



## Stonyfield-PETRO and the Harris Group

### Forming Joint Ventures in the New Russia

*Standing on a frigid street corner in a St. Petersburg industrial park waiting for a driver who had failed to show up, Paul Harris wondered what was propelling him to pursue the endlessly frustrating course of doing business in Russia. It was early 1994, he had been at it for three years and he had still not achieved the fabulous wealth that he was planning on. As the icy January wind blew through his inadequate wool coat, he attempted to re-convince himself that it was all worthwhile. This was an important mental exercise which he sometimes had to do several times a day. Harris was in the process of forming a joint venture in St. Petersburg, Russia to produce ice cream and yogurt and it was requiring a lot of his time, attention and patience.*

### Background

On March 5, 1994, Stonyfield Farm, Inc., PetroMilk 5 and The Harris Group, Ltd. signed an Agreement detailing their collective intention to form a Russian-American Joint Venture (JV) for the purpose of producing and marketing dairy products in St. Petersburg, Russia. The Russian dairy, PetroMilk 5, was to own 40% and Stonyfield Farm, Inc., a U.S. producer of yogurt, was to own another 40%. The Harris Group, Ltd., a U.S.-owned corporation with corporate structures in both the United States and Russia, would own the balance of 20%. Since The Harris Group operates primarily as a Russian entity with primarily Russian employees, they argued that half (10%) of their JV share would in fact be Russian. This structure therefore created an overall 50/50 Russian-American Joint Venture.

More than eight months of research and planning preceded the signing of the March agreement in St. Petersburg. The Harris Group, with three years of experience in the Russian food products market, identified an opportunity in mid 1993 to produce high-quality dairy products in Russia. Domestic production was declining by more than 10% annually,<sup>1</sup> though the market was clamoring for milk

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<sup>1</sup>U.S. Dept. of Agriculture, Annual Dairy Report for Russian Federation, 1993.

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*Paul Harris of The Harris Group prepared this case, which is based on an earlier draft by Research Associate Don Daniels, 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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products, particularly higher quality products with good taste and longer shelf life. Production was not enough even to provide for the children of Russia.

Some of this demand was increasingly being met by imported products, particularly from Western Europe (especially Finland which had a long history of trading with the Russians). However, due to the higher production costs in European countries (raw materials, labor, utilities, etc.) combined with the costs of shipping, prices for these imported dairy products placed them out of the reach of at least 80% of Russian consumers. Further, due to required shipping and distribution times, these imported products were not fresh, and required preservatives. Yogurt and ice cream, in particular were being imported in large quantities, but the yogurt bore virtually no similarity to the fresh, refrigerated dairy products that the Russian palate craved, and some of the ice cream was of poor quality.

Herein The Harris Group saw a market opportunity. As Paul Harris, The Harris Group's President recalls,

It was one of those relatively rare chances to make some money in the good capitalist tradition while materially enhancing the Russian quality of life by helping to insure good nutrition at a time when wholesome foods, particularly dairy products, were in critically short supply. Furthermore, there was a great opportunity to have a positive impact on the faltering Russian economy, by bringing technical skills, state-of-the-art equipment and business discipline to a project that, once operational, could be replicated elsewhere in Russia.

Having identified the opportunity, The Harris Group set about finding partners; a Western partner who had the technical ability and the product line, a Russian partner which had the potential production capability and existing distribution channels. Harris knew that most importantly, each partner had to have the energy, the corporate ambition, and the long-term commitment and vision to see the concept through to a functioning reality. This could be a tall order given the frequent barriers placed in the way of Russian business.

Of immediate concern in finding the Russian partner with production capacity was the ecological cleanliness of the region from which the raw milk was to come. If the cows were grazing in a polluted environment or drinking unclean water, no amount of milk processing was going to lead to the most desirable product. After months of talking with environmental experts, visiting Russian dairy farms and studying transportation corridors, it became clear that the region north of the City of St. Petersburg, known as Karelia, was unique in that it was environmentally unspoiled, had substantial existing dairy production and was reasonably close to a large consumer base. The Harris Group decided to concentrate its search for a production facility in the St. Petersburg area.

The City of St. Petersburg has five primary dairy plants. One of these plants had been fully privatized into a Joint Stock Company and is now called PetroMilk 5. In addition to being the only privatized plant and having unusually forward-looking and honest management, privatization had resulted in some positive changes at PetroMilk, which was a noteworthy exception.<sup>2</sup> Aside from having

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<sup>2</sup>On the subject of privatization, Paul Harris said, "Much has been made in the Western press of the 'privatization' process in Russia. Included in this well-intentioned reporting is a lot of misinformation about the realities of the program. Privatization seldom results in a change of management. The same bureaucrats who were operating the plants under the command economy are still very much in place. In fact, in some respects they are even more firmly entrenched as their positions are now legitimized via elections by the workforce. When the workers are given the opportunity to vote for leaders of the company in which they now have an ownership share, they of course elect the only ones among them who (supposedly) know how to run the business—those who have been doing it all along. There is no increase in accountability. There is rarely any 'new blood.' It is business (or no business) as usual. In the worst cases managers have simply stolen and/or sold all the company's assets. Employees were, and remain, largely powerless to implement effective change."

progressive, honest management, PetroMilk 5 offered several other significant advantages. First, it was the newest of the dairies, built in the late 1980's. Therefore it had the most up-to-date equipment of any Russian dairy. Second, it had huge processing capacity, over 1,000 metric tons of raw milk per day (though it was currently operating at about 15% of this design capacity); it also had the refrigerated warehousing and material handling systems to support this production. Third, the management of PetroMilk 5 already had a track record of other successful Western Joint Ventures. This was important because the managers would have already been introduced to Western business practices and expectations which would make Harris' job easier.

Fourth, the plant had a close working relationship with the farms that supply milk, in fact most of the dairy farmers were stockholders of PetroMilk 5. Lastly, the plant was conveniently located on the northern margin of St. Petersburg with good road and rail access and within 150 km of farms in the desirable clean region north of the city, Karelia. The General Director, Alexei Kapustin, and his senior management team were very enthusiastic about the prospect of an American joint venture to make yogurt and ice cream, two products they had been struggling to produce for several years without much success.

