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FORMATION OF INTEGRATED STRUCTURE AS A FACTOR OF INCREASING THE COMPETITIVENESS OF PRODUCERS ON RUSSIA FOOD MARKET

Creation and development of integrated structures is a world tendency of the dynamics of interbranch interactions. Large financial- industrial conglomerations are able to decrease the costs and win the market competition.

Integrating processes in Russian economy have their own specific features. The author examines the peculiarities of integration in the agro-industrial sector of Russia, those stages, conditions and tendencies of regional agrosystems development , which reflect the degree of diversification and concentration of agricultural production , competitiveness of the food market.

Adaptation of regional interbranch corporations to the market conditions is becoming the key problem of the food market stabilizing. The peculiarities of its present stage of development is the reduction of budget support, unfavorable credit, tax environment, compression of the solvent demand of the population. On the basis of the system interbranch analysis new strategies of the market behavior of the AIC are shown.

The paper contains the suggestions on typology (classification) of integrated structures, the main features of which are the following: forms of property and managing, mechanism of distribution the integrated income , principles of interrelations of agricultural and post-agricultural stages, conditions of interactions and financing.

Creation and development of integrated structures embracing the complete commercial cycle beginning with scientific research and production and ending with market surveys and marketing is a world's tendency in the dynamics of inter-branch interactions.

The problem of development of integration at the food market and establishment of integrated structures is not new for the Russian economy since integration processes in the agricultural sector of Russia began to develop in the 70's. In this very period much of attention in the economic science was paid to methodological and theoretical aspects of integration of agriculture, food processing industry and branches supplying the agricultural sector with the necessary material and technical resources and inputs. Agricultural and industrial production was viewed as a complex consisting of many interconnected branches embracing the complete production cycle and oriented towards final results.

The 80's were marked by development of various organizational forms of integration: there started to appear regional agricultural and industrial associations, agricultural and industrial factories, agricultural companies and etc. The relations between the elements of the aforementioned structures were mostly regulated by using administrative methods.

Development of market relations bringing along greater independence for the commodity producers aggravated one of the most serious problems – the problem of imbalance between the branches included in the agricultural and industrial system. The agrarian reform at its initial stages was mainly connected with transformations in the sphere of ownership aiming to develop a great diversity of ownership types. Most of the enterprises included in the agricultural and industrial complex became private, that means the responsibility for strategic decision making was taken by the owners. The overall economic crisis in the country, break-up of the old, sometimes inefficient and forced by the center production connections and search for new ones, lack of experience of operation in market conditions – all this made the leaders of enterprises choose the direction towards full autonomy of their companies. That period can be called a period of disintegration which took place not in the agricultural sector alone, but in the whole Russian economy.

Now the enterprises get gradually adapted to the market environment. One of

the ways to increase the efficiency of the companies included in the agricultural and industrial sector is considered to be the development of integration on a principally new level and establishment of integrated structures in the agricultural and food sector. Integrated structures are expected to be helpful in solving a number of problems that recently manifested themselves in the agricultural sector and related branches. Now that the existing market relations are yet underdeveloped and the relations between the commodity producers are poorly arranged, the integration processes are driven by a number of objective preconditions.

Agricultural production is specific in that its output is mostly perishable products that are to be sold in due time. The agricultural commodity producers, therefore, strive for firm inter-branch connections and financial stability. The present stage of development of the Russian food market is characterized by severe financial restrictions, declining budget support to commodity producers, unfavorable credit and tax environment and shrinking effective demand of the population. Integration of companies is a means to overcome the so-called hampering effects, that is drawbacks of individual enterprises that can be removed by performing joint well-coordinated activities. Among such drawbacks are the shortage of operating capital in one of the elements of the technological chain, weak coordination of production cooperation, low economic activity as a result of extremely high commercial risks, difficulties in establishing contacts with government regulating structures and other. Vertically integrated structures including a closed production cycle can help achieve balance between demand and supply, improve the situation at the food market and enable the food processing companies to acquire a permanent raw material base and the agricultural enterprises to have permanent marketing channels.

Food security and stability at the national food market can only be achieved through a rise in competitiveness of domestic commodity producers and a possibility to enter the export markets. The world's experience shows that highly competitive are integrated investment-concentrating complexes. The dominating factor of establishment for most integrated structures is growth of their member organizations' resource potential (financial, investment) achieved by means of pooling their financial resources. Pursuing one and the same common strategy, integrated structures operating in the agro-food sector can accumulate sufficient money resources for stimulation of the most efficient elements of the production chain. This in turn will

increase the enterprises' competitiveness, flexibility and mobility and enable them to develop and manufacture goods of a higher quality, expand the assortment and production and etc.

Imperfection of inter-branch economic relations strongly negatively affects the situation at the food market of Russia. This relates to high price rates and supply shortages in terms of both volume and assortment. The inter-branch imbalance to the largest extent manifests itself in the structure of prices of final products. High costs make the domestic agricultural products expensive. Consumer prices are also high because of high transaction costs, multiple taxation (one and the same tax is collected when selling both the farm raw produce and the final product), high prices of electric power and transportation tariffs, low productivity of labor, imperfection of technologies applied and etc.

