



The Ivanovas: A Family Business

Alexei and Marina Ivanova were married in 1980. They have a son, nine years old, and a daughter thirteen. Marina attended the Timiryazevskaya Agricultural Academy and graduated in 1985. Alexei graduated from the same school in 1983.

After Alexei graduated he went to work in Lipetsk at a Sovhoz where he was responsible for determining crop planting times, crop choices, and crop rotation. He also was responsible for the fertilizer inputs, the equipment requirements and harvest timing. In 1985 when his wife graduated they both went to work for a different Sovhoz much closer to Moscow. His responsibilities were broader than in Lipetsk and his wife became one of his workers. Alexei was paid 150 Rubles per month and was given a three-room apartment owned by the Sovhoz.

In 1988 Gorbachev arranged for the passage of a new law that allowed people to organize businesses in a manner similar to Western corporations. Even though these businesses were allowed to have only one stockholder and many workers they were named "cooperatives." Restrictions were included in the law that limited the amount of workers so that the economic effect was the creation of small business corporations since they were known to be a driving force in new employment formation in the West. It also had the effect of legalizing many small businesses, such as plumbing repair, that had been operating illegally.

In 1988 Alexei decided to organize a cooperative in which the General director of the Sovhoz would be the general Director of the cooperative and Alexei would be the Chief Operating Officer (Brigadier in Russian). There were five workers in this cooperative, one of whom was his wife Marina. They decided to name the cooperative: "Success." The name of the Sovhoz was "To The Victory" (PUT K POBEDYE).

"Success" produced potatoes for human consumption and clover for animal feed. In 1991 a new law was passed that allowed people to produce agricultural products totally independent of the Sovhoz or Kolhoz on land of their own. Several workers left the cooperative to pursue these new opportunities and Alexei decided that he and his wife should do the same. "Success" was closed and since their only equipment was one used tractor the general director of "To The Victory" showed his appreciation of Alexei's work by selling him the tractor and all the

Ralph Hoagland, MBA 62 and Marina Paltseva prepared this case under the supervision of Professor Ray A. Goldberg as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

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attachments needed for potato farming at a very favorable price. The appreciation was further extended by allowing them to buy fertilizer, pesticide, and seed potatoes from the Sovhoz.

Alexei purchased 40 hectares from the Sovhoz. Special credits for farms were established by Gorbachev's deputy prime minister, Selaev. This allowed them to borrow 2.5 million rubles at favorable interest rates that were fixed and considerably below the inflation rate. With this money they built a storage shed for potatoes and additional space for their tools and equipment. Their neighbors were surprised that the Ivanovas were able to plant and harvest at the same time that they built the storage areas. It often took three or four years to build storage facilities at the Sovhoz, and as a consequence, some harvested crops were not protected and rotted.

Alexei made these decisions because he had already acquired the skills to raise potatoes and the help from the government credits and the Sovhoz seemed to reduce the risk he was taking. As he looked back on this period at the end of the 1994 harvest he was especially pleased because the situation in agriculture for private farmers had worsened so that the earlier credits and bargains were no longer available. His yields had been:

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|------|----------------------------|
| 1991 | 15 metric tons per hectare |
| 1992 | 10 metric tons per hectare |
| 1994 | 27 metric tons per hectare |

During the summer of 1994 the Sovhoz produced 20 tons per hectare so Alexei felt pleased with his progress. He had accomplished this by treating the leaves in the springtime with special chemicals and the Sovhoz did not. Also, he thought that his special knowledge of the proper timing for pesticides, fertilizer, and planting had made a difference.

The Market

When Alexei first started selling potatoes he drove his small truck into Moscow with Marina and set up a display in the street markets near a Metro station. Oftentimes business would be poor and they would move to other Metro stations until they realized better sales. This system was not effective because the cost of the gas for the truck was more than they received from selling the potatoes.

In 1993 Alexei decided to visit some of the many restaurants that had opened in Moscow. When he talked to the owners and managers he found they were interested in buying his potatoes if he delivered them and his price was lower than the price in the local street markets or state owned vegetable stores. His payments were first made to him with a check system from the restaurants' bank accounts but it took so long for the money to come to his bank that the intervening inflation eliminated all profit. He solved this problem by demanding and receiving cash payments for his products.

During the winter of 1994 Alexei thought of another way to sell his products. At the time the output of the Sovhoz and Kolhoz was delivered to large wholesale markets that were located in each district of Moscow. These wholesale markets were operated by the Moscow government and Alexei noticed that the quality was inferior to his. If he could sell directly to restaurants why not apply this same system to vegetable stores? The quality would be better and he could eliminate the charges made by the wholesalers thus enabling him to lower the price to the stores.

