The plant can sell all the milk it can produce, since Moscow is always short of it.) Shevchenko tries to keep about 30 tons of packed milk products in his warehouses at all times to allow for changes in retailers' delivery orders.

Another specialized Moscow automotive kombinat, Number 31, transports the Ostankino plant's products to retailers. They apparently are contracted to the Ostankino plant, not the stores—which were once part of a Moscow city retail trade association and now variously owned. Shevchenko described this trucking enterprise as wholly "privatized." As in the case of the trucks which deliver his milk from the oblast', that apparently meant the retail delivery enterprise had become a joint-stock company.
Milk production in Moscow is regulated by the Russian government and subsidized by the city authorities. As of the moment Shevchenko left Moscow for the United States, his plant paid milk suppliers (farms or primary processors) 15 rubles for a liter of milk. The Ostankino combine received 18 rubles/liter from the retail stores. But Shevchenko’s cost of production, including buying the milk, transportation, processing, packaging and overhead, amounted to about 25 rubles/liter. The Moscow City government makes up the difference between the plant’s cost of production and what it receives from retailers. The precise subsidy the city pays changes weekly, but the plant presents only a monthly bill to the city government through the Combine’s bank. Funds are then debited from the city and credited to the Combine.

Shevchenko did not mention any difficulties in receiving the city subsidy, although there is a good deal of anecdotal evidence from other sources suggesting that not all governmental units that promise to pay subsidies keep their word. The kolkhoz deputy chairman mentioned above, for instance, said that his farm received its Russian government subsidy to cover losses for livestock production, but added that it did so because he made sure the farm was always first in line at the bank on the day when subsidy bills had to be presented each month.

The Effects of Privatization

For some thirty years, the Moscow "Milk" Production Association ran its six city milk plants as a unit, with a single plan and bank account (raschetnyi schet) for the whole association. Technically municipal property, they were subordinated to both the city authorities and the Russian Ministry of the Meat and Dairy Industry. Ostankino plant director Shevchenko was also a deputy general director of the "Milk" association. This combination had its advantages, Shevchenko said. For instance, the Leonovskii Milk Plant
took three years to get fully on-stream after its completion, and during that time its losses were covered by profits from the other five plants.

On July 1, 1992, however, Moscow Mayor Iurii Luzhkov signed a decree breaking up the thirty-year-old association and making each unit a separate legal entity. Still formally municipal property, they were thereby freed from Ministerial control. Shortly thereafter, the plant’s "labor collective" decided to begin the process of privatizing the plant. The Ostankino plant was the first enterprise in the former "Milk" trust to begin this process, and Shevchenko clearly implied in the conversation that he was responsible for the decision to begin doing so.

Under the newly-adopted rules for privatizing food processing enterprises, the Ostankino Combine could be denationalized in one of four ways:

1) by forming a joint-stock company which sells its shares openly (or, as a food processor, only to producers of its raw material);

2) by selling the enterprise at auction;

3) by liquidating the enterprise and selling its assets at auction; or

4) by selling an already-leased-out enterprise to a private purchaser.

Since the Ostankino plant is profitable by Russian accounting rules and not currently leased out, only the first two possibilities could be considered. A general meeting of the plant’s workers chose to form a joint-stock company because they intended to keep it operating.

At that point, a private consulting-auditing firm (of about ten employees), was hired to prepare the documents needed for privatization. Essentially, these are: a business plan, a balance sheet for the whole enterprise, and an auditors' report evaluating the firm and setting a price on its assets. The privatization consultants also acted as auditors. In addition, the

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3The privatization mechanism for food processing industries is set out in a statute approved by the Russian government in early September, 1992. See "Polozhenie o privatizatsii predpriiatii po pervichnoi pererabotke sel'skokhoziaistvennoi produktsii, ryby, moreproduktov i predpriiatii po proizvodstvenno-tekhnicheskому obsluzhivaniyu i material'no-tekhnicheskomu obsluzhivaniyu i material'no-tekhnicheskomu obespecheniu agropromyshlennogo kompleksa," Krest'ianskie vedomosti, No. 39 (September 29, 1992), p. 6.
privatization documents had to include a deed (akt) to the land which the plant occupies, prepared by the city branch of the State Committee on Land Reform and Land Use, and a technological evaluation from the city prefecture (described by Shevchenko as a combined economic and environmental impact report).

All of these documents were then presented to the city authorities in charge of food processing. Once they had approved the privatization, the city privatization commission also had to agree. They did so, although it took them two weeks longer to issue their approval than it should have under the law.

As of the interview in early December, the director continued, privatization was almost completed. The plant needed only an official "extract" (vypiska) from the city privatization commission's decision approving the combine's reorganization to officially register its new charter with the city and announce the change in a "legal notices" newspaper advertisement.

Once these details were done, the plant's workers would meet again, in late December or early January, to approve the whole process and distribute shares of stock. Again the plant had a variety of choices. They could not simply make it a closed joint-stock corporation, as they had wished to, because of the privatization rules. However, they could choose to distribute the stock in any of three ways:

1) The enterprise gets 30% and the Moscow city committee on state property holds the balance, which is not to be sold. The city government then would retain a controlling interest in the firm.

