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**REPORT ON THE COOPERATIVE "START":
A CASE STUDY***

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Organization

The cooperative, which goes by the name "Start," was founded in November 1989 and is located in Mytischchi, a small industrial city just outside the city limits of Moscow. It has been in operation for a year and a half. It originally had 8 members. The number of members has grown to 28 today, and the original cooperative has spawned three related co-ops. As of the beginning of 1989, there is a total of 108 people in the 4 organizations, of whom only 28 are the real decision-making members. The co-op has a managing board which elects a "president", the man with whom the consultant talked.

It is clear that the president is the boss. His "team" consists of himself and 2 additional people whom he "trusts 100 per cent." One is a bookkeeper whom he has known since they were both students in a higher education institute. The other is the production chief. Other members of the 7-member managing board (presumably the charter members of the coop), go along but are not real insiders. He intends to and can keep control over decisionmaking. The members of the three-man "team" are paid well above the other workers in the co-op. As the financial report shows, however, there are five highly paid people. The explanation for the high pay to the other two (the welder and the painter) is that the management originally set too low a piece rate and hence too high a wage for them. He intends to adjust their wage downward, on the pretext of the higher tax rate that will start 1 July 1989.

Facilities

The co-op operates in premises leased from a machine-building plant subordinated to the Ministry of Light Industry, hereafter referred to as the "zavod." Securing a location in which to produce was difficult, finally achieved through "connections." The president's father-in-law has some connections and persuaded the zavod to enter into this deal. The facilities when leased were without equipment except for one old machine-tool. The rest of the equipment was purchased from other plants in the area. The equipment was purchased and is shown on its balance sheet at the depreciated book value, multiplied by two. If a state enterprise buys used equipment, it is priced at depreciated book value. This is related to the fact that the co-ops are supposed to pay retail prices or wholesale prices adjusted by special coefficients for their inputs.^{1/}

Among the equipment purchased is an old worn out forklift that they repaired and a couple of trucks.

The co-operative pays the zavod a lease payment for the space. In the first year the payment was zero, but it is now figured as 1 per cent of the gross sales of the cooperative.

That rate can be decided on by the co-op and the zavod without requiring approval from any other body. The lease contract is for 1 year. The co-op would prefer a multi-year contract, but the plant wants only a 1-year contract. The lease payment is thus renegotiable and could change. The co-op also pays for electricity received from the zavod (use is metered) and for other utilities (heat and water) on a per-person basis. There is a telephone in the office that works off the zavod's PBX. The president views all these payments as small.

Product line

The main product line today is exercise equipment which is sold mostly to institutions and sport clubs. It is a fairly simple item--combinations of frames, pulleys, and weights. These can be assembled in several variations of various complexity. It requires very simple production processes--a little work on machine tools, welding, cutting, painting. They have several metal-working tools of various kinds, there is a welding shop, and a simple paint shop where they spray-paint the final product. Earlier they manufactured playground equipment for kindergartens but are closing out that line of product.

^{1/} Kooperativy novogo tipa, Moscow, 1989, page 97.

Marketing

Two channels are used for marketing. Most of the output is sold through the state wholesale trade network, the rest direct. The playground equipment was all sold direct, through mail advertising. They made up a list of all the kindergarten in the area, mailed out pictures and other information about the item, soliciting orders. Problems with using state trade are: a) slower pay--the co-op is building up a big receivables item (when they sold playground equipment, they received payment in advance); b) the state trade network is short of warehouse space, and so has postponed taking delivery; c) more control over pricing. When marketing through wholesale trade, the co-op must "justify" the price. No real problem, but it contrasts with direct marketing where it need not account to anyone for the price charged. Their pricing strategy is to sell above the state price fixed for similar output from state enterprises, but below that of their non-state competitors. State enterprises therefore use bigger, heavier, tubing in construction of their equipment frame than does the co-op. That is one source of the co-op's profit when it sells at state prices. The other main source is the much higher productivity of its workers.