The Harris Group found identifying a suitable Western partner was more difficult. Only a small, independent company could move fast enough to seize this opportunity. A company with a clearly-defined sense of social mission, rather than a singular focus on profits, could best appreciate the chance to bring something of value to the Russian people. After meeting with several European dairies and two in the U.S., Harris recognized Stonyfield Farm, Inc. of Londonderry, New Hampshire as the appropriate choice. A producer of products of the highest quality, recognized as a premium brand, with a rapidly growing market share in the highly competitive U.S. market, Stonyfield would know a lot about cost-efficient production and persistence. The president of the company, Gary Hirshberg, and the chairman/founder, Samuel Kaymen, realized that this was an opportunity that demanded their attention and that this project fit with their planned initial forays into international markets.

## The Partners

PetroMilk 5, the second largest dairy plant in St. Petersburg, is run by its president, Alexei Kapustin. Mr. Kapustin has been involved with the dairy since its start-up in 1989, took the plant through the privatization process and is a substantial shareholder. Mr. Kapustin has a background in dairy farming and is sensitive to the difficulties faced by the farms that supply his dairy with raw milk. He has made a substantial investment of time, energy and money to help these farms produce higher quality milk (lower somatic cell counts) and made many of them shareholders of PetroMilk 5 to give them a financial incentive for the dairy plant's success and profitability. Kapustin seemed to understand that cleaner raw milk allows PetroMilk 5 to produce a higher quality final product (better tasting with longer shelf life) and reduce costs in the process. This in turn could allow the plant to pay farmers more for the milk. He needed help to initiate this cycle of education, training, technology transfer and capitalist management. This infusion of Western experience, technical know-how and capital was to be a focus

of the new joint venture, which the partners agreed to call Stonyfield-PETRO. About PetroMilk's management, Harris reflected:

Like many Russian organizations, PetroMilk was run by one man. The skills of delegation and spreading authority among a management team have yet to be learned. The result was that every decision of consequence was made by Alexei Kapustin. If he was out of the office, at a meeting or on vacation, there was a paralytic halt in decision making in anticipation of his return and only the most basic daily functions of the plant could continue. This made the pace of negotiating the joint venture entirely beholden to Kapustin's schedule.

Stonyfield Farm, Inc. is a Delaware corporation based in New Hampshire which produces yogurt and frozen yogurt. Established in 1983, Stonyfield has become a premium brand of yogurt in the United States and its product is now distributed nationally. The company's market share has increased steadily (now over two percent) in a highly competitive market and sales now exceed \$25 million annually. Stonyfield's President, Gary Hirshberg, has run the business since 1983 and oversees all aspects of the company's marketing and financial development. The company's Chairman and Founder, Samuel Kaymen, developed the recipe which has propelled this yogurt to its national stature. An engineer by training, Samuel also handles all plant design and product specifications. Together, Hirshberg and Kaymen have become known for fostering a corporate culture at Stonyfield which emphasizes responsible environmental and energy policy and empowers employees through stock ownership and involvement in corporate planning and decision making.

The Harris Group began its business in Russia four years ago. The company has offices in both Moscow and St. Petersburg, and employs a mostly Russian staff to oversee a number of projects, most of which are in the consumer products industry. (The Harris Group also is involved in aviation, export of high-tech Russian manufacturing materials, sales of computer networking equipment and other Russian manufacturing and distribution ventures.) The Harris Group planned and supervised the opening of the first American-style supermarket in Russia in 1991 (with laser-scan checkout counters, shopping carts and a video security system—all firsts in Russia), the LUX store in Moscow's Olympic Village (for more information see HBS case No. 594-059, "Food Distribution in Russia, The Harris Group and the LUX Store"). In addition to supplying LUX and other stores directly, the company has supplied substantial quantities of wholesale food products and other consumer items to Moscow and St. Petersburg-based distributors for resale across the C.I.S.

## The Market

Russian's mania for ice cream is legendary. When the temperature is -10° C and the wind is blowing at 15 kilometers per hour in January, one can often see lines of people on the street waiting to buy ice cream and eating it. Virtually all ice cream sold in Russia is single-serve (since most Russian families have little or no freezer space at home), typically consumed at the point of sale. There is less seasonal variation in consumption than in most Western countries. Russians consider ice cream a food, rather than a treat, and consume it whenever it is available year-round. There are very few varieties, the prevailing flavor is vanilla. Some of the ice cream is well made with good texture and flavor. Much of it is grainy and weak-flavored, the result of cutting corners on hardening and quality of flavoring. Some imported ice cream is usually even worse, with extremely high overrun (% of air injected) which makes it taste like biting into a sponge.

Samuel Kaymen first came to St. Petersburg at the invitation of PetroMilk 5 in March of '94, at which time two documents were negotiated and signed. The first was an Agreement outlining the broad terms of the proposed Joint Venture. The second was a Test Marketing Agreement. The partners agreed that it would be very important to know from the outset how the Russian market reacted to the Stonyfield product. To that end, a climate-controlled container of 66,000 8 oz (226 grams) cups of fresh yogurt in five fruit-on-the-bottom flavors was shipped to St. Petersburg in mid-May. The President of Stonyfield Farm, Inc., Gary Hirshberg, traveled to St. Petersburg to personally witness the test marketing program and to gauge the reception to his yogurt among Russian consumers. The test marketing program was an unqualified success, demonstrating that Russian consumers are concerned about what they eat and enthusiastic about a fresh product which is made without chemical additives and contains live cultures (acidophilus, bifidus, etc.) which are good for the body. Russian consumers are actually more aware than the average American consumer about the purity and healthfulness of foods and are concerned about food additives and chemicals. They have also had a long tradition of recycling and ask instinctively if packaging can be recycled or otherwise reused. The fact that they could reuse the Stonyfield-PETRO plastic ice cream and yogurt cups was seen as a major advantage to this packaging system.

The Russian word for ice cream is very similar to the word which means frozen and thus does not distinguish between sherbet, frozen yogurt, frozen novelties, etc. There is, however, a separate word for premium ice cream (butterfat over 14%), "plombir." No Russian companies are currently producing plombir, though it was produced in large quantities as recently as ten years ago. Russians are discriminating ice cream consumers and prefer the higher butterfat, stronger flavored plombir. With these understandings, which were gained through several months of market research, the joint venture partners decided to make a high fat (15%) product in 100 gram plastic cups, initially in three flavors, Chocolate, Strawberry and French Vanilla.