2) 51% of the shares are given to the enterprise's collective, 29% are sold to its raw-material suppliers (primary processing plants and farms), and 20% are retained by the city committee on state property.

3) All shares are sold to individuals or groups of investors openly.

Shevchenko said he preferred the second option, and apparently the plant's employees had already approved that choice. But, he added, it had not yet been decided how much of the stock, and at what price, each worker would receive. He clearly expected to keep his job and his authority, however.
Expansion Plans

The Ostankino facility once produced kefir, and Shevchenko plans on adding yogurt and dessert pudding. He has no plans to expand into dairy products already produced by other processing factories in Moscow. The Moscow Milk Plant, another unit of the former "Milk" association, repackages butter delivered in bulk from Moscow oblast' for retail sale. Ice cream products come from a plant in the city (which he called "The Iceboxes") owned by the Ministry of Trade. Because of its location in town, the plant cannot expand into cheese production, which (like butter) is now produced in bulk by the rural district processing plants. The whey that results from cheese-making is fed to livestock and it would be too difficult to transport it back to the farms from the plant.

Shevchenko would like to find the hard currency to import an additional line capable of producing what he called "sterilized" milk—milk heated to above 100 degrees centigrade, rather than the 62-degree heat used in pasteurization. As he described it, his current product has only a thirty-six hour shelf life while sterilized milk will not go sour for fifteen days. (These shelf life figures must assume refrigeration, since fluid milk will sour within a day unless it is kept cool.) In the West, "Ultra-High-Temperature Process" (UHT) milk will keep indefinitely without refrigeration if packed under aseptic conditions. UHT milk which is not packed aseptically goes bad after about a month. Shevchenko's shorter shelf-life estimate for this product presumably reflects quality problems with the milk he can get to process.

The Ostankino Plant has excess warehouse space. Asked where he would be spending the short-term internship that is a standard part of the Managers' Training Program, Shevchenko answered that he would not really be doing one. Instead, he planned on going to Charlotte, North Carolina, where he would agree with a wholesaler for deliveries of chewing gum and other small consumer goods which he could import and then resell to the ubiquitous street traders in Moscow. Long term investment in the dairy plant is less profitable than quick returns from rapid retail turnover because of the high inflation wracking the Russian economy.
Some Observations

Given the city subsidies, the Ostankino Combine continues to work under economic conditions like those of the old command economy. Shevchenko can pass through any cost increases to the city government, so he is relatively unaffected by changes in energy or capital costs. Subsidies for such basic foodstuffs in large urban areas are now locally determined. Since Moscow is certainly more solvent than most Russian municipalities, the full effects of marketization and privatization have not been felt by the Ostankino plant.

How much longer Shevchenko's plant will be this fortunate is uncertain. Regional differentials in retail food price subsidies have already led to extensive arbitraging between regions. Consumers buy subsidized foodstuffs at the low price and resell them in areas where higher free-market prices prevail. As a result, some areas, like Tatarstan, have introduced rationing since food prices were liberalized earlier in 1992 to cut demand while maintaining subsidized (low) prices for consumers. (The author was shown the "bread tokens" being issued to each family there during a visit to Kazan in mid-November.) In mid-December authorities in Saint Petersburg were reportedly preparing to increase bread prices by 150% as a result of the exhaustion of municipal funds for subsidies. Not only are these subsidy policies ruinously expensive but they contribute to the fragmentation of the market and so to the collapse of Russia's economy and political unity.

Shevchenko's comments illustrate some typical dilemmas that plant managers have always faced in the command economy. Because of chronic shortages, he has little influence over his suppliers. Nor can he do much to influence retailers to better store his product. So he deals with quality problems by changing his own production processes as best he can. Instead of trying to improve the quality of milk delivered to him, or insisting that other links in the farm-to-customer chain properly handle and refrigerate his milk, he wants hard currency to install a UHT processing line. He won't get as much gain from the expense as a Western processor would, but the Ostankino Plant can make the change without relying on other economic actors to alter their behavior.

Shevchenko is used to working in a shortage economy where particular plants monopolize particular products. He's not willing to consider competing with his former
colleagues in the "Milk" Production Association by expanding his product line into things which others already produce. The obvious reason is that he knows he could sell much more of his basic product, fluid milk, if he could increase his own supplies and packaging capacity.

The Ostankino plant director clearly controls his enterprise. His reticence in answering some questions about privatization suggests that he, reasonably enough, expects to benefit from the change. Not that the process is rigged in his favor or that he will unfairly profit—Shevchenko is clearly a good manager, and his knowledge and entrepreneurial talents are likely to be severely tested in the future. But he also clearly understands that he needs to take the chance to make his own future more secure by benefitting from privatization.

Shevchenko is clearly a good manager in a crazy economy. His actions are rational, given the situation—which means he can change as those circumstances do.