With the 1994 harvest Alexei successfully implemented the plan to sell directly to retail stores. For example, on November 15, 1994 he sold four tons in this manner at a price of 500 rubles per kilo. The stores were selling these potatoes for 700 rubles per kilo. (Note: at this time the

average pension in Moscow was 80,000 rubles per month; a full professor made 150,000 and the average manufacturing wage was about 200,000. The average manufacturing wage per hour was 1,176 rubles and therefore a worker had to work about 35 minutes to afford a kilo of potatoes. In comparison, the average manufacturing worker in America had to work about one minute to purchase a kilo of potatoes.)

Alexei was concerned about the rapidly rising costs of production. In 1991 he had paid 145 rubles per ton for NPK fertilizer and in 1994 the price was 500,00 rubles per ton. During the same period the price of potatoes had risen from 1.25 rubles per kilo to 600 rubles.

He had anticipated this problem to some extent by planting and harvesting as soon as possible in 1994. On July 27, 1994 he was one of the first to harvest and was able to sell his potatoes for 1,500 rubles per kilo. This advantage lasted until about the middle of August when many others began to harvest and the price dropped rapidly to 500-700 rubles per kilo. He sold about 100 tons before the price dropped and was pleased with these results but he felt he needed some further successes for the rest of his crop to pay for the rapidly rising cost of gasoline for his truck and the constantly increasing prices of pesticides and fertilizer.

In 1994 he experimented with improving his quality by hiring four retired grandmothers from the local village. He explained to them that if they could work quickly and skillfully at sorting the potatoes he could stop using his potato sorting machine which always damaged some of the potatoes. He told them he would pay them 20,00 rubles to an eight hour day. They worked effectively instead of talking and smoking all the time and he felt he more than recovered his investment in their labor.

At the same time he realized that costs were rising so fast that he would need to find other improvements. He investigated the cost of machinery to turn the potatoes into potato chips which were rapidly becoming a popular snack food for Muscovites. The price for the machinery was too high because he could only use a small amount of the machine's capacity. Since he was president of the local association of private farmers he knew that his neighbors all faced the similar problems and he wondered if he could process their potatoes into chips and be able to charge them enough to justify the costs involved. One of his friends in Moscow told him that the cheapest machine for making chips with good quality would have to be imported and with the import taxes and the bribes paid to customs officials it would probably amount to \$100,000.

Alexei was especially concerned about the financial changes that were occurring. In 1991 the government credit system only charged him 8% annual interest for the loans necessary to cover his costs before the harvest was completed and his earnings commenced. Since inflation was much higher than 8% per year he actually had significant profits from these financial conditions. But now, in 1994, he was getting no help from the government and was paying private banks interest of 150% per year. Through his association he knew that some banks were charging 230% interest causing some farmers to stop using fertilizers.

In 1991 it was not necessary to pay any significant taxes. But now, in 1994 new taxes were being added on profits by the regional government and he heard that they would be increased again in 1995. It was disturbing to him that the Sovhoz and Kolhoz were not paying taxes and through their political power they were getting significant funds from the federal budget to subsidize their deficits.

The private farmers association (Accor) was not able to help in these matters. Accor had very little money and most of that went to pay officials in Moscow. These officials were not able to

provide any real help to the farmers in the way that the officials of the Sovhoz and Kolhoz were able to provide. This was discouraging because Alexei could see that if the private farmers could just get some of the generous financial grants that were going to the Sovhoz and Kolhoz they could be sure to survive. It was obvious to him that the private farmers were efficient in their operations and he wondered why the government was not doing more to encourage them financially.

This lack of the kind of government support available to private farmers in 1991 had resulted in a new situation in 1994 that made it impossible for the establishment of new private farms. This shift of political support away from the private farmers in favor of the Sovhoz and Kolhoz worried Alexei. People who were receiving land in 1993 and 1994 were using it in different ways. Some were building homes on the land, others were building retail stores and others were building storage facilities. He knew this was necessary for them because if you received land from the government and did not make some use of it then the ownership would revert back to the state.

On the other hand, Alexei was pleased that his operations had been profitable in 1993 and would be profitable in 1994. But if the gap between rising costs and profits continued he wondered how he could find new ways to close the gap. This was his reason for thinking again and again about the possibility of getting machinery to convert his production into potato chips. Unlike his original entry into farming there was no system for credits that would allow him to buy the machinery.