One of the challenges of bringing a Western partner into the venture was getting them to accept the cultural differences in eating habits. Stonyfield gained much of its market share in the United States by producing a good-tasting non-fat yogurt and frozen yogurt with fruit juice sweeteners. They instinctively wanted to take these skills to Russia. But the Russian market demanded a very different product. Russians consider fat to be a desirable characteristic of their food. The higher the fat content (shown on Russian labels as "fat-value"), the more they are willing to pay for it. A product which appeared on the shelf labeled "non-fat"—no matter how good it tasted, would be dead on arrival. Getting Stonyfield to increase fat and add sugar for the Russian recipes flew in the face of its eleven-year corporate culture. But because of their small size and managerial agility, they were able to see the need to change the tactics to suit the market.

One of Stonyfield's primary interests in production in St. Petersburg was for the potential to export to Western Europe. St. Petersburg, a port city, has an excellent location for this purpose, in fact it is the closest manufacturing site to the West European markets with low labor rates. Part of the joint venture agreement specified that Stonyfield had the exclusive distribution rights for the product outside of the FSR and could buy the product from the joint venture for a preferential price for export.

## Distribution

One of the issues that faced the joint venture partners early on was the question of distribution of the product. PetroMilk sold their existing products to some 700 wholesalers and institutional clients. About half of these customers came to the plant to pick up their orders, the other half were serviced by PetroMilk's fleet of 15 delivery trucks. However, neither PetroMilk nor any of its customers had refrigerated trucks and only a few of the trucks were insulated. In fact, there was no manufacturer of refrigerated trucks in Russia. This was going to present a problem for selling premium ice cream which, because of the high fat content, needs to be kept very cold (-20°F). Another problem was that most retail outlets (stores, kiosks, street stands) did not have refrigeration. PetroMilk owned 23 dairy stores that sold its products and even these stores had inadequate refrigeration. Proper handling of the product from processing to consumer was going to be a challenge.

Stonyfield wanted to concentrate its energies on the production of ice cream and yogurt and did not want to get involved in distribution. PetroMilk recognized the need and was a willing partner, but didn't have any money. Harris viewed distribution as an interesting opportunity and decided to start a separate joint venture with PetroMilk to handle the distribution (to be called Trans-PETRO). PetroMilk would supply drivers, frozen storage and materials handling facilities. Initially it was decided to start with two trucks each with a capacity of about 5 tons of ice cream. The trucks would be equipped with hydraulic lift gates to facilitate deliveries to stores and wide rear doors to permit loading with forklifts at the plant. Stonyfield-PETRO would contract with Trans-PETRO (the new distribution joint venture between Harris and PetroMilk) for distribution of Stonyfield-PETRO's products, initially ice cream and subsequently yogurt. Trans-PETRO would charge a flat fee per ton of product handled and would not own the product it distributed for Stonyfield-PETRO. This would avoid any possible conflict of interest Harris might have in pricing strategy. Harris foresaw that once the ice cream distribution system was established, there would be opportunities to add additional products to the distribution routes. Virtually all of PetroMilk's products should be delivered in refrigerated trucks (milk, cheese, yogurt, butter, etc.). Furthermore, other Western joint ventures were also facing the distribution issue and had approached

Harris about working together. Clearly, there was a market for refrigerated distribution services if the logistical hurdles could be overcome.

After locating two used trucks with appropriate bodies and cooling systems, Harris got a bid to get them rebuilt and refurbished and to acquire a supply of spare parts. Taking a risk-averse approach using used trucks, Harris figured the total cost of start-up of the distribution joint venture, Trans-PETRO, was in the range of \$85,000. Harris was setting out to find a financing partner to either guarantee a bank loan or put up the money in exchange for above market interest and equity in the venture. But since the collateral (primarily the trucks) was going to be in Russia, he knew this would be another challenge.

## Management

With the partners identified and the business goals agreed, Harris began the work of implementation. The early concepts of the working relationship between the partners was influenced by Harris' experience in Russia and having learned from the mistakes of others. For example, he knew that the simpler the financial structure was, and the less it depended on Russian accounting practices<sup>3</sup>, the better the chances for success. It was axiomatic that the Russian partner could not put cash into the deal. However, there were a lot of other things that they *could* contribute that were valuable, like space in the plant and associated utilities, a workforce familiar with dairy practices, supply relationships for basic raw materials (milk, sugar) and a distribution network for the product. To start a food production venture without these basic components lined up would be very time consuming and would require risking much greater amounts of capital, if it were possible at all. Clearly PetroMilk brought something of value to the deal, the challenge was to optimize their potential contribution by making sure the expectations were clear and well documented.

Given Harris's experience in Russia, he was aware of another very important ingredient for success that PetroMilk 5 brought to the deal, though he did not wish to get into the matter in depth with Stonyfield. Organized crime was a constant threat to any business venture. By operating in a discrete, low profile way under PetroMilk's name and corporate organization, the new joint venture could leverage PetroMilk's solution to the crime problem. It was made very clear by Harris to PetroMilk at the outset that it was the expectation of the American side that PetroMilk would deal with this issue and that the new business would not be bothered by it or hear about PetroMilk's problems or solutions. This formula had served Harris well through four years of business in Russia. Organized crime had not interfered with any of their ventures.

PetroMilk had been trying to start up a viable ice cream operation for several years without much success. Clearly they knew of the substantial market for the product, in fact they were being asked to produce it with offers of pre-paid contracts from large wholesalers and appeals to their sense of civic duty by government officials. PetroMilk's difficulty was in the technical aspects of production, specifically the lack of quality ingredients (flavors, stabilizer, sweeteners, etc.), improper hardening technique and poor equipment for filling with inappropriate packaging. These were problems that Stonyfield knew how to solve. The plant had about half of the equipment required for the planned initial

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<sup>3</sup>Russian accounting practices have changed very little since the days of GosPlan and a centralized command economy. There is no calculation of profit as it is known in the West. Most Russian companies have no idea what their true costs are. As the government deregulates various industries and utilities, costs skyrocket to seek a level on par with the West. There is no basis calculated for the cost of physical plants and equipment that were formerly owned by the government but have now been turned over to private industry. PetroMilk in particular was trying out "full absorption accounting," a process by which they tried to absorb the costs of the full million square foot plant and 800 employees on the proceeds from sales of the few products (less than 15% of capacity) they were selling. In particular, PetroMilk tried to get Western JV partners to carry a disproportionate share of the plant overhead. This potential trap was avoided by negotiating a flat monthly fee for all utilities used by the joint venture.

production of ice cream. A survey of this equipment by Stonyfield and a prominent Danish dairy equipment manufacturer (APV, which had done previous work at the PetroMilk plant) indicated that it was serviceable and could be the basis for a production system with some additions and modifications.