One of the problems on the horizon in marketing is a change in regulations--in the past a state enterprise could buy from a co-op using money earmarked for its development fund, or its cultural fund. There is usually plenty of money available in those funds that they cannot easily spend anyway. The new rule says the enterprise can pay for purchases from co-ops only from the funds designated for paying wages. This will make enterprises willing to purchase such goods only when they see a tremendous payoff.

Employment and Earnings

The work force is a little over 100 people. About half are full-time, half work at other jobs as well. The operation works 7 days/week, with staggered assignments so that each person works six days a week. They work two shifts, but the day of the expert's visit, not much seemed to be going on. The labor force grew by informal contact among friends. They have hired some walk-ons, but do not advertise for help. The wage is high compared to people's other opportunities, and they have no problem getting help. The nature of their operation does not require skilled workers, so they are not in a conflict with state plants over attracting away valuable employees. The president says that this problem occurs mostly in the case of construction industry co-ops and R and D co-ops. In the latter, the conflict concerns valuable programmers. Pay is the same on both shifts. The second shift has been set up for the convenience of part-time workers after all, and pay is high enough anyway that this is not an issue. Workers are paid almost exclusively on a piece rate basis. The president thought that out of inexperience they originally did a poor job on norm-setting for piece rate work, so there are some inequities and some workers who get an unnecessarily high income. He is currently trying to bring down these highest incomes.

As the financial report shows, the average monthly income per worker in the first quarter of 1989 was 485 roubles per month, compared to the 222 roubles per month average income in the Soviet industry in 1988. This is the striking thing about the co-ops -- they really do pay workers better, and the main management principle they embody is to pay for good work. The big lesson of the co-ops is that with managerial independence and interest, it is possible to tell the Soviet worker--we don't pay for non-work, but if you work hard, you can earn well.

Other Benefits

In addition to wages, the co-op pays for sick leave at a 100 per cent rate. That is better than in state enterprises where it is 80 per cent. They also pay for 30 days free vacation. Most state enterprises pay for 24 days of paid vacation, but that does not include holidays given off like May Day that are included in the co-op's 30 days. So total paid vacation days come out about the same as in state enterprises. Those are the only two benefits, but everybody gets medical care from the state, so co-op workers do not suffer compared to others. The main difference is that workers in state enterprises get pensions, which co-op workers do not.

Accounting for Income and Taxes

They have done their accounting in a simple and amateur way. It is mostly on a cash basis, except that they cannot do that for income accounting for tax purposes. There is a gap of 1-3 months between shipment and sales, so it makes a difference in that gross sales are counted only when goods are shipped and paid for. The co-op's bookkeeper was out of the country at the time of the review and the president was a bit vague about accounting. It is assumed that depreciation is treated as a cost and that there is no depreciation reserve. Like any co-op, they must account quarterly to the Financial Department of the City Government in whose jurisdiction they are located. They are audited, but rather cursorily. There are about 300 co-ops in Mytishchi, and the financial department has only 4 auditors to do all its auditing work, which includes other entities beside co-ops.

Taxes are based on "gross labor income"--which means sales less expenditures, except expenditures for labor. Originally, taxation was controlled by the Ministry of Finance of the USSR (Minfin SSSR). Under that system, the tax rate varied with the age of the coop--1 per cent in the first year; 2-3 per cent in the second year; 5 per cent in the third year, and 10 per cent thereafter. Under a new law on taxing cooperatives, which is to go in to effect July 1, 1989, rates will be set by the republics, and passed on down, to be differentiated and applied by the local soviets. So far there are only rumors as to what the rate will be, but it is known that it will be differentiated with rates from 20 to 60 per cent, and that the rate for industrial co-ops will probably be 30 per cent. Under the old system, taxes went to the all-Union budget, but under the new system all will go to the local budget.

A nearly complete quarterly income statement (for the first quarter of 1989) submitted to the tax authorities was reviewed. Sales are when delivered and paid for. For the quarterly report they estimate material expenditure by norms.