The current situation is such that the producers' (agriculture and food industry) share in the retail prices of food is much smaller than it should be. The share of intermediaries and trade organizations in the final price of some individual products reaches 20%, while the share of tax payments the food processing enterprises and trade companies are subject to (agriculture excluding) constitutes up to 30%. Most of the taxes refer to the product cost, while the profit tax, VAT and excises are added to the taxes and payments already included in the product cost, thus representing double taxation. As a result, the share of taxes and payments in the final price reaches 40% and even higher figures.

The way the goods go from the producer to the consumer lies through numerous intermediaries, which considerably increases the transaction costs and, consequently, the retail prices. Small share of agriculture in the countries with developed market economies reflects low agricultural production costs and relatively higher costs born at the subsequent stages in connection with diversification, rate of processing, packing and etc. Russia is specific in that the drop of the share of agriculture in the retail price goes in parallel with the rise of production costs in all elements of the agricultural production system and with the decline in the sphere of food processing. Intermediate marketing organizations often only contribute by imposing markups, which only makes the final price rise and is in no way an evidence of a better quality. That is why one of the major concerns at the present stage of development of the agricultural and industrial complex is the branch price balance in

the vertical food chain.

It is clearly seen from the Table below that the role of direct deliveries from the producers to the retail trade companies excluding any intermediaries becomes more important. More than a third of the retail commodity turnover resources in 1997 was delivered by using direct channels. It is worth mentioning that the intention to save on transaction costs becomes also characteristic of less flexible state-owned retail trade companies. However, the role of small intermediaries in the food chain still remains dominating covering somewhat 40%-60% of the overall volume of commodity resources. It is expected that integrated structures will allow making price adjustments with the view to clamp down the prices, remove the price differences in the agrarian and food sector and decrease the transaction costs. In this case the enterprises will be able to make the final price formation process more efficient and challenge their competitors by setting lower prices.

Table

Structure of Commodity Food Deliveries to Retail Trade Organizations, per cent of the overall amount

	State-owned organizations		Private organizations	
	1996	1997	1996	1997

Retail turnover commodity resources,	100	100	100	100
Incl. delivered from:				
- industrial enterprises directly;	16	23	33	34
- wholesale trade organizations;	10	17	28	27
- intermediate companies and natural persons.	74	60	39	39

Integrated structures make the economy to a larger extent regulated, enable to concentrate the resources for priority purposes and ensure efficient communication between the government and the agro-food sector. The government can take the following measures to support the integrated structures:

- introduce privileged taxation for profits reinvested in the projects implemented by integrated structures and provide for delays in the payment of the profit tax in part used for investments up to the end of the current financial year;
- exempt the members of integrated structures from the tax on emission of securities issued for the projects intended to increase the production and improve the quality of products, and also to achieve balance at the market for basic food products;
- offset the debts of the federal and regional budgets to the members of integrated structures with taxes paid by the latter to the budgets of different levels;
- provide the integrated structures with the opportunity to make consolidated tax payments;
- give the integrated structures priority in bidding for support.

Large and sound production units are more attractive to potential investors. It should be noted here that the branches of the agro-food sector of Russia still differ greatly in terms of investment attractiveness. Compared with the food processing and infrastructure branches, the agrarian sector has a lower investment rating, which hampers the development of the raw material base and forces the processing enterprises to be oriented towards imported raw farm produce.

Integration in the agricultural and industrial complex is very much likely to produce positive social effects. Taking into account the fact that the agricultural production in Russia is strictly seasonal, development of integration processes and diversification of production will enable to more efficiently utilize the labor force, increase the wages, qualification and skill of the personnel.

Analysis shows that there are different types of integrated structures functioning in the agricultural and industrial complex of Russia. This is explained by diversity of regional specific features on the territory of Russia like the rate of specialization and concentration of agriculture and food industry, local peculiarities of reforms in the agrarian sector, financial potential of individual regions and other.

At the present time the agricultural and industrial sector comprises integrated structures of the following types: 1. Vertically integrated structures established as a result of transfer of the food processing and service companies' controlling interest to agricultural producers; 2. Integrated structures established by agricultural enterprises by means of creation of their own processing and storing base (which is quite a usual practice in Russia today), or vice versa - by processing companies looking for their own raw material base; 3. Inter-branch joint stock companies established on the contractual basis; 4. Agricultural and industrial associations registered as legal entities; 5. Services (consumer) cooperatives established on the premises of food processing companies; 6. Integrated structures of the holding type; and 7. Financial and industrial groups established in the agrarian sector.