Once there was agreement in late May of '94 that the existing facility could be successfully renovated for initial production, the Russians were ready to start production. They reasoned that summer was just starting and this would be a good time to get to market. They even offered to introduce the new product at the Goodwill Games in St. Petersburg in July, of which they were a sponsor. There seemed to be very little understanding of the large amount of planning and logistics that would be required on the American side. Specifically, the new production and filling lines had to be engineered, custom equipment had to be ordered and manufactured, all this new equipment had to be shipped and installed and, not least important, the American side had to prepare to finance the project for approximately half a million dollars. Harris had to encourage the Russians to be patient, stressing that only a well-planned venture could help them meet their market aspirations. As diplomatically as possible, he even tried to suggest that they look back over their track record of short-term efforts and "band-aid" solutions to see that it had brought no results.

The American (Harris Group & Stonyfield) partners knew that they would need to have management control. PetroMilk had already demonstrated they couldn't make good ice cream on their own, so Western management and technical ability was obviously necessary. Further, if the American side was putting up the money, it wanted control of how it was spent. With Harris as the managing partner and the 40-40-20 share ownership structure, this goal of operational and financial control could be achieved. The partners agreed that Harris would put his Director of Russian Operations, a very capable Russian with management experience in overall local control of the project as Deputy Chairman (Gary Hirshberg, President of Stonyfield was to be Chairman). Stonyfield-PETRO would hire The Harris Group to manage the joint venture and pay Harris a monthly fee, from which Harris would pay management expenses, including management payroll. The joint venture would have its own payroll for operational employees, including the General Director, who had day-to-day operating supervision of the plant. He would be one of PetroMilk's former employees, the senior plant engineer. These two individuals each approached their new task with enthusiasm and seemed to develop a good working relationship early on. Clearly, they held the key to the success or failure of the project in their hands.

PetroMilk was still operating with some 800 employees at the plant, about 10 times what a comparable production volume would require in the United States. Since the joint venture would be depending on PetroMilk to provide a pool of employees from which to draw the 20 workers it needed, it would be important to make it particularly desirable to work for Stonyfield-PETRO. Obviously offering higher salaries was one way this could be achieved, but it was only part of the picture. Russian employees responded to a chance to take real pride in their work. They wanted to be part of a team that made a really good, healthy product with modern equipment and Western packaging. The quality and color of the uniforms, the special clothing provided for work in the freezers, an adequate supply of appropriate cleaning equipment and supplies, quality office furnishings and equipment—all of these were part of creating an atmosphere of professionalism and competence that would make the joint venture able to attract the best employees. In Stonyfield, Harris had found a partner that was prepared to accept that Russians would be great employees if you treated them fairly, gave them quality tools and materials to work with and made expectations clear. As in Western companies, ultimately the quality and motivation of the employees can make the difference between success and failure. Harris was hopeful that the joint venture could introduce a number of management practices that would filter down through the rest of the PetroMilk operation and ultimately benefit the whole company.

## Economics

The normal ratios of costs of production of dairy products are skewed doing business in Russia. The cost of basic raw ingredients (milk, sugar) were marginally lower than in the West. The cost of labor was substantially lower. Since no Western-standard packaging materials were available locally, they had

to be imported incurring substantial shipping costs and import taxes. The same was true with other ingredients (flavoring, stabilizers, etc.) The result was that packaging and ingredients combined were about 75% of production costs and labor about 1.5% (after doubling all Russian employees previous salaries. There is no system of benefits.). Automated material handling systems and computerized process control were not a priority because labor was cheap. But getting the best price and lowest shipping rates on packaging materials and some of the ingredients became critical. This was another area where Stonyfield's experience, particularly that of its founder and Chairman, Samuel Kaymen, proved very valuable since he had the ability and relationships to negotiate aggressively with suppliers. Even before production started, the new joint venture was leveraging Stonyfield's volume pricing and payment terms.

Getting the PetroMilk management fully vested in the undertaking from the beginning was essential. They had to be involved in making decisions about finances, packaging, marketing and sales prices from the outset or else they could always "wash their hands" of responsibility down the road. They had to be fully immersed, to make commitments to plans and projections, to sign off on major decisions—a real partnership from the beginning. To that end, Harris and Stonyfield hosted the top management of PetroMilk in the United States for a week in July 1994, during which time most of the pivotal decisions about the working of the joint venture were worked out at a series of meetings at Stonyfield's headquarters. These meetings ended with a document being signed in both English and Russian which set forth the terms and decisions made over the previous week. These two-page handwritten documents were to become the cornerstone on which the legal and financial structure was subsequently built.

The engineering, specification, ordering and production of equipment proceeded over the next few months. By late September equipment, packaging and ingredients were at the Russian border ready to be cleared through customs. But there was a problem, in Russia there's always a problem. The legal documentation of the joint venture was not yet complete. Drafting over a hundred pages (8 separate documents) of complex documentation in two languages in a rapidly changing regulatory environment had taken longer than anyone anticipated. The partners soon realized that there is no such thing as an expert on Russian law on either side of the Atlantic. Misinformation and frustration were pervasive and the legal budget was quickly exceeded by 400%. The joint venture would have to pay 20% VAT plus a 3% "Presidential Tax" on all the goods in the containers which were at the border if they were imported before the joint venture was legally registered in Russia. Before the documents could be submitted for registration, the Anti-Monopoly Committee had to approve the business plan; but the Anti-Monopoly Committee was not meeting this month and would have to be paid a "commercial fee" to meet specially. The wire transfer of funds to pay the registration fee had been misdirected and hadn't reached Stonyfield-PETRO's bank in St. Petersburg. The registration office in St. Petersburg was closed for renovations. The end of the year holidays were rapidly approaching during which virtually nothing happens in Russia.