The co-op keeps its money--its liquid assets--all in a settlement account in the Zhilkomsotsbank, one of the five main banks that form the state system. The Gosbank originally said they ought to keep on account a minimum of 4,000 - 5,000 roubles. Distribution of after-tax profit "is the prerogative of the managing board." The co-op principally accumulates its bank balance from net income, and now has a balance of about 500,000 roubles. By the end of 1989 the president expects to have about 1.5 million roubles in that account. The big question to be decided before long is what to do with that accumulation. Last year's sales were about 1.5 million roubles, and in the first 5 months of 1989, about 900,000 roubles or about the same annual rate. The explanation for how the balance can grow so much by the end of the year is that the co-op has on hand in the warehouse about 800,000 roubles worth of finished goods waiting to be shipped.

The president and the bookkeeper learned on the job to fill out the income and tax reporting forms and how to set up a simple accounting system. Improved accounting will come later--income is high enough now to let them get by with poor administration, he says. He could not supply a regular balance sheet, though he was able to reconstruct some of the most important items on the balance sheet.

Supply

Supply is the biggest problem faced by this co-op, in line with the generalization usually made about co-ops. Earlier the co-op had an able person doing this, "a genius at finding stuff in all kinds of odd places." He has now left, but the co-op now has on hand enough materials to last for the rest of the current year. The president will have to take on this task as his most important function. He says one can always get supplies somehow, but it is a catch-as-catch-can matter, inconsistent with maintaining regular production schedules. They secure weights (simple castings) from an agricultural machinery factory, whose interest in supplying them is that this helps the factory fulfil its assignment to produce consumer goods. That, incidentally, is one motivation for the zavod from which the co-op leases space--the zavod is permitted to count the co-op's sales toward its consumer goods assignment.

The Future

The co-op is a turning point. It must now make some big decisions on a new direction regarding product line, on making new investment, and on its relationship with the zavod. Competition in the present product line will increase. It is difficult to know just what line to take on. The president wants to do something "interesting". But future conditions are very uncertain, especially what government policy, including tax policy, will be. He does not have a product that he can propose for a joint venture, though some co-ops do. The president is a little reluctant to consider anything that would require more extensive supply. When power mowers were suggested as something that might be a good idea, he said, "but they take motors", and concerning exercise bicycles, he said that Soviet citizens weren't ready for that yet. Because the zavod is expanding, he could get more space, either by leasing it or by buying it outright through participating in the financing of a new plant. The present plant would like to consider a closer association, from asking the co-op to taking on some additional responsibilities to becoming a co-op itself. One proposal is that the co-op take over a small unit in the zavod that makes plastic parts that go into its main product, equipment controllers. (This really is a very small unit, employing only three people). The co-op could do that on an after-hours basis, producing consumer goods from plastic, or could take on the whole unit, producing both for the zavod and for itself. There is the possibility of a joint venture to assemble computers in partnership with a Dutch firm. The president doesn't see that as very likely.

Lessons learned and Overall Impressions

This co-op underlined the point that experience as a whole demonstrated: there are able, entrepreneurial-type people in the Soviet economy, who are trying to take advantage of the independence that the co-op form gives them. But they work under very difficult conditions--they are economically discriminated against, in taxes and prices, for example. Supply is a terrible problem for which the State made no provision when it opened the door to co-ops. As one person put it: "The state enterprise has authorizations to buy goods, but no independence, and the co-ops have independence but no authorization to buy goods." Much depends on the attitude of the local authorities and in this case, the president says that though the local authorities are not really very encouraging, they are smart enough not to interfere, and generally do not take repressive actions.

The other lesson was stated earlier. The experience of the co-ops demonstrates that better incentives can improve productivity--co-ops really do pay workers better. They have demonstrated that with managerial independence, it is possible to tell the Soviet worker, "We don't pay for non-work, but if you work productively, you can earn well."

The president confirmed the common observation that one big problem facing the movement as a whole is that the attitude of the general public is very negative. He sees as important successes of the co-ops: a) the fact that they have been able to grow fast in output and employment; b) that they have been able to make money and pay high wages; c) a shift in the attitude of the Government, which in the past thought of them as purely small scale, but now sees them as a vehicle for production on a more ambitious scale.