However, there are also a number of factors hampering the development of integration in the agricultural and industrial complex of Russia. One of the aforementioned factors is the inertness of the leaders of traditionally exclusive enterprises not wishing to lose independence in decision making. In the time of the overall economic crisis and permanent inflation preference in the development of enterprises is given to reaching tactic rather than strategic goals, which results from the impossibility for the enterprises to estimate the possible direct and indirect economic effects of integration and which is also a consequence of the unpleasant situation some individual monopolist companies found themselves in when they lost a part of their profits at the initial stage of establishment of integrated structures in the favor of other enterprises participating in the production chain. In view of this it seems essential to develop methodological approaches to measuring the efficiency of integration

processes, i.e. estimation of synergic effects produced by integration on both the macro- and micro-levels, fair distribution of integrate revenues among the elements (companies) of the food chain, estimation of production costs, determination of competitive prices in integrated structures and etc.

One of the most important problems which needs to be settled at the present stage is the construction of such a mechanism of formation and distribution of profits that would best take into account the interests of all the participants in the vertical production chain.

The mechanism of distribution of profits among the elements of integrated structures we propose is based on the following principles.

First of all we believe there should be a company acting as an integrator of the complete production and commercial cycle which should also be in charge of marketing of the final produce. The role of such integrator companies can well be played by processing enterprises, large wholesale trade organizations or banks. On the one hand, food processing enterprises are the concluding elements of the food production chain and are oriented towards the final consumer, and on the other hand, they are located in the center of the technological and marketing chain leading from the producer to the consumer and are therefore closely connected with practically all the elements of the food chain. Large wholesale trade organizations can embrace chains consisting of retail trade companies and agricultural producers, which can decrease the share of transaction costs in the final price of raw agricultural and processed food products. Placing a bank in the center of an integrated structure would enable to take highly professional control over the financial transactions carried out by the member companies, provide the commodity producers with the required financial and credit support based on optimal distribution of the available resources on relatively privileged terms and also to accumulate and efficiently make use of the available financial resources.

The overall amount of profits is subject to the competition strategy of the company at the market. In the current conditions the demand is governed by the low incomes of the Russian population. The possibility to maximize the profits by increasing the price is therefore much doubtful. That is the reason why we call minimization of production costs a prospective strategy. The scheme of movement of goods along the vertical food chain we propose is based on contracts between the

member companies which provide for free transfer of material resources in the form of commodity credits. Operating capital in the required amount is provided to the integrated structure members by the participating bank in the form of credit at minimum possible interest set out in an agreement signed by all members. The cost of production is formed stage by stage as a sum of the costs born by each member, depreciation, wages fixed in a corporate agreement and interests on credits. Banking costs include the expenses incurred by the participating bank and lost profits from the possible extension of credits at average interest rates at the market for credit resources. The aforementioned scheme enables to considerably reduce the production costs, increase the competitiveness of domestic commodity producers at the food market and solve such pressing problems like mutual non-payments, own operating capital shortages and increased costs of fixed assets maintenance.

Reduced production costs offer the integrated structures competitive advantages at the market. Selling the final produce at market prices, the commodity producers gain extra profits by lowering the production costs down below the average rate. Application of strategies of the kind makes all the commodity producers participating in the food chain interested in the production of the final produce and enables to monitor more precisely the demand and consumer behavior at the market. Integrated structures having the form of financial and industrial groups should be allowed to make consolidated tax payments, which would also make it possible for them to significantly reduce the costs of production.

Money resources resulting from the sales of the final produce go to the bank's financial settlements center and then taxes are paid by consolidated amounts. This procedure is not intended to reduce the taxes, but to change the mechanism of taxation in such a way as to stimulate the investment process and economic growth and facilitate the extension of the taxable base thus compensating for the lowered rates of individual taxes.

Common profits yielded by an integrated structure are calculated as a difference of the revenues from sales and the overall production costs. A part of the net profit (from 1% to 5%) is forwarded to the common fund of the corporation, which is then made use of in accordance with the strategic goals to be attained by the integrated structure.

The remainder part of the net profit is distributed among the members of the integrated structure in accordance with the functional structure of production costs indicating the share of each member in the overall volume of costs. Schemes of distribution of profits of the kind are already applied by a number of integrated agricultural and industrial associations. The functional structure of production costs is calculated based on either the average branch rate of costs for each member of the integrated structure, or on the average rate of each member's individual costs for the last 5 years. This approach to the distribution of profits is specific in that it excludes the intermediate product both inside and between the elements of the food chain from the calculations and that it curbs on the production costs of some individual enterprises – members of the integrated structure. This scheme of distribution of profits allows differentiating the necessary profitability rates, as it takes into account not all of the costs, but only the incremented ones.

As the market relations develop in Russia, more attention is paid to transfer price formation as the common methodic basis for measuring, estimation, evaluation, monitoring and stimulation of activities performed by companies – members of integrated structures. Application of transfer prices helps harmonize the interests of individual elements (enterprises) of a vertically integrated structure with a common strategy and centralized management and allows controlling the efficiency of individual member companies and that of distribution of costs and assets. Various conceptions of transfer prices are currently applied that being total costs based prices, marginal costs based prices, market prices, negotiated prices and other.

Introduction of the transfer price formation mechanism into the practice of operation of integrated structures takes serious improvement of the domestic accountancy system, which for the present time fails to match with the international accountancy standards.