As the managing partner, Harris was under a lot of pressure. From PetroMilk's side, they wanted to know why we weren't producing ice cream yet. Didn't Stonyfield know that the market for ice cream was strong even in the winter months? Why were all these legal agreements even necessary? Can't we start producing now and finish the legal documentation later? Doesn't our American partner trust us? Alexei Kapustin felt that an agreement in spirit had been reached between himself, Hirshberg and Harris and that as individuals, there was a commitment to proceed. That was enough for him. Harris understood this Russian perspective, and, in his experience, had found that Russians were honest and could be trusted to live up to their word. But this was new to Hirshberg and Kaymen (President and Chairman of Stonyfield).

Since Russia was a country where intra-corporate legal agreements were virtually unknown, the more Stonyfield tried to define and tie down the details of the joint venture agreement, the more suspicious PetroMilk became that there was a fundamental mistrust between the partners. The more PetroMilk chafed at the time, costs and delays required for the documentation, the more Stonyfield suspected they might be trying to avoid commitment. Additionally, Stonyfield was nearing the



maximum capital outlay for the project and delays were costing money and putting off the expected start of repayment. Harris had a delicate job to bridge and balance the cultural differences and keep both parties focused on the mutually desired outcome.

In spite of all the difficulties, Paul Harris was optimistic about the future. His company's success in distribution and retailing development made him feel confident that this important manufacturing operation would be successful for the Russian domestic market and eventually the export market as well. He hoped that what his company was doing would be an appropriate model for helping to improve the Russian food system.

## Exhibit 1

**Stonyfield Farm, Inc. Corporate Description**

**Stonyfield Farm, Inc.** has two primary goals: To produce the purest, healthiest and most natural yogurts on the market, and to encourage consumer's support of family farmers. The Company was founded by President Gary Hirshberg's partner and Company Chairperson Samuel Kaymen, who also founded the Natural Organic Farmers Association (NOFA). Stonyfield has enjoyed spectacular (average 60% per year) growth over the last eight years. The Company has earned numerous honors including, 1994 *America's Corporate Conscience Award for Environmental Stewardship*, Council on Economic Priorities; 1992 Manufacturer of the Year, NH Business Magazine; The 1990 Business Ethics Award by Business Ethics Magazine; two consecutive listings in INC. Magazine, *500 Fastest Growing US Private Companies* and the NH winner and a national finalist of the *Blue Chip Enterprise Initiative*, sponsored by Nation's Business magazine. Stonyfield's product lines are distributed nationally and include whole milk, low fat and nonfat refrigerated cup yogurt and nonfat soft serve and hard-pack frozen yogurt. The Company's mission statement reflects its commitment to a balanced goal of sound financial and ethical objectives.

**STONYFIELD FARM, INC. MISSION STATEMENT**

To provide and sell the very highest quality natural agricultural products possible.

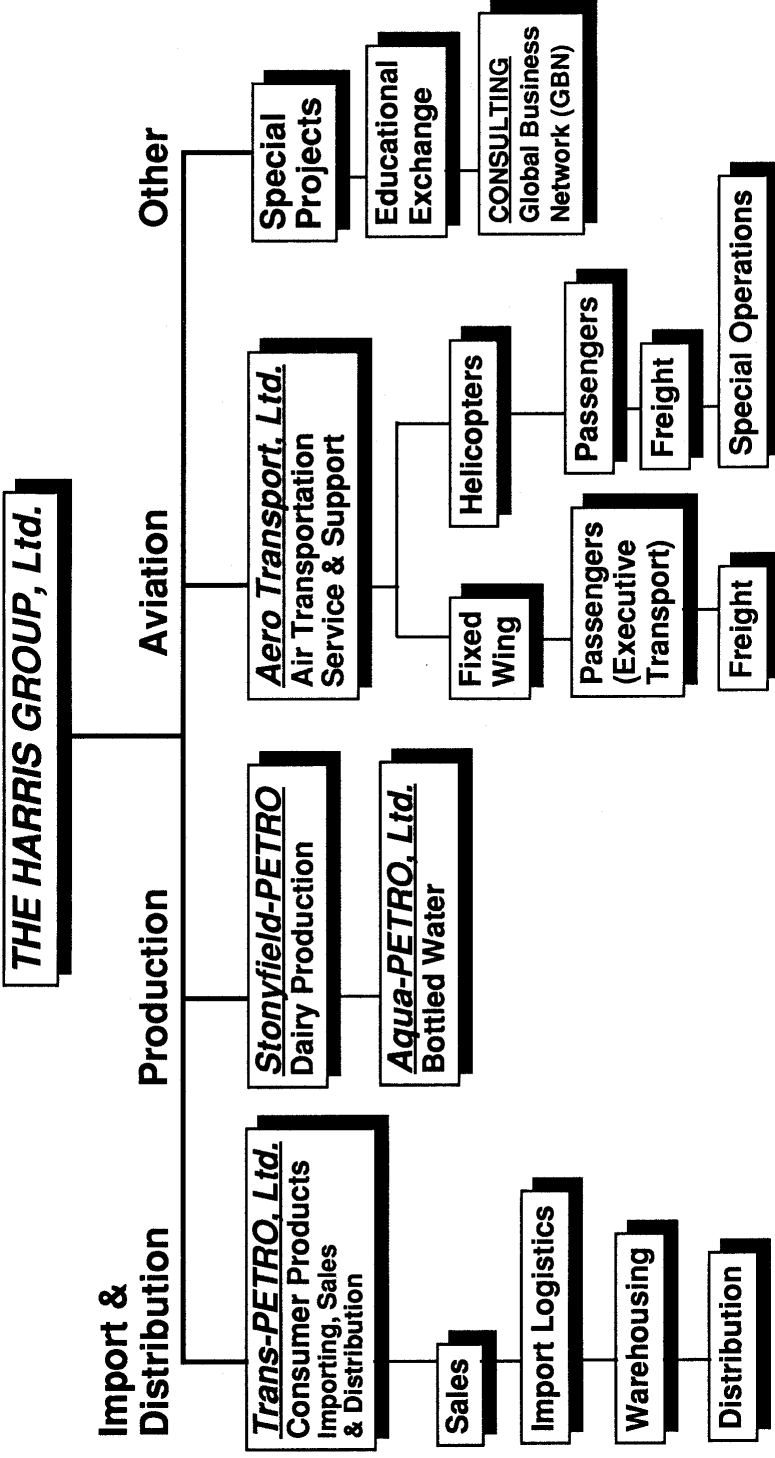
To educate consumers and producers about the value of supporting family farmers.

To provide a healthful, productive and enjoyable work place for all employees, with opportunities to gain new skills and advance personal career goals.

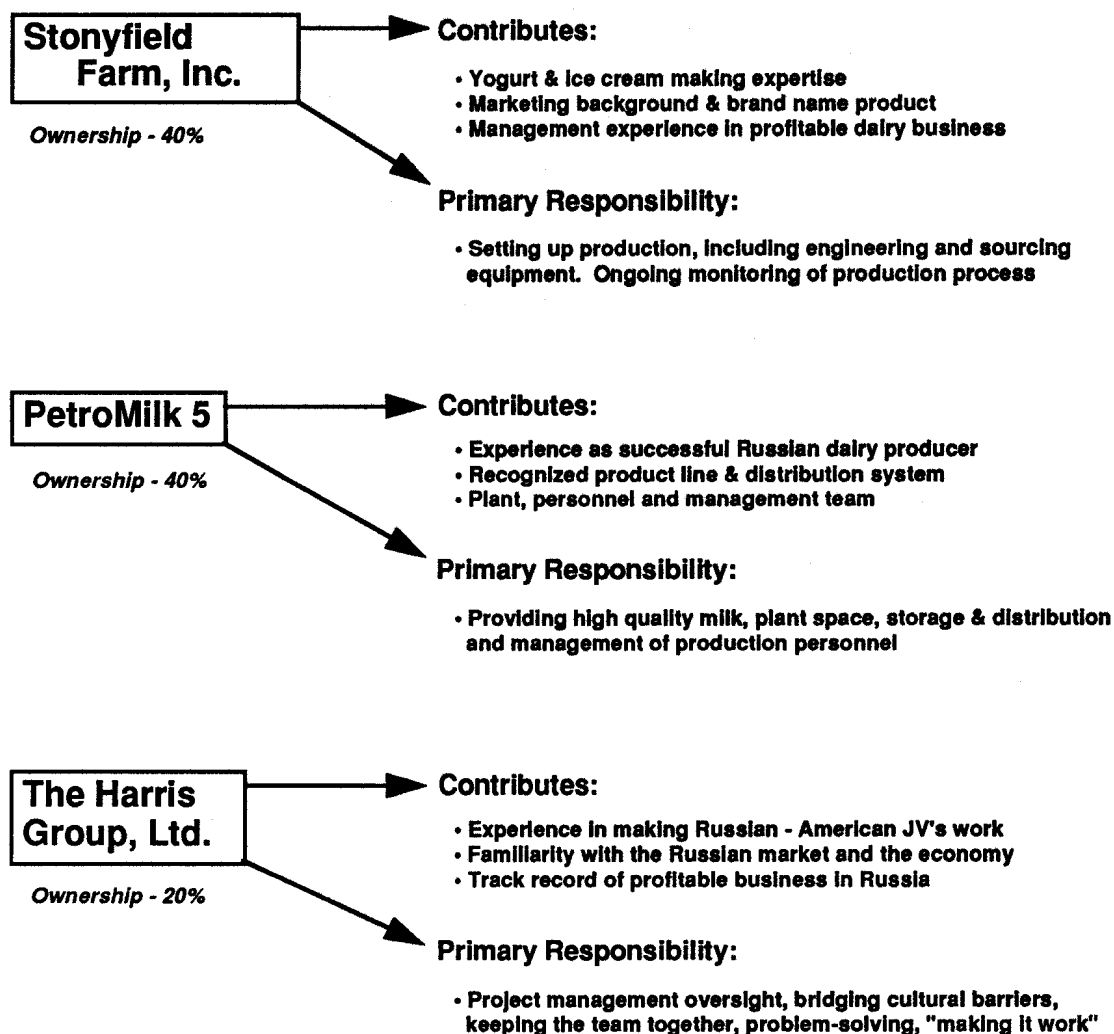
To recognize our obligations to stockholders and lenders by providing an excellent return on their investment.

To serve as a model that environmentally and socially responsible businesses can also be profitable.

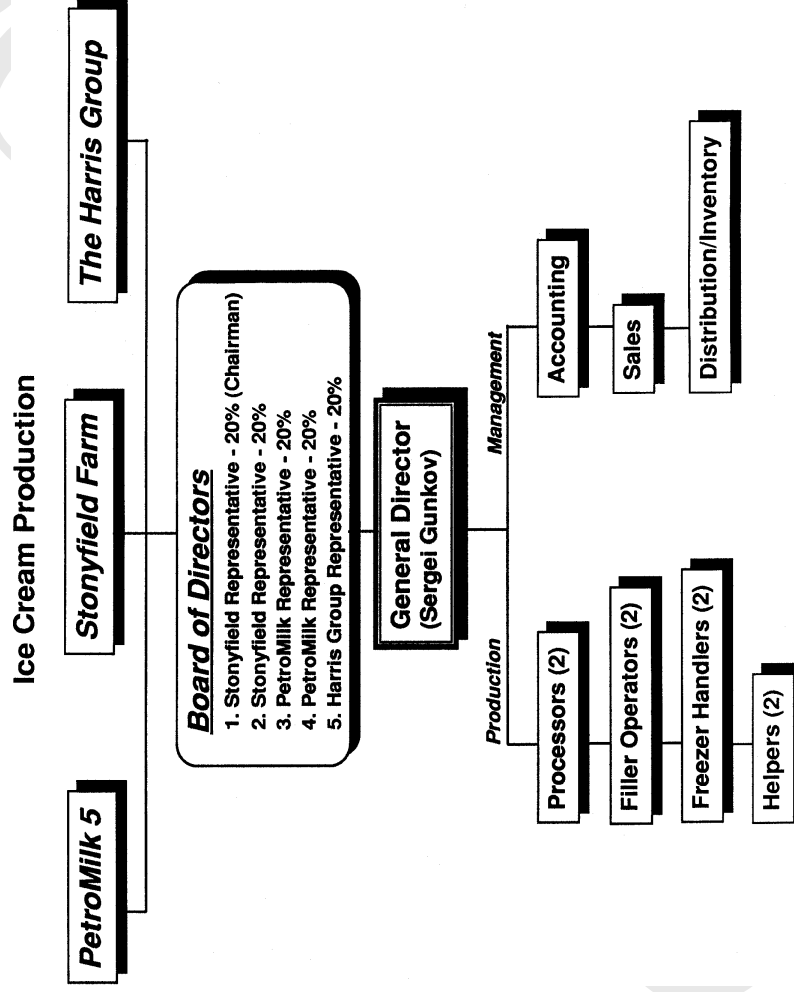
Company Organizational Structure



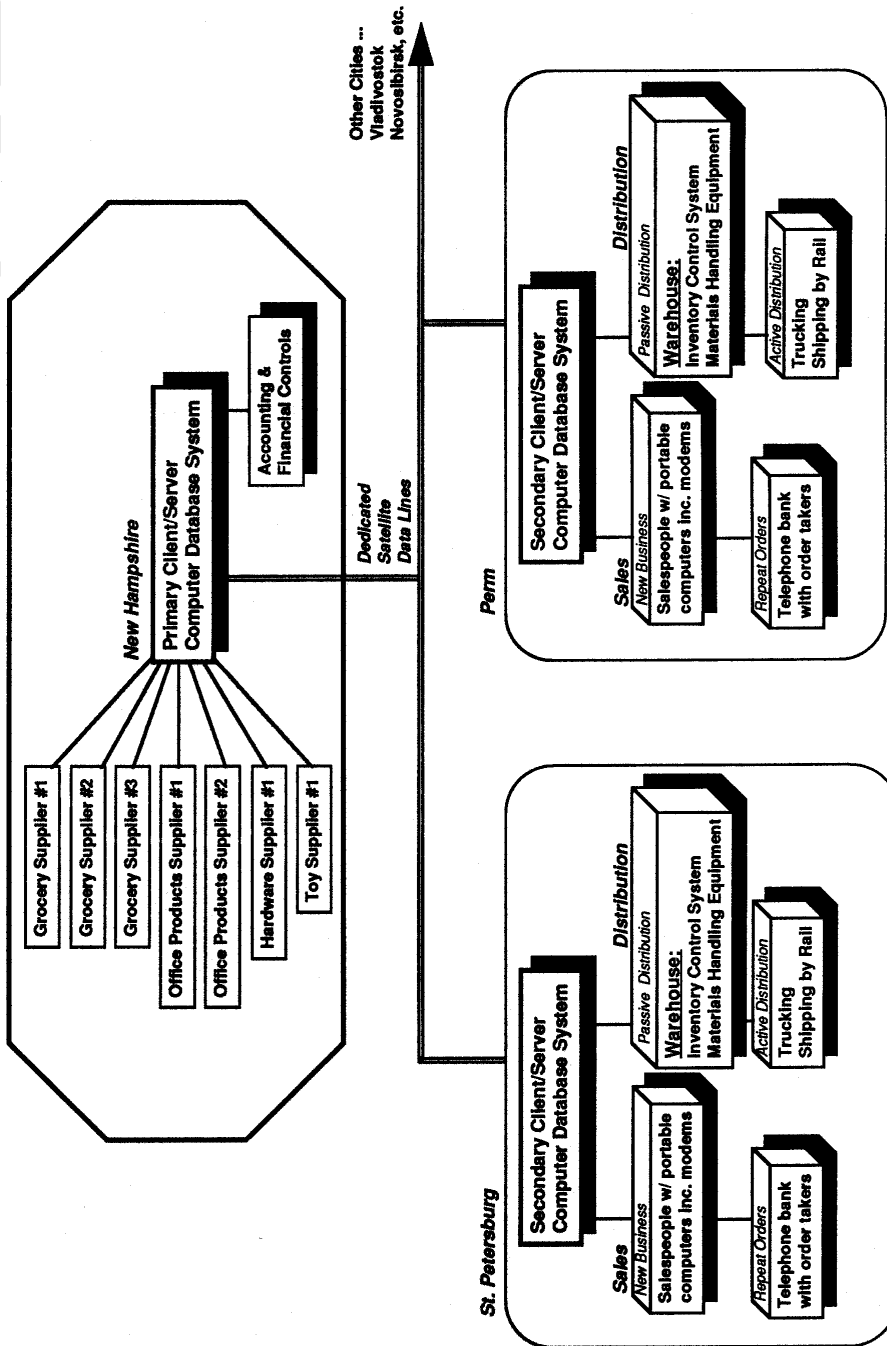
## Exhibit 3

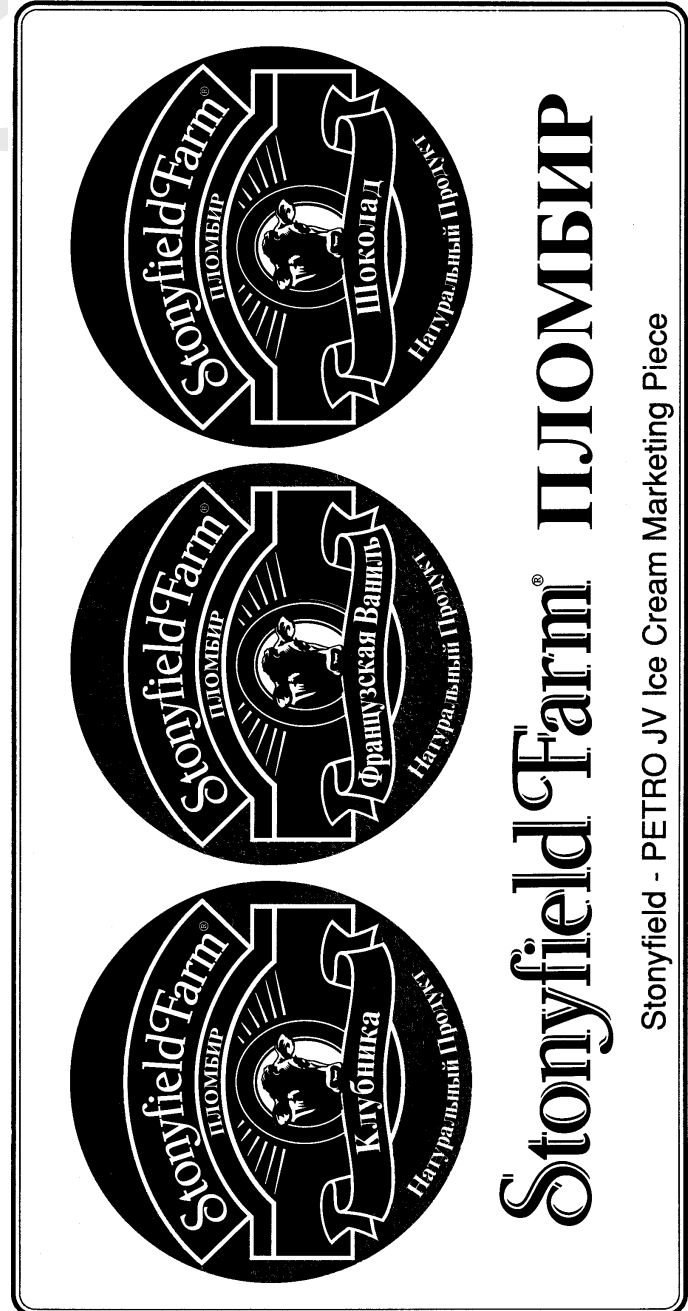
Russian Dairy Production Project**Ownership Structure**

ORGANIZATIONAL STRUCTURE FOR Stonyfield - PETRO JV



Concept for THG Russian Consumer Products Distribution System





5" x 11" Adhesive-backed Exterior Vinyl

NOTE TO THE READER:

This decal is being used to develop name and brand recognition among Russian consumers for the Stonyfield Farm logo which is used on all Stonyfield-PETRO product. It is printed on special weatherproof, ultraviolet decay-resistant vinyl for use on kiosks and pushcarts as well as in shop windows during harsh Russian winters.

Exhibit 6 (continued)

На 100 гр продукта:

Кислот	240
Жиры	15 гр
Углеводы	23 гр
Белки	3,2 гр

Срок хранения  
в закрытой упаковке  
в течение 20 месяцев  
Произведено на  
заводе "ПЛОМБИР"  
Санкт-Петербург, Россия

Это замечательное мороженое из США, от Stonyfield.  
Американской фирмы. Сделанное только из чистых продуктов  
и сахара и молока с самых экологически чистых российских  
ферм, это абсолютно натуральная и здоровая продукт. Мы  
направляем 5% всех наших доходов на защиту и восстановление  
окружающей среды и улучшение жизни детей. Мы знаем, что  
Вы полюбите наше мороженое. Не забудьте рассказать об этом  
Ваши друзья и напишите нам о Ваших впечатлениях.  
Росси, Санкт-Петербург, 194024-08 Республик, СП Стомат-ПЕТРО  
Stonyfield Farm, Inc. - Petromilk 5. The Harris Group, Ltd.

French Vanilla Flavor

Stonyfield - PETRO JV Ice Cream Cup Label

**NOTE TO THE READER:**  
This is the label printed on the plastic 100 gram cups for ice cream. There are three flavors: French Vanilla, Chocolate and Strawberry. Premium ice cream (butterfat content greater than 14%) is called ПЛОМБИР in Russian (pronounced "plombir"). The story on the right tells of the formation of the JV, that 5% of profits go to socially responsible projects, lists the partners and asks consumers to tell their friends about our great product and write with their comments.



## Appendix

### Biographical Information on the Principals

#### Alexei Kapustin, General Director, PetroMilk 5

Mr. Kapustin's education and experience include degrees from St. Petersburg's (Leningrad's) College of Milk and Meat Industry (1968-1972); service in the Soviet Army (1973-1976) with advancement to the rank of Captain; Institute of Coolants (Refrigeration-Specialty of Meat and Milk Processing, 1975-1980); and the Advanced Economics School (1986-1989). Mr. Kapustin's employment history includes service as Chief of Energy (Utilities), with St. Petersburg's largest bread plant, 1980-1983; and from 1983-1989 chief coordinator of the St. Petersburg area Department of Food Industry. As the Food Industry coordinator under the guidance of the Area Committee of the Communist Party, Mr. Kapustin was overseer of all aspects of the food industry: Personnel, supply of raw materials, production, storage, handling, processing, distribution, and sales to shops. Mr. Kapustin's experience in the Department of Food Industry gives him a unique understanding of the problems and needs of food enterprises and, in addition, a wealth of contacts within the industry.

#### Gary Hirshberg, President & CEO, Stonyfield Farm, Inc.

Gary Hirshberg has overseen Stonyfield Farm, Inc.'s growth from infancy in 1983 to its current \$21 million annual sales level. In the Company's early years he doubled as Director of The Rural Education Center, a small organic farming educational organization from which Stonyfield Farm was spawned. Previously, Gary served for three and one-half years as Executive Director of the New Alchemy Institute, and prior to that worked in positions ranging from water pumping windmill specialist (and windmill book author), to environmental educator with the U.S. Fish and Wildlife Service. He has had extensive experience as an environmental activist, including terms as the founding President of the Cape and Island Self Reliance Corporation and as founding President of the Cape Cod Environmental Alliance. Gary has consulted and written extensively on appropriate technology and business topics in the United States and in the People's Republic of China, where he worked off and on over a six year period. A New Hampshire native, he was among the first graduates of Hampshire College in Amherst, Massachusetts, is married to Meg Cadoux Hirshberg, author of *The Stonyfield Farm Yogurt Cookbook*, and is the father of three little yogurt eaters.

#### Paul Harris, President, The Harris Group, Ltd.

Mr. Harris is the President of The Harris Group, Ltd., a New Hampshire corporation he began in 1986. Initially, The Harris Group provided support and consulting services for lending institutions, including feasibility studies, branch location and design analysis and real estate workout advising and management. Clients included prominent banks and insurance companies throughout the northeast. Projects managed ranged from ongoing manufacturing operations to large real estate developments appraised for over \$50 million.

In 1989, Mr. Harris saw the chance to develop an international business rather than one limited to the regional and then faltering New England economy. Previous to the attempted coup in Russia (August of 1991) he had been approached by a Russian team eager to do business with American companies. Today the partnership between these Russians and The Harris Group is cemented, based on number of successes.

Mr. Harris graduated from Amherst College in Amherst, Massachusetts with a concentration in Economics. A former airline captain, he is a rated Airline Transport Pilot and a commercial helicopter pilot as well as an avid polo player. He and his wife and one little ice cream eater live on a farm in New Hampshire with an office that has internationally networked computers, allowing him to be in close contact with offices and partners in Russia and clients around the world at all times.